

Regulating the Political Speech of Noncharitable Exempt Organizations
After *Citizens United**

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Introduction.....	3
I. Case Law	8
A. <i>Taxation with Representation v. Regan</i>	8
B. <i>Taxation with Representation v. Regan’s Ancestors: Slee and Cammarano</i>	13
C. Case Law After <i>Taxation with Representation</i>	20
1. <i>FCC v. League of Women Voters</i> and <i>Rust v. Sullivan</i> : Emphasizing the Distance Between the Court’s Opinion and the Concurrence in <i>TWR</i>	20
2. <i>American Society of Executives v. United States</i> and <i>Branch Ministries v.</i> <i>Rossotti</i> : Merging the Court’s Opinion and the Concurrence in <i>TWR</i>	23
3. <i>Mobile Republican Assembly v. United States</i> and <i>Ysursa v. Pocatello</i> <i>Association</i> : A Return to the Court’s Opinion in <i>TWR</i>	27
D. <i>Citizens United</i>	31
II. Political Speech by Noncharitable Tax-Exempt Organizations.....	38
A. Lobbying.....	38
1. Lobbying as a Permitted Purpose.....	38
2. The Impact of Section 6033(e) and the Definition of Lobbying	41
B. Politicking.....	47
1. Allowing and Defining Politicking.....	47
2. History of Section 527	58
III. The Impact of <i>Citizens United</i> on Noncharitable Tax-Exempt Organizations	67
A. Definitions of Political Activity	67
1. Politicking.....	67
2. Lobbying.....	70
B. No Duty to Subsidize Versus No Limits on Political Speech	72
C. The Validity and Burden of the Alternate Channel After <i>Citizens United</i>	79
D. <i>Citizens United</i> and the 2000 Amendments to Section 527	82

IV. New Requirement for Noncharitable Tax-Exempt Organizations That Engage in Political Speech.....	87
A. Require Notice of Application for Exemption Within Specified Time Period.	88
B. Create a New Category for Tax-Exempt Organizations Engaged Primarily in Lobbying	90
C. Increase Public Disclosure of Contributors to Noncharitable Exempt Organizations	91
D. Tax Politicking Conducted Directly by Noncharitable Tax-Exempt Organizations Whether or Not They Have Investment Income	93
V. Conclusion	94

The Supreme Court decreed in *Citizen's United* that “[n]o sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporations.”¹ It did so in the context of holding unconstitutional the ban in federal campaign law on corporate independent expenditures for speech that expressly advocates the election or defeat of a candidate or that is an “electioneering communication.”² The Internal Revenue Code, however, imposes a variety of limits on different categories of tax exempt nonprofits, including tax exempt section 501(c)(4) entities such as Citizens United itself. Tax law also burdens for-profit corporations by denying them a deduction for lobbying and political expenditures.³ Nowhere does *Citizens United* acknowledge the tax limits on political speech or address their constitutionality. Supreme Court cases predating *Citizens United* have justified these tax limits on the grounds that government has no duty to subsidize political speech. That is, our system operates so that, with only a few limited exceptions, money devoted to lobbying and politicking consists of only after-tax dollars, not tax-deductible or tax-exempt dollars.⁴ To the extent that “no duty to subsidize” is and remains the justification, nothing in *Citizens United* explicitly threatens the current tax regime.

The key “no duty to subsidize” authority, *Regan v. Taxation with Representation of Washington*,⁵ proclaimed, “Both tax exemptions and tax-deductibility are a form of

¹ *Citizens United v. Fed. Election Comm'n*, 130 S. Ct. 876, 913 (2010).

² An electioneering communication is “‘any broadcast, cable or satellite communication’ that ‘refers to a clearly identified candidate for public office’ and is made within 30 days of a primary or 60 days of a general election.” *Id.* at 887, *quoting* 2 U.S.C. §434(f)(3)(A). Under the FEC regulations, an electioneering communication is one that can be received by 50,000 or more persons in a state where a primary election is being held within 30 days. *Id.*

³ 26 U.S.C. § 162(e) (1994). *See* discussion of this provision *infra* Parts I.C.2, II.B, III.A.1-2. All subsequent references will be to the Internal Revenue Code of 1986, as amended, unless otherwise specified.

⁴ For purposes of this piece, I will refer to direct or indirect political campaign activities on behalf of or in opposition to candidates for public office as well as variants on this concept as “politicking.” “Lobbying,” unless otherwise specified, will rely on part of the definition in Treas. Reg. § 1.501(c)(3)-1(c)(3), namely, “to engaging in attempt to influence legislation by contacting legislators or urging the public to contact them to propose, support, or oppose legislation, or advocating the adoption or rejection of legislation.” “Political speech” will be used to refer to both lobbying and politicking.

⁵ *Regan v. Taxation with Representation*, 461 U.S. 540, 544 (1983) [hereinafter *TWR*].

subsidy that is administered through the tax system.”⁶ Justice Blackmun in *TWR* concurred that limits on lobbying by a tax-exempt section 501(c)(3) organization eligible for tax-deductible contributions were consistent with the First Amendment. He did so, however, only because such a section 501(c)(3) organization could form a tax-exempt affiliate not subject to lobbying limits (but also not eligible for tax-deductible contributions) under section 501(c)(4) without “significant restriction on this channel of communication.”⁷ *TWR* was unanimous, and thus Justice Blackmun’s concurrence, which Justices Brennan and Marshall joined, was not necessary to the result. Yet, in the years since *TWR*, both Supreme Court and appellate court opinions have relied upon this concurrence,⁸ and it has played an important role in the unconstitutional conditions doctrine.

Citizens United, however, rejected the notion that requiring a corporation to establish a corporate affiliate—even an affiliate that is no more than a separate bank account—in order to engage in political speech satisfies the First Amendment, at least for purposes of campaign finance law. According to *Citizens United*, such a political action committee or PAC does not speak on behalf of its affiliated corporation because a “PAC is a separate association from the corporation.”⁹ Moreover, *Citizens United* admonished, “Even if a PAC could somehow allow a corporation to speak—and it does not—the option to form PACs does not alleviate the First Amendment problems PACS are burdensome alternatives; they are expensive to administer and subject to extensive regulations.”¹⁰ The opinion went on for more than a page detailing the requirements to which PACs are subject.¹¹

To the extent that case law following *TWR* upheld limits on the ability of tax-exempt organizations to engage in political speech because of their ability to establish an

⁶ See *TWR*, 461 U.S. at 553.

⁷ See *id.*

⁸ See *infra* Part I.C.

⁹ *Citizens United v. Fed. Election Comm’n*, 130 S.Ct. 876, 897 (2010).

¹⁰ *Id.*

¹¹ *Id.*

affiliate with a greater ability to do so, we must ask whether the reasoning of *Citizens United* has undermined these precedents. Furthermore, the rules regarding politicking by tax exempt entities have changed significantly since *TWR*. As a result, the standards as announced in the case and interpreted by its progeny may call for a different conclusion today.

In particular, section 527, which governs political organizations, including segregated funds established by those section 501(c) organizations permitted to politick, was substantially amended in 2000. As amended, it not only requires organizations to give notice that they are section 527 organizations, but also imposes reporting and disclosure obligations on section 527 entities not subject to state or Federal Election Commission requirements, obligations that parallel some of those to which PACs are subject, as well as a hefty penalty for failure to comply.

Moreover, to the extent that those exempt organizations that are permitted to engage in politicking choose not to set up separate section 527 organizations, they are subject to a tax equal to the lesser of their investment income or the amount they spend on politicking for the taxable year under section 527(f). This section 527(f) tax applies most often and most importantly to section 501(c)(4) social welfare organizations such as *Citizens United* itself; section 501(c)(5) labor, agricultural, and horticultural organizations; and section 501(c)(6) business leagues, chambers of commerce, and boards of trades trade.¹² All of these are organizations that are permitted to lobby without limit so long as the lobbying is related to their exempt purpose and to engage in politicking so long as such activities are not their primary purpose. Much scholarly attention has focused on the rules and policy applicable to the limits on lobbying and the prohibition on politicking applicable to section 501(c)(3) organizations. Less scholarly work has been devoted to the tax regulation of these other 501(c) organizations in the political arena.

¹² These categories of section 501(c) will be referred to as “noncharitable tax exempt organizations” or “noncharitable section 501(c) organizations” for purposes of this paper.

Yet the role of noncharitable exempt organizations is perhaps the key feature of this year's election. For example, the U.S. Chamber of Commerce, a section 501(c)(6) organization, has said it plans to spend \$75 million in connection with the 2010 election and, according to a study from the Wesleyan Media project, it was the second biggest spending national group after the Republican Governors Association as of September 15th.¹³ Media coverage emphasizes that section 501(c) organizations do not have to disclose their supporters. One article quotes a lobbyist as saying that the "501cs are the keys to political kingdom" precisely "because they allow anonymity" and former FEC counsel Larry Noble as concluding that the major impact of *Citizens United* "is that more money is going to 501(c)(4) groups, trade groups and others that don't disclose their donors."¹⁴ A New York Times editorial declared: "For all the headlines about the Tea Party and blind voter anger, the most disturbing story of this year's election is embodied in an odd combination of numbers and letters: 501(c)(4)"¹⁵ Democracy 21 and the Campaign Legal Center has filed a complaint with the IRS asserting that Crossroads GPS, a section 501(c)(4) organization, is "operating in violation of its tax status because it has a primary purpose of participating in a political campaign in support of, or in opposition to, candidates for public office."¹⁶ The letter of complaint asserts that the organization sought to organize as a Section 501(c)(4) entity because such status requires no public disclosure of donors.

The role of noncharitable tax exempt organizations in this year's election has also drawn Congressional attention. Senator Baucus as Chairman of the Senate Finance

¹³ Ben Smith, *News Corp. gave pro-GOP group \$1M*, Politico, September 30, 2010, available at <http://www.politico.com/news/stories/0910/42989.html>.

¹⁴ Peter Stone, *Campaign Cash: The Independent Fundraising Gold Rush Since 'Citizens United' Ruling*, Center for Public Integrity, October 4, 2010, available at <http://www.publicintegrity.org/articles/entry/2462/>.

¹⁵ Editorial, *The Secret Election*, N.Y. TIMES, Sept. 19, at WK8. The editorial called for passage of the DISCLOSE ACT. See also Michael Luo & Stephanie Strom, *Donors' Names Kept Secret as They Influence Midterms*, N.Y. TIMES, Sept. 21, 2010, at A1 (Crossroads Grassroots Policy Strategies set up by Karl Rove as 501(c)(4)).

¹⁶ *Democracy 21 and Campaign Legal Center Call on IRS to Investigate Crossroads GPS to Determine if Group is Improperly Claiming 501(c)(4) Tax Status to Avoid Disclosing Its Donors to the Public* (October 5, 2010), available at http://www.democracy21.org/index.asp?Type=B_PR&SEC={91FCB139-CC82-4DDD-AE4E-3A81E6427C7F}&DE={D2251079-0D60-4405-B467-D80DD27C4F3A}.

Committee sent a letter to IRS Commissioner Shulman on September 28, 2010 calling upon the IRS to survey major noncharitable 501(c) organizations to ensure that they are obeying the rules regarding political activity, including limits on politicking. The letter asked whether the tax code is “being used to eliminate transparency in the funding of our elections.”¹⁷ It stated that, based on the IRS report, the Finance Committee would open its own investigation or take appropriate legislative action.

This piece will explore both the tax rules that are, and some that might be, applicable to the political speech of noncharitable tax exempt organizations. Part I will review *TWR*, its ancestors and its progeny as well as *Citizens United*. Part II will describe the current tax rules regarding lobbying and politicking applicable to exempt organizations that can engage in unlimited lobbying and politicking as part, but not the primary purpose, of their activities: section 501(c)(4) social welfare organization, section 501(c)(5) labor organizations, and section 501(c)(6) trade associations. The discussion will include consideration of treatment of contributions to such organizations for gift tax purposes and the special tax that may be applicable to membership dues because of lobbying and politicking by such organizations. Part II will also review the history of section 527, the section governing political organizations, with particular attention to the 2000 amendments that added registration and disclosure requirements. Part III examines the possible impact of *Citizens United* on the tax law’s current approach to political speech. It highlights the difference between the definitions of lobbying provided in the Internal Revenue Code and Treasury regulations and the uncertain “facts and circumstances” approach employed by the Internal Revenue Service (“IRS” or “Service”) in identifying politicking. It offers a reconciliation of seemingly contradictory language in *Taxpayers With Representation* and *Citizens United* regarding use of affiliates to conclude that *Citizens United* has not *sub silentio* overturned *TWR*’s “no duty to subsidize” holding. It defends, albeit unenthusiastically, the 2000 amendments to section 527. Part IV proposes a number of possible additional disclosure requirements for noncharitable exempt

¹⁷ Letter from Senator Baucus to Commissioner Shulman *available at* <http://finance.senate.gov/newsroom/chairman/release/?id=9bc04792-1ead-4668-a512-89443f342312>.

organizations engaged in lobbying and politicking. They include requiring applications for exemption, establishing a new category of exempt organizations for organizations primarily engaged in lobbying and expanding disclosure of contributors for all or for some noncharitable exempt organizations. It also explores the possibility of taxing the politicking expenditures of noncharitable tax exempt organizations not conducted through a separate segregated fund, whether or not the organization has investment income. The piece concludes by reminding us that the tax law regulation cannot substitute for campaign finance regulation.

I. Case Law

In order to judge whether *Citizens United* has undermined the rationale of “no duty to subsidize” established most firmly by *TWR*, we must review not only those two cases, but also the ancestors and progeny of *TWR*. This section undertakes that case review.

A. *Taxation with Representation v. Regan*

TWR, the key case for analyzing tax limits on exempt organizations’ political speech and the use of affiliated organizations, involved a challenge to the lobbying limits on section 501(c)(3) organizations. *TWR* challenged the prohibition on substantial lobbying by section 501(c)(3) organizations under both the First Amendment and the equal protection clause of the Fifth Amendment. The opinion of the Court, authored by Justice Rehnquist, rejected the First Amendment challenge on the grounds that “Congress has merely chosen not to pay for *TWR*’s lobbying.”¹⁸ It viewed both exemption and deduction as a form of subsidy: “A tax exemption has the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual’s

¹⁸ 461 U.S. at 545.

contributions.”¹⁹ The opinion looked to the availability of such subsidies, not their actual benefit to the organization. It did not require a case by case determination of the extent of the benefit to the particular organization. It seemed to assume that TWR would have taxable income in the absence of the exemption and that its contributors in fact itemized deductions, assumptions that often may not hold.²⁰

Congress, the opinion continued, is not required to subsidize First Amendment activity and can choose to subsidize lobbying less extensively than other activities that section 501(c)(3) organizations undertake. In the view of the Court, such a selective subsidy did not impose an unconstitutional condition on the exercise of First Amendment rights. Citing *Cammarano v. United States*,²¹ the case upholding a regulation denying a business deduction for lobbying expenses, the Court explained that Congress neither infringed nor regulated First Amendment rights by declining to pay for them. According to the Court, that Congress had amended the Internal Revenue Code to permit businesses to deduct the expenses of some kinds of lobbying did not affect this principle or the Court’s holding in the instant case.²²

The Court observed that TWR could qualify for exemption under section 501(c)(4), although it would not then qualify for tax-deductible contributions, or could return to the dual structure it had used in the past, “with a 501(c)(3) organization for nonlobbying activities and a 501(c)(4) organization for lobbying activities.”²³ The Court stressed that under the dual structure TWR would have to take care that the 501(c)(3) did

¹⁹ *Id.* at 544.

²⁰ In 2005, for example, only approximately 35% of taxpayers itemized and thus took the charitable contribution deduction, although these 35% of taxpayers represented 80.5% of all income for that year. See I.R.S., SOI Tax Stats--Individual Income Tax Returns Publication 1304 (Complete Report) tbls.1.2 & 2.1 (Tax Year 2005), available at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=134951,00.html>. As for the value of exemption, in the case of social clubs, for example, exemption under section 501(c)(7) is largely an administrative convenience, because “the organization merely facilitates a joint activity of its members.” JOINT COMM. ON TAXATION, HISTORICAL DEVELOPMENT AND PRESENT LAW OF THE FEDERAL TAX EXEMPTION FOR CHARITIES AND OTHER TAX-EXEMPT ORGANIZATIONS 28 (Apr. 19, 2005), and thus investment income and net revenue from dealings with nonmember is taxed. See § 512(a)(3).

²¹ See *Cammarano v. United States*, 358 U.S. 498 (1959).

²² 461 U.S. at 546 n. 7.

²³ *Id.* at 544.

not subsidize the 501(c)(4). In a footnote, it rejected the concern of TWR and amici that “the IRS might impose stringent requirements that are unrelated to the congressional purpose of ensuring that no tax-deductible contributions are used to pay for substantial lobbying and effectively make it impossible for a 501(c)(3) organization to establish a 501(c)(4) lobbying affiliate.”²⁴ The Court did not view IRS requirements that the two groups be separately incorporated and maintain records showing that tax-deductible contributions were not used for lobbying as “unduly burdensome.”²⁵

The Court also found unpersuasive TWR’s claim that Congress violated the equal protection clause of the Fifth Amendment by permitting veterans’ associations exempt under section 501(c)(19) but not section 501(c)(3) organizations to lobby without limit and to receive tax-deductible contributions. The Court explained that not only are statutory classifications generally “valid if they bear a rational relation to a legitimate governmental purpose,”²⁶ but also that legislatures are given particular discretion in creating tax classifications. While statutes may be subject to greater scrutiny if they interfere with a fundamental right, such as speech, a decision to subsidize some, but not other, speech does not infringe that right, so long as the distinction is not based on content of the speech or intended to suppress any ideas. It is not irrational, the Court explained, for Congress to limit the public subsidy for lobbying by section 501(c)(3) organizations²⁷ or subsidize lobbying by veterans’ associations, in recognition of their service to the nation. In short, Congress was not required to provide TWR with public money with which to lobby.

The Court’s opinion, in sum, blessed a dual affiliate structure, at least so long as the record-keeping and other burdens were related to the Congressional purpose of not subsidizing substantial lobbying and were not “unduly burdensome,” rejected the First

²⁴ *Id.* at 544-45.

²⁵ *Id.* at n. 6.

²⁶ *Id.* at 546.

²⁷ The Court suggested that Congress limited the ability of exempt organizations to engage in lobbying out of concern that they might use tax-deductible contribution to lobby on behalf of the private interests of their members. *Id.* at 550 (relying on remarks of Sen. Reed and Sen. La Follette in Congressional Record).

Amendment challenge on the grounds that Congress is not required to subsidize First Amendment activity, and spurned the equal protection contest on the grounds that it met the rational relation test to give a greater subsidy to veterans' associations. For both constitutional arguments, it took care to point out that the rules did not single out the content of the speech or aim at suppression of particular ideas.

According to Justice Blackmun's concurrence, which Justice Brennan and Justice Marshall joined, if the provisions of section 501(c)(3) were viewed in isolation, excessive lobbying would deny an organization not only the ability to receive tax-deductible contributions for its lobbying activities, but also the ability to achieve tax-exempt status and to receive tax-deductible contributions for any of its activities. Such a consequence would deny a significant benefit to organizations choosing to exercise their First Amendment right to lobby²⁸ and, in his view, would be unconstitutional. In a footnote, Justice Blackmun cited *Cammarano*, in which Justice Douglas' concurrence contrasted the constitutionally permissible denial of the business expense deduction for lobbying with an unconstitutional denial of all deductions of business deductions for a business that lobbies.²⁹

For Justice Blackmun, avoiding constitutional defect required that a tax-exempt organization be able to set up another tax-exempt affiliate subject to fewer restraints on constitutionally protected speech: "A 501(c)(3) organization's right to speak is not infringed, because it is free to make known its views on legislation through its 501(c)(4) affiliate without losing tax benefits for its nonlobbying activities." He cautioned, "Any significant restriction on this channel of communication, however, would negate the saving effect of 501(c)(4). . . . Should the IRS attempt to limit the control these organizations exercise over the lobbying of their 501(c)(4) affiliates, the First Amendment

²⁸ Justice Blackmun did not go into any detail about the First Amendment basis for the right to lobby, tying it specifically to neither the Free Speech nor the Petition Clause. Justice Brennan in his concurrence in *McDonald v. Smith*, 427 U.S. 479, 485 (1985), viewed the Petition Clause as granting no protection beyond that guaranteed by the Free Speech Clause.

²⁹ 461 U.S. at 553.

problems would be insurmountable.”³⁰ He warned against any “attempt to prevent 501(c)(4) organizations from lobbying explicitly on behalf of their 501(c)(3) affiliates.”³¹

Justice Blackmun’s concurrence thus sounded a note of caution regarding the unconstitutional conditions doctrine. Although this doctrine is murky at best,³² one formulation of its meaning is that the government cannot condition acceptance of a government benefit on a burden that extends beyond the scope of the benefit so that the burden limits what recipients of the government benefits can do with their own funds or on their own time. Conversely, if the condition does not extend beyond the scope of the benefit and does not so limit recipients’ time or money, the Court generally rejects an unconstitutional condition challenge.³³ That is, the doctrine is triggered only if the government is offering a meaningful benefit, or at least a benefit commensurate with the condition attached to it. The government, at a minimum, must be offering some benefit for the doctrine to apply.

Here, according to Justice Blackmun, without the (c)(4) alternative, section 501(c)(3) “deprives an otherwise eligible organization of its tax-exempt status and its eligibility to receive tax-deductible contributions for all its activities, whenever one of those activities is ‘substantial lobbying,’” an activity protected by the First Amendment.³⁴ As a result of the ability to establish a (c)(4) lobbying affiliate for the (c)(3) charity, however, the denial of ability to engage in substantial lobbying matches the subsidy of receiving tax-deductible donations while still permitting the organization to lobby on a tax-exempt basis through its affiliate, and TWR’s challenge was properly rejected.

³⁰ *Id.*

³¹ *Id.*

³² See, e.g., Robert C. Post, *Subsidized Speech*, 106 YALE L. J. 151 (1996); Cass R. Sunstein, *Why the Unconstitutional Conditions Doctrine is an Anachronism*, 70 B.U. L. REV. 593 (1990); Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1413 (1989); Richard A. Epstein, *Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 HARV. L. REV. 4 (1988).

³³ See David D. Cole, *Beyond Unconstitutional Conditions: Charting Spheres of Neutrality in Government-Funded Speech*, 67 NYU L. REV. 675 (1992).

³⁴ 461 U.S. at 552 (Blackmun, J. concurring).

The Court’s opinion and concurrence differ regarding the significance of the affiliate structure and the importance of the alternate channel of communication. In the Court’s opinion, the ability to create a controlled affiliate was permissible and useful. In Justice Blackmun’s concurrence, it shifts to being a constitutionally required structure, crucial to upholding under the First Amendment the 501(c)(3) limits on lobbying. The nature of the impermissible burden the IRS might impose shifts as well, from one having to do with its purpose and with administrative and record-keeping burdens to one centering on control.

While the facts of *TWR* involved limits on lobbying, its approval of affiliates for expression of political speech has implications for, and has been applied in, the context of politicking as well. Both the Court’s opinion and the concurrence rely on an earlier case, *Cammarano*, however, and we will turn to that case, *TWR*’s ancestor, before turning to the cases that followed it.

B. Taxation with Representation v. Regan’s Ancestors: Slee and Cammarano

The Court in *TWR* stated that *Cammarano v. United States*,³⁵ a 1959 case, controlled its First Amendment analysis. *Cammarano* involved for-profit taxpayers and the proper tax treatment of expenses for lobbying the public. In *Cammarano*, individual and corporate taxpayers challenged a regulation dating back to 1918 that interpreted the statute permitting a deduction for ordinary and necessary business expenses as denying business deductions for lobbying expenses.³⁶ The taxpayers, both involved in sale of alcohol, had contributed money to associations that had run advertisements against state alcohol initiatives, with one initiative calling for state control and the other state prohibition. The Court’s opinion, authored by Justice Harlan, rejected taxpayers’

³⁵ 358 U.S. 498 (1959).

³⁶ For early history of the denial of the deduction for business lobbying, see Lloyd Hitoshi Mayer, *What Is This “Lobbying” That We Are So Worried About?*, 26 YALE L. & POL’Y REV 485, 496-97 (2006). The denial of deduction for lobbying expenses, except for local lobbying, for politicking expenses, and for expenses of contact with high level executive officials is now statutory. See § 162(e) (1994). See also *infra* Part II.A.2.

arguments that the regulation applied only to direct dealings with legislators or that the Court should exempt sums expended to preserve the taxpayer's business from destruction. The opinion found the regulation to express a sharply defined national policy, the "ordinary and necessary" language of the statute sufficiently ambiguous to leave room for interpretative regulation, and the regulation to have the force of law by reenactment of the governing statute in the 1954 Code after consistent rulings by courts as to its meaning. Justice Harlan opinion pointed to the statutory policy adopted toward what are now section 501(c)(3) organizations. It explained that such organizations had since 1934 expressly been forbidden from engaging in substantial lobbying³⁷ and discussed their eligibility to receive tax-deductible contributions. It also looked to Learned Hand's analysis in *Slee v. Commissioner*.³⁸

Slee had affirmed the decision of the Commissioner of Internal Revenue and the Board of Tax Appeals that disallowed deductions for gifts to the American Birth Control League because the League was not a "corporation . . . organized and operated exclusively for religious, charitable, scientific, literary or educational purposes," as required for deductibility under the Internal Revenue Act of 1921. That is, the statute at the time did not explicitly refer to or explicitly permit any amount of lobbying.³⁹ The League's charter included among its objectives: "To enlist the support and co-operation of legal advisors, statesmen and legislators in effecting the lawful repeal and amendment of state and federal statutes which deal with the prevention of contraception."

In operation, the League's activities included a clinic for married women and research on its clinical work. It also offered direction on "how best to prepare proposals for changes in the law" and distributed "leaflets to legislators and others recommending

³⁷ 358 U.S. at 512.

³⁸ See generally *Slee v. Comm'r*, 42 F.2d 184 (2d Cir. 1930).

³⁹ Regulations at the time, however, provided that "the dissemination of any 'controversial or partisan propaganda' was inherently not educational and therefore disqualified an organization for tax exemption." See George Cooper, *The Tax Treatment of Business Grassroots Lobbying: Defining and Attaining the Public Policy Objectives*, 68 COL. L. REV. 801, 816 (1968) (citing Treas. Reg. 69, art. 571 (1927); Treas. Reg. 65, art. 517 (1925); Treas. Reg. 62, art. 517 (1923)).

such changes.”⁴⁰ Judge Hand was willing to countenance lobbying “ancillary to the end in chief,” such as a society of booklovers working to “relax the taboos upon works of dubious propriety” or even the Birth Control League seeking to change the law “in order to better conduct its charity.”⁴¹ But lobbying as an independent mission rather than in service of its charitable activities, he reasoned, went beyond the statutory bounds. As a result, the opinion concluded that the Board did not err in denying deduction for contributions to the League; the statement in its charter regarding lobbying prevented it from being exclusively charitable. Judge Hand wrote, in language quoted by the Court in *Cammarano*, “Political agitation as such is outside the statute, however innocent the aim. . . . Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them.”⁴²

Relying on *Slee*, the Court in *Cammarano*, wrote, “The Regulations here contested appear to us to be but a further expression of the same sharply defined policy”⁴³ and a “determination by Congress”⁴⁴ not to permit deductions for lobbying. The *Cammarano* Court found the policy sharply defined even though Judge Hand had simply inferred it; it was nowhere stated by Congress in 1930, and Judge Hand in *Slee* did not even refer to the then-existing Treasury regulations that forbade lobbying. At the time of *Cammarano*, the policy was a matter of administrative and case law; it was nowhere embodied in an explicit statutory statement. Moreover, as the Court recognized earlier in the opinion,⁴⁵ at the time of *Cammarano*, unlike the time of *Slee*, charities were permitted to engage in some lobbying, making the policy in fact not so sharply defined.

The *Cammarano* Court then quickly rejected the petitioners’ First Amendment, unconstitutional conditions argument. The nondiscriminatory denial of the benefit of a

⁴⁰ 42 F.2d at 185.

⁴¹ *Id.* at 184-85.

⁴² *Id.* at 185.

⁴³ 358 U.S. at 512 (citing *Slee v. Comm’r*, 42 F.2d 184, 185 (2d Cir. 1930)).

⁴⁴ *Id.* at 513.

⁴⁵ *See id.* at 533.

tax deduction was not “aimed at suppression of dangerous ideas.”⁴⁶ The taxpayers were “not being denied a tax deduction because they engage in constitutionally protected activities;” instead, they, like everyone else engaged in these activities must pay for them “entirely out of their own pockets.”⁴⁷ It trumpeted this conclusion despite the fact that supporters of charities could, to at least a limited extent, support lobbying with deductible contributions. It assumed, without discussion, its baseline, namely, judging this deduction against the treatment of lobbying costs by all other persons, whether individuals, tax-exempts organizations or for-profit entities, rather than against the treatment of other business costs by businesses.

Justice Douglas expanded on the First Amendment issue in his concurrence, and *TWR* relied primarily on Justice Douglas’s opinion. Justice Douglas’ concurrence opened by asserting that the First Amendment extends to speech undertaken with a profit motive, including the taxpayers’ speech at issue in the case. Since they were exercising First Amendment rights, he wrote, Congress could not penalize them for this exercise. Had Congress denied corporations engaged in lobbying all deductions for ordinary and necessary business expenses, Congress would have been subjecting them to a penalty. Allowing some, but not all, deductions, however, is not a penalty, because deductions are a matter of legislative grace.⁴⁸ Justice Douglas dismissed the notion that this item of expense must be allowed as a deduction, because it would “savor of the notion that First Amendment rights are somehow not fully realized unless they are subsidized by the State,” a view that “runs counter to our decisions.”⁴⁹

In *Cammarano* the Court and the Justice Douglas diverge regarding the First Amendment basis for denying business deductions for lobbying and politicking. The Court’s justified the denial of deduction for lobbying expenses as a nondiscriminatory

⁴⁶ *Id.* at 513.

⁴⁷ *Id.* at 514. The opinion attributed this policy to “Congress,” even though a regulation was at issue. The opinion had, however, deemed the regulation to have the force of law because of Congress’ knowing reenactment of the statute so interpreted by the regulation.

⁴⁸ *Id.* at 514.

⁴⁹ *Id.*

general policy regarding the treatment of lobbying expenses: “[I]t appears to us to express a determination by Congress that since purchased publicity can influence the fate of legislation which will affect, directly or indirectly, all in the community, everyone in the community should stand on the same footing as regards its purchase so far as the Treasury of the United States is concerned.”⁵⁰ Nondiscriminatory denial of deduction would be problematic only if aimed at suppression of dangerous ideas. That the case involved an IRS regulation adopted by Congress at best indirectly did not trouble the Court; the issue was equal treatment of all taxpayers in our democracy.

Justice Douglas’s concurrence, which no other Justice joined, argued that the taxpayers had been denied some, not all, ordinary and necessary deductions and thus had not been penalized.⁵¹ He stated that deductions are a matter of legislative grace,⁵² although he did not indicate at what point denial of grace metamorphosed into a penalty. Ignoring the fact that a regulation, not a statutory provision, was at issue, he took as his baseline Congressional policy regarding deductions in general. To support his proposition that deductions are a matter of legislative grace, he cited *Commissioner v. Sullivan*,⁵³ an opinion he authored, which had upheld deductions for rent as ordinary and necessary expenses of an illegal bookmaking enterprise. It did so in order not to avoid making this type of business taxable on the basis of its gross receipts in the absence of action by Congress. While *Sullivan* noted that deductions are a matter of grace, it did so in the context of disallowing deductions, emphasizing that Congress could disallow deductions if it so chooses.⁵⁴ In *Cammarano*, Justice Douglas took the opposite tack by emphasizing that allowing any deduction is a matter of Congressional grace. By subtly shifting the baseline regarding treatment of business deductions, he was able to characterize allowance of a deduction for lobbying activity as a subsidy, an argument the Court’s opinion suggests only

⁵⁰ *Id.* at 513.

⁵¹ *Id.* at 515.

⁵² *Id.*

⁵³ See *Comm’r v. Sullivan*, 356 U.S. 27 (1958).

⁵⁴ *Id.* at 28.

in passing by quoting Judge Hand in *Slee* on conducting legislative controversies “without public subvention.”⁵⁵

Today we do not generally conceptualize the deductions that we allow businesses in arriving at net income from gross income as subsidies; we think of them as income-defining. Justice Douglas himself recognized in *Sullivan* that we do not tax gross income under our income tax system. Itemized deductions for individuals, including the charitable contribution deduction, in contrast, do not define income so neatly; they are much more a matter of legislative grace.⁵⁶ The charitable contribution deduction in particular is understood as a subsidy.⁵⁷ Denying a deduction for lobbying expenses for businesses thus has a very different impact than a denial of such a deduction for individuals,⁵⁸ particularly when federal legislation has such a strong impact on business life.⁵⁹ Nonetheless, it is Justice Douglas’ subsidy language from *Cammarano* that has

⁵⁵ One commentator has called the meaning of this phrase “simply unclear.” Jasper L. Cummings, *Tax Policy, Social Policy, and Politics: Amending Section 162(e)*, 61 TAX NOTES 595, 604 (1993) (“The meaning of the brief *Slee* opinion quote has been discussed by virtually every commentator on the subject and that meaning is simply unclear.”).

⁵⁶ See Thomas D. Griffith, *Theories of Personal Deductions in the Income Tax*, 40 HASTINGS L.J. 343 (1989); Mark Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an “ideal” Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831 (1979).

⁵⁷ For the classic exposition of this position, see Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988). For recent discussion of the tax subsidy approach, see David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and Private Support of Public Good*, 62 TAX. L. REV. 221 (2009); Miranda Perry Fleischer, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165 (2008); David. E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531 (2006).

⁵⁸ For example, Jasper Cummings has written that denial of a tax deduction to a business for lobbying “penalizes legal, rational economic behavior in a manner that is inconsistent with the theory of a tax on net income. . . . Business taxpayers normally can deduct the expenses of earning income and nonbusiness taxpayers generally cannot deduct personal expenses, including quite unremarkably the expenses of pursuing their personal nonbusiness legislative interest either directly or through charitable contributions.” Cummings, *supra* note 55. See also David I. Walker, *Suitable for Framing: Business Deductions in a Net Income Tax System*, 52 WM. & MARY L. REV. (forthcoming 2011), available at <http://www.bu.edu/law/faculty/scholarship/workingpapers/documents/WalkerD080910.pdf>; Mayer, *supra* note 36 at 498-99. As with any particular deduction, in some cases, a deduction for lobbying expenses will not provide a subsidy because the business has no income tax liability without use of the deduction, whether because of net operating losses or because it zeroes out its income with other expenses, such as salary.

⁵⁹ See Jill E. Fisch, *How Do Corporations Play Politics: The FedEx Story*, 58 VAND. L. REV. 1495 (2005) (using FedEx as a case to argue that political activity, whether lobbying or politicking, is an integral and necessary part of a corporation’s operating strategy).

endured and shaped *TWR*'s First Amendment discussion in both the Court's opinion and Justice Blackmun's concurrence.

If deductions, even for business expenses are seen as a subsidy, however, Justice Douglas's concurrence demonstrates neatly the unconstitutional conditions doctrine. Businesses' acceptance of the benefit of deducting their other ordinary and necessary expenses as well as other tax credits and incentives is conditioned on their not having a deduction for lobbying expenses. If they were denied all business deductions, there either would be no benefit on which to attach a condition or the condition would no longer be proportionate to the benefits the business obtains under the tax code, such as credits or other incentives that may exist.

The cases about deductions for lobbying in the charitable and in the business context exhibit an odd interdependence. Each depends on rules applicable to the other sector, in ways not always accurate, in defining the policy baseline. *Cammarano*, the case finding constitutional a regulation denying a business deduction for lobbying, depends on *Slee*, the case that found permissible denial of a charitable contribution deduction for an organization that had lobbying as a stated mission, to find a sharply defined Congressional policy that the facts do not seem to support.⁶⁰ The statute which *Slee* had interpreted had been changed by the time of *Cammarano* to permit some lobbying. The policy at issue in *Cammarano* was an administrative one, adopted by Congress only by reenactment, a slim basis for a sharply defined policy. *TWR*, which considered the limits on charitable lobbying, in turn relied on the regulation forbidding a deduction for lobbying by businesses upheld in *Cammarano*, although at the time of *TWR* businesses were in fact allowed by statute to deduct the costs of direct lobbying. Furthermore, the cases assume

⁶⁰ Others have also questioned the existence of a clearly defined public policy at the time. See Daniel L. Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 FLA. L. REV. 1, 27 n. 167 (citing Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities*, 71 TEX. L. REV. 1269, 1284 (1993); Dean E. Sharp, *Reflection on the Disallowance of Income Tax Deductions for Lobbying Expenditures*, 39 B.U.L. REV. 365, 379 (1959); and George Cooper, *The Tax Treatment of Business Grassroots Lobbying: Defining and Attaining the Public Policy Objectives*, 68 COLUM. L. REV. 801, 808-10 (1968)).

that the availability of a tax benefit, whether a deduction or an exemption, in fact provides a subsidy, without considering, for example, the extent to which deductions were in fact claimed by contributors. The cases operate by assumption as much as by analysis.

C. Case Law After *Taxation with Representation*

1. *FCC v. League of Women Voters* and *Rust v. Sullivan*: Emphasizing the Distance Between the Court’s Opinion and the Concurrence in *TWR*

The distance between the majority and concurrence in *TWR* became evident in *FCC v. League of Women Voters* and *Rust v. Sullivan*, the first two Supreme Court cases that rely upon it. The term after *TWR* was decided, Justice Brennan, writing for the Court, relied on Justice Blackman’s concurrence in *TWR* to decide *Federal Communication Commission v. League of Women Voters*.⁶¹ There, the owner and operator of noncommercial television stations, among others, challenged a provision of the Public Broadcasting Act of 1967 forbidding any such station that receives a grant from the Corporation for Public Broadcasting from engaging in editorializing. In striking down the provision as unconstitutional, Justice Brennan’s opinion rejected the government’s defense based on Justice Rehnquist’s opinion in *TRW* that the Congress had “in the proper exercise of its spending power,” simply determined that it “will not subsidize public broadcasting station editorials.”⁶² Relying instead on Justice Blackmun’s concurrence to characterize *TWR*, Justice Brennan distinguished the instant case because a station is unable to “segregate its activities according to the source of its funds.”⁶³ Unlike exempt organizations that can establish one organization financed with tax-deductible contributions and an affiliate funded with nondeductible gifts, a station cannot limit the use of its federal funds to all “noneditorializing activities” or use “wholly private funds to

⁶¹ *FCC v. League of Women Voters of Cal.*, 468 U.S. 364 (1984).

⁶² *Id.* at 399, quoting Brief for Appellant 42.

⁶³ *Id.* at 400.

finance its editorial activity.”⁶⁴ The majority found the prohibition on editorializing attached to receipt of the subsidy to be unconstitutional because there was no alternate channel available that would leave it free to use its private funds to conduct the First Amendment activity.

Justice Rehnquist, the author of the Court’s opinion in *TWR*, dissented sharply. To him, the majority opinion in *TWR* required the conclusion that the statute was constitutional because, like the limit on lobbying in section 501(c)(3), Congress did not violate the First Amendment when it chose to subsidize some speech but not others in the exercise of its spending power. To Justice Rehnquist, the majority in *FCC v. League of Women Voters* sought “to avoid the thrust” of *TWR* by “relying primarily on the reasoning of the concurrence rather than that of the majority opinion.”⁶⁵

A few years later, in *Rust v. Sullivan*,⁶⁶ Justices Rehnquist and Blackmun, authors of the two opinions in *TWR*, each invoked its authority, but to opposite ends. The case centered on a constitutional challenge to regulations that prohibited recipients of federal healthcare funding from engaging in abortion counseling, referral or activities advocating abortion as part of the project receiving the funding.⁶⁷ For Justice Rehnquist writing the majority opinion, *TWR*’s principle that government need not subsidize constitutional rights insulated the regulations from constitutional challenge: “Within far broader limits than petitioners are willing to concede, when Government appropriates public funds to establish a program it is entitled to define the limits of that program.”⁶⁸

⁶⁴ *Id.* at 400.

⁶⁵ *Id.* at 405 (Rehnquist, J. dissenting).

⁶⁶ *Rust v. Sullivan*, 500 U.S. 173 (1991).

⁶⁷ *Id.* at 197-199.

⁶⁸ *Id.* at 194. As he further explained, “The Government can, without violating the Constitution, selectively fund a program to encourage certain activities it believes to be in the public interest, without at the same time funding an alternate program which seeks to deal with the problem in another way. In so doing, the Government has not discriminated on the basis of viewpoint; it has merely chosen to fund one activity to the exclusion of the other. . . .” *Id.* at 193.

Justice Rehnquist's opinion for the Court, however, drew on one element of Justice Blackmun's *TWR* concurrence, the availability of an alternate channel. Justice Rehnquist observed that recipients of the federal funds at issue were free to engage in abortion-related activities "through programs that are separate and independent from the project."⁶⁹ Justice Blackmun's dissent in *Rust* relied on his concurrence in *TWR*. He emphasized that the lobbying restrictions at issue in *TWR* were not content based. In contrast, the provisions of the regulations forbidding discussion of abortion "constitute content-based regulation of speech."⁷⁰ To him, the regulations were therefore unconstitutional.

Rust, with its broad approval of governmental limitations on a governmental spending program far beyond the seeming scope of the benefit, has come to be seen as an outlier among the unconstitutional condition cases.⁷¹ Yet it demonstrates how far the reasoning of the Court's opinion in *TWR* can extend.

Rust and *League of Women Voters* point up the enormous differences between the Justice Rehnquist's opinion for the Court and Justice Blackman's concurrence in *TWR*. These differences were obscured in *TWR* itself because the two opinions agreed on the result. Justice Rehnquist's opinion permitted the government an almost unfettered leeway in conditioning spending that Justice Blackmun's opinion did not. *Rust* followed the

⁶⁹ *Id.* at 196.

⁷⁰ *Id.* at 209.

⁷¹ As one First Amendment scholar has written, "At the very least, it is clear that in every single opinion after *Rust*, the Court hedged on its application, carved out broad exceptions to it, and finally defined its scope in a way that seems to undercut its very holding." Steven G. Gey, *Default Rules in Private and Public Law: Extending Default Rules Beyond Purely Economic Relationships: Contracting Away Rights: A Comment on Daniel Farber's "Another View of the Quagmire,"* 33 FLA. ST. U. L. REV. 953, 963 (2006). *Rosenberger v. Rector of the Univ. of Va.*, 515 U.S. 819 (1995), where the Court held that the state violated the First Amendment in not providing funds to a Christian group that published a religious magazine, narrowed *Rust* to a case in which the government used "private speaker to transmit specific information pertaining to its own program," that is, private speakers speaking on behalf of the government. 515 U.S. at 834. *Legal Serv. Corp. v. Velasquez*, 531 U.S. 533 (2001), struck down a statute imposing restrictions on the kinds of claims government-funded lawyers could raise in court, in face of the government's defense that the restrictions were indistinguishable from those in *Rust*. According to the Court, the lawyer's speech funded by the government, unlike the doctor's speech funded by the government, was private. Justice Scalia dissenting for himself and three others found the distinction and the decision "quite simply inexplicable on the basis of our prior law." 531 U.S. at 561. See also Ronald J. Krotoszynski, Jr., *Brind & Rust v. Sullivan: Free Speech and the Limits of a Written Constitution*, 22 FLA. ST. U. L. REV. 1 (1994).

Court's opinion in *TWR* and upheld the government's program; *League of Women Voters* relied on the *TWR* concurrence to strike down the government program at issue in the case. How subsequent cases view the relationship between the two opinions in *TWR* affect and perhaps determine their result.

2. *American Society of Executives v. United States* and *Branch Ministries v. Rossotti*: Merging the Court's Opinion and the Concurrence in *TWR*

The first two Circuit Court cases that relied on *TWR*, *American Society of Association Executives v. United States*⁷² and *Branch Ministries v. Rossotti*,⁷³ failed to distinguish the Court's opinion in *TWR* and Justice Blackmun's concurrence. They instead treat Justice Blackmun's concurring opinion as if it were part of the opinion of the Court.

In *American Society of Association Executives*,⁷⁴ a coalition of trade associations challenged changes to tax provisions regarding the nondeductibility of lobbying expenses. Amendments to section 162(e) in 1993 included provisions designed to ensure that taxpayers could not deduct dues paid to tax exempt organizations to the extent that such organizations engaged in lobbying. Under the 1993 legislation, a tax exempt organization that engages in lobbying funded by tax-deductible membership dues and other contributions must either pay a "proxy" tax on its lobbying activities or follow notification "flow-through provisions."⁷⁵ The proxy tax is imposed at the highest marginal rate of the corporate income tax on all lobbying expenses of the tax exempt organization, as defined in section 162(e)(1). The flow-through option requires the organization to provide all donors or other contributors with a reasonable estimate of the portion of dues or other contributions that is allocable to expenditures not deductible under section 162.

The Association argued that these provisions burdened its freedom of expression in violation of the First Amendment. The court did not reach the First Amendment

⁷² *American Soc'y of Ass'n Executives*, 195 F.3d 47 (D.C. Cir. 1999), *cert. denied* 529 U.S. 1108 (2000).

⁷³ *Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Cir 2000).

⁷⁴ 195 F.3d 47.

⁷⁵ § 6033(e).

arguments. It extrapolated from *TWR* to split the 501(c)(6) organization into two such organizations, “one that engaged exclusively in lobbying and one that completely refrains from lobbying,”⁷⁶ one for which members can take a deduction for dues and one for which it cannot. With such a structure, the court explained, only rational basis scrutiny is required, and it looked to the Supreme Court’s opinion in *TWR* to justify the dual affiliate structure and the level of review, citing as well to both *Rust v. Sullivan* and *FCC v. League of Women Voters* regarding the need for an alternate channel.⁷⁷ In particular, it relied on language from *TWR* accepting IRS requirements designed to ensure that tax-deductible contributions do not pay for substantial lobbying. The court concluded that the scheme in section 6033 overall bore a rational relation to the legitimate governmental purpose of withholding the benefits of tax deductibility from lobbying.

In *TWR* the organization had previously structured itself as an affiliated 501(c)(3) and (c)(4). In *American Society of Executives*, the court itself suggested the structure of a paired (c)(6) organizations. In doing so, it also took an analytical leap. It assumed it was applying the Court’s opinion in *TWR*,⁷⁸ when it in fact applied the approach of the *TWR* concurrence. It was the *TWR* concurrence that stressed as crucial the availability of an alternate channel. But *American Society of Executives* applied the *TWR* concurrence only superficially, with its too clever Solomonic splitting of the baby into two 501(c)(6) organizations. The section 501(6) organization that lobbied would still have to pay the proxy tax or follow the notification flow through provisions.

The court in *American Society of Executives* avoided grappling with the unconstitutional conditions argument underpinning the *TWR* concurrence. The unconstitutional conditions argument as applied to section 6033(e) would question whether a proxy tax can be imposed on one entity in order to ensure compliance by

⁷⁶ 195 F.3d. at 51.

⁷⁷ *See id.* at 50.

⁷⁸ The opinion cites four times to the Court’s opinion in *TWR*, *id.* at 50-51, and only once to the Blackmun concurrence, and then only as further support for the proposition that IRS regulations need not to be burdensome. *Id.* at 51.

another entity, since the proxy tax undermines any tax benefit exemption provides to a section 501(c)(6) trade association.⁷⁹ However reasonable a proxy tax may be from an economic point of view, it is possible that it fails to pass muster under an unconstitutional condition analysis. It may well be that, in the case of the section 6033(e)(2) proxy tax, the availability of the notification alternative suffices to answer the unconstitutional conditions argument because it offers a tax-free alternative. Yet, notification also imposes an administrative burden and cost on the section 501(c)(6) for its decision to engage in lobbying. The appellate court, however, did not analyze these difficult questions.

In *Branch Ministries v. Rossotti*,⁸⁰ the D.C. Circuit applied *TWR* to the rules prohibiting politicking rather than those limiting lobbying by section 501(c)(3) organizations. It affirmed revocation of a church's exemption for violating the prohibition on intervention in a political campaign. The church had placed full-page advertisements in two national newspapers four days before the presidential election urging Christians not to vote for then-presidential candidate Bill Clinton because of his positions on abortion, homosexuality, and birth control for teenagers. Each advertisement also asked for tax-deductible contributions.

The church's challenges to its revocation included the First Amendment argument that it was substantially burdened by lack of an alternate means by which to communicate

⁷⁹ Plaintiffs had first challenged the constitutionality of these provisions in 1984, but the court had granted the government summary judgment under the Tax Injunction Act. *American Society of Association Executives v. Bentsen*, 848 F. Supp 245 (D.C.D.C. 1994). Plaintiffs renewed the suit after paying the proxy tax. *American Society of Association Executives v. United States*, 23 F. Supp 2d. 64 (D.C.D.C. 1998). The district court, granting summary judgment for the government, rejected plaintiffs' First Amendment challenge that the provisions imposed a penalty on tax-exempt associations that engage in lobbying. Relying on the Court's opinion in *TWR*, it concluded that they simply enforced the Congressional decision to eliminate the subsidy for lobbying and that they did not deny the plaintiff an independent benefit on account of its intention to lobby or discriminate on the basis of the taxpayer's speech. *Id.* at 69. From the court's reasoning, it appears, although it is not completely clear, that the plaintiffs argument that the provisions impose a penalty was or could be framed as an unconstitutional conditions argument. It does not appear that the Association made any challenge based on the need to allow the lobbying deduction in order to measure income accurately. The opinion for the Circuit Court stated that the Associations acknowledged that the government had no obligation to subsidize speech and agreed, perhaps too quickly, on the legitimacy of withholding the benefits of tax deductibility from lobbying. 195 F.2d at 49, 51.

⁸⁰ 211 F.3d 137 (D.C. Cir 2000).

its sentiments about candidates to public office. In rejecting this argument, the court relied on *FCC v. League of Women Voters* to view the Blackmun concurrence as the holding in *TWR*. Thus, *TWR* meant that “the availability of . . . an alternate means of communication is essential to the constitutionality of section 501(c)(3)’s restrictions on lobbying.”⁸¹ The court found that the church could establish a section 501(c)(4) organization, which in turn could establish a political action committee under the federal election laws to communicate these sentiments.

It rejected the practical problems of such a structure raised by counsel for the Church, who at oral argument “doggedly maintained that there can be no ‘Church at Pierce Creek PAC.’”⁸² The court was satisfied that with a 501(c)(4) intermediary “the church can initiate a series of steps that will provide an alternate means of political communication that will satisfy the standards set by the concurring justices in [*Taxation with Representation v.*] *Regan*”⁸³ At the time of *Branch Ministries*, setting up a 501(c)(4) required no more than it had at the time of *TWR*. As the court observed, a political action committee need be no more than a separate segregated fund. But the case did not pause for a even moment to ask whether having to form both a section 501(c)(4) and a PAC subject to regulation by the FEC might be too great a burden under *TWR*.⁸⁴

Both these cases evidence a too quick acceptance of the *TWR* concurrence. Both assume special purpose affiliates will solve the problem presented, without careful consideration of the purpose of the exempt organization to be established or the relationship between the entities they are so eager to establish. *American Society* fails to recognize that a pair of section 501(c)(6) organizations does not resolve the

⁸¹ *Id.* at 143.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ The court misunderstood Treasury Regulation § 1.504(c)(4)-1(a)(2)(ii) as forbidding all political intervention by section 501(c)(4) organization rather than forbidding such activity only if it is the organization’s primary activity. See Part II.B.1 *infra*. It also failed to consider that the Church might be able to establish a so called “MCFL” section 501(c)(4) that could engage in express political advocacy directly rather than through a PAC. See Part III.B *infra* for discussion of MCFL organizations.

unconstitutional condition issue that undergirds both Justice Blackmun’s concurrence in *TWR* and the provisions being challenged in the case. Housing all lobbying activity in a separate section 501(c)(6) entity does not resolve any of these issues; the relationship between two section 501(c)(6) organizations does not parallel a paired 501(c)(3) and 501(c)(4), which are subject to different rules. Similarly, *Branch Ministries* does not inquire with sufficient detail as to whether it is feasible for an individual church to maintain a section 501(c)(4) organization that in turn has a PAC or whether the burden of such a tripartite structure might run afoul of *TWR*. Both of these Circuit Court opinions adopt the easy aspects of the Court’s opinion and the Blackmun concurrence in *TWR* without grappling with their more difficult implications.

3. *Mobile Republican Assembly v. United States* and *Ysursa v. Pocatello Educational Association*: A Return to the Court’s Opinion in *TWR*

The two most recent cases relying on *TWR*, *Mobile Republican Assembly v. United States*⁸⁵ and *Ysursa v. Pocatello Educational Association*,⁸⁶ have been satisfied with citing to Court’s opinion in *TWR* without any mention of Justice Blackmun’s concurrence. As a result, they avoid the consideration of proportionality of benefit and burden that the concurrence at least implicitly demanded.

Mobile Republican Assembly was a declaratory action brought to challenge the 2000 amendments to section 527. These amendments added sections 527(i) and 527(j) to the Internal Revenue Code.⁸⁷ These provisions were enacted in response to the growth of section organizations under section 527 that engaged in issue advocacy intended to influence federal elections without being subject to regulation by the Federal Election Commission.⁸⁸ Section 527(i) requires that a political organization give notice to the Secretary of Treasury in order to receive tax-exempt treatment for amounts received to

⁸⁵ *Mobile Republican Assembly v. United States*, 353 F.3d 1357 (11th Cir. 2003).

⁸⁶ *Ysursa v. Pocatello Educ. Ass’n*, 129 S. Ct. 1093 (2009).

⁸⁷ 353 F.3d at 1359.

⁸⁸ The history of these provisions is discussed in more detail *infra* Parts II.B.2, III.D.

influence campaigns. Section 527(j) requires organizations that have given such notice to disclose the name, address and occupation of each contributor of \$200 or more in aggregate during a calendar year and disclose the name and address of each recipient of \$500 or more in aggregate made to any person during a calendar year.⁸⁹

The Eleventh Circuit, vacating the district court's decision,⁹⁰ viewed the requirements of section 527(j) as conditions imposed upon the receipt of a voluntary tax subsidy and as part of an overall tax scheme. As such, injunctive relief was barred, and the suit had to be dismissed for lack of jurisdiction. In reaching its conclusion, the court looked exclusively to *TWR*. It quoted the statement from Justice Rehnquist's opinion in *TWR* that tax exemptions were a form of subsidy and described the prohibition against lobbying as "a legitimate, congressionally-mandated component of the voluntary tax exemption."⁹¹ Further, according to the circuit court, "The Court observed that *TWR* remained free to receive tax-deductible contributions for non-lobbying activities and to engage in lobbying using other financial resources."⁹² While this characterization of *TWR* may seem to rehearse the alternate channel language of Justice Blackmun's *TWR*'s concurrence, the *Mobile Republican Assembly* did not go on to make such an alternative crucial to its decision or to consider the match between the benefit and burden. It moved instead to the argument from Justice Rehnquist's opinion in *TWR* that Congress has no obligation to subsidize speech. It quotes *TWR*: "Although *TWR* does not have as much money as it wants, and thus cannot exercise its freedom of speech as much as it would

⁸⁹ After the District Court opinion in the case, Congress amended section 527 to require disclosure of the purpose of any expenditure as well as the identity of the recipient. It also exempted organization focused solely on state and local election and subject to state disclosure laws. 353 F.3d at 1360 n. 2.

⁹⁰ The District Court, in a lengthy opinion, had characterized section 527(j) as a penalty instead of a tax and applied strict scrutiny to the governmental interest in increased disclosure to deter actual and perceived corruption. *National Federation of Republican Assemblies v. United States*, 218 F. Supp.2d 1399 (S.D. Ala. 2002).

⁹¹ 335 F.3d at 1361.

⁹² *Id.*

like, the Constitution does not confer an entitlement to such funds as may be necessary to realize all the advantages of that freedom.”⁹³

To the court in *Mobile Republican Assembly*, section 527(j) fell within the contours of *TWR* as “certain requirements that must be followed to claim the benefit of a public tax subsidy.”⁹⁴ In order to come within this framework, the opinion viewed as voluntary the initial decision by a political organization to register under section 527 in order to have its campaign-related income be treated as tax-exempt. “Any political organization uncomfortable with the disclosure of expenditures or contributions may simply decline to register under section 527(i) and avoid these requirements altogether. The fact that the organization might then engage in somewhat less speech because of stricter financial constraints does not create a constitutionally mandated right to the tax subsidy.”⁹⁵ The court reached this conclusion regarding section 527(i) without any discussion of the seemingly contradictory language of some provisions of section 527, as discussed in more detail below.⁹⁶

Moreover, “the fact that some self-declared section 527 organizations may later choose to withhold disclosure and, as a result, may pay more in taxes than they would have paid without tax-exempt status” did not trouble the court because it understood “the consequences of violating the conditions of the subsidy” as simply “part of the tax framework.”⁹⁷ In this statement, the opinion’s reliance on the Court’s opinion rather than the concurrence in *TWR* became manifest. That the condition can exceed the benefit troubled it not at all, or, at least not in a case that it views as subject to the Anti-Injunction Act and thus not yet subject to a careful scrutiny of the benefit and burden.

⁹³ *Id.* at 1361, quoting 461 U.S. 540, 549.

⁹⁴ *Id.* at 1361.

⁹⁵ *Id.*

⁹⁶ See Part III.D *infra*.

⁹⁷ *Id.* at 1362.

The recent Supreme Court case, *Ysursa v. Pocatello Educational Association*,⁹⁸ returned repeatedly to Justice Rehnquist's opinion in *TWR*.⁹⁹ The case involved the decision by the State of Idaho not to permit payroll deductions for local government employees' union political activities of local government employees, although it did permit payroll deductions for union dues and for charitable contributions. A group of unions argued that this limitation violated their First Amendment rights. The Supreme Court disagreed. Chief Justice Roberts observed that government is "not required to assist others in funding the expression of particular ideas, including political ones."¹⁰⁰ He then, by quoting *TWR*, equated the decision not to supply such assistance, however little the burden or cost,¹⁰¹ with a decision not to subsidize. Next, he reasoned that because a decision not to subsidize a right does not infringe it under the Court's opinion in *TWR*, the State need demonstrate only a rationale basis for its decision.¹⁰² Justice Roberts found the State's asserted rationale, "avoiding in reality or appearance of government favoritism or entanglement with partisan politics,"¹⁰³ sufficient to pass the rationale basis test. There was no need to compare benefit and burden.¹⁰⁴ Moreover, the case permitted the government to refuse to assist – that is, burden - political speech that is at the heart of the First Amendment, even when it was assisting other kinds of speech, such as that

⁹⁸ 129 S. Ct. at 1093.

⁹⁹ 129 S. Ct. at 1098.

¹⁰⁰ *Id.*

¹⁰¹ Both the District Court and the Court of Appeals found that "there is no subsidy by the State of Idaho for the payroll deduction systems of local governments." *Id.* at 1101. The Chief Justice's opinion found that immaterial because the question "is whether the State must affirmatively assist political speech by allowing public employers to administer payroll deductions for political activities." *Id.*

¹⁰² *Id.*

¹⁰³ *Id.* at 1099.

¹⁰⁴ In contrast, none of the dissenters relied on *TWR*. Justice Breyer would have applied "what the Court sometimes calls an 'intermediate scrutiny' inquiry," *id.* at 1103, and asked "whether the statute imposes a burden upon speech that is disproportionate in light of the other interests the government seeks to achieve," *id.* Justice Stevens viewed the statute not as viewpoint neutral, but as discriminatory in application because aimed at union speech in particular, *id.* at 1104-1108; and Justice Souter, because of a suspicion of discrimination that could not be examined in the case before the Court, would have dismissed the writ of certiorari as improvidently granted, *id.* at 1108-09.

conducted by charitable organizations by permitting payroll deductions for charitable contributions.¹⁰⁵

These two recent cases demonstrate how reliance on the Court's opinion in *TWR* gives government considerable freedom in offering assistance, whether through direct spending, subsidies, or employee benefits such as payroll deductions. Governments have freedom not to offer such programs and to decide among the many possibilities which they prefer. At times, the Court's opinion in *TWR* has dominated later understanding of the case; at other times the case has been seen through the lens of Justice Blackmun's concurrence. The popularity of and reliance on the *TWR* concurrence and, accordingly, at least an implicit need to engage in an unconstitutional conditions analysis seem currently to have waned. At the same time, however, if, however, vindicating First Amendment rights requires establishing an affiliate exempt organization, the Court's opinion in *TWR* articulates greater concern with the purpose and burdens of such a structure than does Justice Blackmun's concurrence.¹⁰⁶

It is *Citizens United* that has gone into exquisite and agonizing detail describing the kinds of burden exempt political organizations face today, and thus a return to the Court's opinion in *TWR* combined with the concerns articulated in *Citizens United*, as described below, might lead to reconsideration of the affiliate structure we have long taken for granted for tax-exempt organizations.

D. *Citizens United*

In *Citizens United*, the Supreme Court by a 5-4 vote struck down on First Amendment grounds a provision of the federal campaign finance laws that prohibit corporations and unions from using their general treasury funds to make independent

¹⁰⁵ For further discussion, see Miriam Galston, *When Statutory Regimes Collide: Will Wisconsin Right to Life and Citizens United Invalidate Federal Tax Regulation of Campaign Activity?* (GWU Legal Studies Research, Paper No. 499), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1572511.

¹⁰⁶ Justice Blackmun seems satisfied if the 501(c)(3) can control the 501(c)(4). See *supra* Part I.D.

expenditures¹⁰⁷ for electioneering communications or speech expressly advocating the election or defeat of a candidate. By a vote of 8-1, it upheld disclaimer provisions, which require that televised electioneering communications state who was responsible for the content, and disclosure provisions for anyone spending more than \$10,000 on electioneering communications in a calendar year identifying the name of the person making the expenditure, the amount of the expenditure, the election to which the communication was directed, and the names of certain contributors.

The case involved Citizens United, a section 501(c)(4) organization, which had made a 90-minute movie about then-Senator Hillary Clinton (“*Hillary*”). Citizens United wished to make the movie available through video-on-demand and produced advertisements to promote it. Concerned that its release would violate the ban on electioneering communication funded by corporate treasury funds,¹⁰⁸ and thus subject it to civil and criminal penalties, it sought declaratory and injunction relief against the FEC before the District Court. The District Court denied its motion for preliminary injunction and granted the FEC’s motion for summary judgment. After the Supreme Court noted probable jurisdiction and oral arguments were held, the Court heard reargument after asking the parties to file supplemental briefs to address whether *Austin v. Michigan Chamber of Commerce*¹⁰⁹ and parts of *McConnell v. Federal Election Commission*,¹¹⁰ cases that had upheld the facial validity of the provision prohibiting the use of corporate and union general treasury funds for independent expenditures, should be overruled.

¹⁰⁷ That is, a communication that is not made in cooperation, consultation or concert with, or at the request or suggestion of, a candidate, the candidate’s authorized committee, or their agents, or a political party or its agents. See 11 CFR 100.16(a).

¹⁰⁸ Citizens United accepted some funds from corporations. 130 S.Ct. at 887. Thus, it was not eligible for an exception from the these rules known as the MCFL exception, from the case which established it, *Federal Election Commission v. Massachusetts Citizens for Life, Inc.* 479 U.S. 238, 107 S.Ct. 616 (1986). A nonprofit corporation is eligible for this exception is it is formed for the sole purpose of promoting political ideas, does not engage in business activities, and does not accept contributions from for-profit corporations or from labor union. MCFL corporations are always section 501(c)(4) organizations, although not all section 501(c)(4) organizations are MCFL organizations, as the facts of *Citizens United* demonstrate.

¹⁰⁹ *Austin v. Mich. Chamber of Commerce*, 494 U.S. 652 (1990).

¹¹⁰ *McConnell v. FEC*, 540 U.S. 93 (2003).

Justice Kennedy wrote the opinion of the Court. He first rejected a number of narrower bases for resolving the case. According to Justice Kennedy, video-on-demand came squarely within the statutory term “electioneering communication;” the film was equivalent to express advocacy,¹¹¹ and the Court could not invalidate the provision as applied to video-on-demand, or allow an exception to the expenditure ban for “nonprofit corporate speech funded overwhelming by individuals.”¹¹² As to the last suggestion, the opinion protested that applying a *de minimis* standard “would require case-by-case determinations;” and such a process would be objectionable because “archetypical political speech would be chilled in the meantime.”¹¹³

The opinion next engaged in a lengthy discussion of as applied and facial challenges, a discussion that bears upon consideration of the current tax regime. Justice Kennedy tied the need for considering the facial validity of the provision closely to its chilling effect on speech that is of “primary importance” to the “integrity of the election process.” His opinion described with seeming horror the FEC’s 568 pages of regulations, 1,278 pages of explanations and justifications for those regulations and 1,771 advisory opinions since 1975 and a two-part 11-factor balancing test to determine an “appeal to vote” test for determining whether a communication was the functional equivalent of express advocacy.¹¹⁴ To the court, these efforts to provide guidance were an “onerous restriction” that “function as the equivalent of prior restraint by giving the FEC power analogous to licensing laws implement in 16th- and 17th-century England, laws and governmental practices of the sort that the First Amendment was drawn to prohibit.”¹¹⁵ Thus, the FEC is a “censor” that “has created a regime that allows it to select what political speech is safe for public consumption by applying ambiguous tests.”¹¹⁶ Instead of

¹¹¹ Justice Kennedy disagreed with Citizens United argument that *Hillary* is “just a documentary film that examines certain historical events. . . . As the District Court found, there is no reasonable interpretation of *Hillary* other than as an appeal to vote against Senator Clinton.” 130 S. Ct. at 890.

¹¹² *Id.* at 891.

¹¹³ *Id.* at 892.

¹¹⁴ *Id.* at 895.

¹¹⁵ *Id.* at 896.

¹¹⁶ *Id.*

eschewing “the open-ended rough-and-tumble of factors,”¹¹⁷ the opinion continued, the FEC has embraced them, creating “an unprecedented governmental intervention into the realm of speech.”¹¹⁸

The opinion then examined the validity of the provision on its face under the First Amendment. It characterized the provision as an “outright ban, backed by criminal sanctions.”¹¹⁹ It acknowledged that a PAC created by a corporation can engage in express advocacy and electioneering communications, but rejected the argument that a PAC can speak for the corporation that created it because a “PAC is a separate association from the corporation.”¹²⁰

Justice Kennedy next wrote, with language also important to consideration of current tax rules:

Even if a PAC could somewhat allow a corporation to speak – and it does not – the option to form PACs does not alleviate the First Amendment problems with §44(b). PACs are burdensome alternatives; they are expensive to administer and subject to extensive regulations. For example, every PAC must appoint a treasurer, forward donations to the treasurer promptly, keep detailed records of the identities of the persons making donations, preserve receipts for three years and file an organization statement and report changes to this information within 10 days.¹²¹

The opinion went on to describe the detailed monthly reports that PACS must file with the FEC, due at different times, depending on the type of election.¹²²

The prohibition on corporate independent expenditures, according to the Court, “could repress speech by silencing certain voices at any of the various points in the speech

¹¹⁷ *Id.* at 896, quoting *FEC v. Wis. Right to Life*, 551 U.S. at 469 (Opinion of Roberts, C.J. (quoting *Jerome B. Grubart, Inc. v. Great Lakes Dredge & Dock Co.*, 513 U.S. 527, 547)).

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 897. The Court offered hypothetical involving a number of well-known 501(c)(4) organizations – the Sierra Club, the National Rifle Club, and the American Civil Liberties Union, although it did not identify them as such.

¹²⁰ *Id.*

¹²¹ *Id.* quoting *McConnell*, 540 U.S. at 330-332, quoting *MCFL*, 479 U.S. 253-54.

¹²² *Id.* at 897-98.

process.” Because speech “is an essential mechanism of democracy” as “the means to hold officials accountable to the people,” laws, such as this one, which burden political speech, are subject to strict scrutiny.¹²³ For Justice Kennedy and the four Justices who joined his opinion, the First Amendment is “[p]remised on mistrust of government power” and “stands against attempts to disfavor certain subjects or viewpoints “ because [s]peech restrictions based on the identity of the speaker are all too often simply a means to control content.”¹²⁴ Moreover, “government may not . . . deprive the public of the right and privilege to determine for itself what speech and speakers are worthy of consideration.”¹²⁵

Justice Kennedy then reassessed Supreme Court case law regarding corporate political spending. His opinion concluded that the law prior to *Austin* did not support *Austin*’s holding that upheld the ban on corporate independent expenditures. The *Citizen United* majority read *Austin* as relying on an “antidistortion rationale,” that is, in “preventing ‘the corrosive and distorting effects of immense aggregations of wealth that are accumulated with the help of the corporate form and that have little or no correlation to the public support for the corporation’s political ideals.’”¹²⁶ Justice Kennedy unequivocally rejected this rationale, reasoning it could permit the banning of books and the speech from media corporations. Neither could the special rights granted corporations, such as limited liability and perpetual life, justify such abridgement of First Amendment rights. “It is rudimentary that the State cannot exact as the price of those special advantages the forfeiture of First Amendment rights.”¹²⁷

Justice Kennedy also repudiated anticorruption as a justification for the provision because, according to the opinion, independent expenditures “do not give rise to corruption or the appearance of corruption.”¹²⁸ The evidence offered for the conclusion

¹²³ *Id.*

¹²⁴ *Id.* at 898-99.

¹²⁵ *Id.* at 899.

¹²⁶ *Id.* at 903, 494 U.S. at 660 (citing *MCFL*, 479 U.S., at 257).

¹²⁷ *Id.* at 905 (quoting Justice Scalia’s dissent in *Austin*, 494 U.S. at 680).

¹²⁸ *Id.* at 909.

appears to be that 26 States do not restrict independent expenditures by for-profit corporations and the “Government does not claim that these expenditures have corrupted the political process in those States.”¹²⁹

Finally, the opinion discarded a shareholder protection basis for the provision. Such a basis, it explained, would also apply to media corporations. Furthermore, it is both under and overinclusive in that it is not logically limited to a short period before an election and does not logically apply at all to nonprofit corporations.

The opinion then justified abandoning *stare decisis* on the grounds that *Austin* was not “well reasoned,”¹³⁰ the government did not defend it well,¹³¹ the case was “undermined by experience,”¹³² and “no reliance interests”¹³³ were at stake.” The Court proceeded to overrule the case and that part of *McConnell* upholding the electioneering provision.

All of the Justices except Justice Thomas joined the next part of the Court’s opinion, which upheld disclaimer and disclosure provisions.¹³⁴ Such requirements, Justice Kennedy wrote, while they burden the ability to speak, they “impose no ceiling on campaign-related activities.”¹³⁵ Thus, they “are subject to exacting scrutiny,” which requires a “substantial relation between them and a sufficiently important government interest.”¹³⁶ Justice Kennedy found that the same interest that sustained facial challenges to such provisions, namely helping citizens to “make informed choices in the political marketplace,” applied here.¹³⁷ Moreover, because “disclosure is a less restrictive

¹²⁹ *Id.*

¹³⁰ *Id.* at 912.

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.* at 913

¹³⁴ *Id.* at 914.

¹³⁵ *Id.* quoting *McConnell*, 540 U.S. at 291.

¹³⁶ *Id.* quoting *Buckley* at 64.

¹³⁷ *Id.* at 914-15.

alternative to more comprehensive regulations of speech,” disclosure requirement need not be limited to speech that is the functional equivalent of express advocacy.¹³⁸

Citizens United argued that disclosure requirements can chill donations to an organization by exposing donors to retaliation, but the Court concluded that it had made not a showing of harassment or retaliation in its case. In fact, the “First Amendment protects political speech; and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and to give proper weight to different speakers and messages.”¹³⁹

Chief Justice Roberts, joined by Justice Alito, wrote a concurring opinion explaining why the principles of judicial constraint and *stare decisis* nonetheless permitted overruling *Austin*. Justice Scalia, joined by Justice Alito and Justice Thomas in part, wrote a concurring opinion disputing Justice Stevens’s account of the original understanding of the First Amendment. Justice Stevens, along with Justices Ginsburg, Breyer, and Sotomayor, issued a lengthy opinion concurring on the disclaimer and disclosure provisions, but dissenting on all other aspects of the Court’s opinion. At the conclusion of his opinion, Justice Stevens said that the Court’s decision “elevates the majority’s agenda over the litigants’ submissions, facial attacks over as-applied claims, broad constitutional theories over narrow statutory grounds, individual opinions over precedential holdings, assertion over tradition, absolutism over empiricism, rhetoric over reality.”¹⁴⁰ Finally, Justice Thomas dissented for himself alone on the constitutionality of the disclaimer and disclosure provisions.

Language in the Court’s opinion raises questions about limits on political speech by noncharitable tax exempt organizations and the affiliate structure as a means to comply with the tax laws. The majority opinion seems ambivalent about disclosure, both

¹³⁸ *Id.* at 915.

¹³⁹ *Id.* at 916.

¹⁴⁰ *Id.* at 979 (Stevens, J. concurring in part and dissenting in part).

welcoming it and calling attention to its burdens.¹⁴¹ The Court’s opinion is also highly critical of multifactor tests in the context of political speech. In order to consider the possible impact of both *Citizens United* and the principles of *TWR* on the current rules for political speech for exempt organizations, we must, of course, review the current rules. Such is the purpose of the next section.

II. Political Speech by Noncharitable Tax-Exempt Organizations

This section will review the rules regarding lobbying and politicking for tax-exempt organizations. Unlike section 501(c)(3) organizations, which can lobby only to a limited extent and which are completely prohibited from politicking, section 501(c)(4), (5) and (6) organizations can lobby without limit under the Internal Revenue Code, provided that the lobbying is related to their exempt purpose. In addition, these organizations may engage in politicking provided that such politicking does not constitute the organization’s primary activity. The prohibition on business deductions for lobbying and politicking can add another set of rules and complications for these 501(c) organizations. Moreover, if they engage in politicking directly, they will be subject to tax under section 527(f). Organizations that have politicking as their primary purpose, however, are subject to another set of rules under section 527. Consideration of the rules regarding lobbying will come begin this part, followed by the rules for politicking for both noncharitable section 501(c) organizations and section 527 organizations.

A. Lobbying Rules

1. Lobbying as a Permitted Purpose

¹⁴¹ As Justice Stevens wrote, “Administering a PAC entails some administrative burden, but so does complying with the disclaimer, disclosure and reporting requirements that the Court today upholds.” *Id.* at 942.

Although more than substantial lobbying disqualifies an organization from exemption under the statutory definition of section 501(c)(3) and thus from the ability to receive tax-deductible contributions under that section,¹⁴² the IRS has recognized, albeit in quite different ways, that an organization can be exempt under section 501(c)(4) as a social welfare organization,¹⁴³ under section 501(c)(5) as a labor, agricultural, or horticultural organizations,¹⁴⁴ or under section 501(c)(6) as a trade association,¹⁴⁵ even if the organization's sole activity is advocacy, so long as the primary purpose for the legislative activities is to achieve the organization's exempt purposes.

Revenue Ruling 71-350, for example, described an organization formed to improve the tax system.¹⁴⁶ The organization identified experts to testify at legislative and administrative hearing on tax matters, aided them in preparing and publicizing testimony, and used contributions from the public to cover the costs of transporting these witnesses, preparing and reproducing their statements, publicizing recommendation on proposed tax changes, and paying salaries and other expenses. As the ruling sets forth, the statute requires that a section 501(c)(4) organization be operated "exclusively for the promotion of social welfare," but the applicable regulation states that the "exclusively requirement is

¹⁴² Section 170(c)(2)(B), the provision governing tax-deductible contributions for purposes of the income tax, uses the same language as section 501(c)(3) to prohibit politicking ("For purposes of this section, the term 'charitable contribution' means a contribution or gift to or for the use of . . . a corporation, trust, or community chest, fund or foundation . . . organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention to cruelty to children or animals. . . .").

¹⁴³ "An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements." Treas. Reg. § 1.501(c)(4)-1 (1995).

¹⁴⁴ Such organizations must have "as their objects the betterment of conditions of those engaged in such pursuits, the improvements of the grade of their products, and the development of a higher degree of efficiency in their respective occupations." Treas. Reg. § 1.501(c)(5)-1 (1995).

¹⁴⁵ A business league is "an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. A business league's activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons." Treas. Reg. § 1.501(c)(6)-1 (1995).

¹⁴⁶ Rev. Rul. 71-350, 1971-2 C.B. 237.

satisfied if the organizations is “primarily engaged in promoting in some way the common good and general welfare of the people of the community.”¹⁴⁷ The ruling characterized the organization as promoting the common good by helping policymakers “form better judgments” about tax legislation. It concluded, “[t]he fact that the organization’s only activities may involve advocating changes in law does not preclude the organization from qualifying under section 501(c)(4) of the Code.”

Thus, attempts to influence legislation are considered to promote social welfare, even though they are not considered “charitable,”¹⁴⁸ and, as *TWR* suggested, many section 501(c)(4) organizations are advocacy organizations.¹⁴⁹ That is, an organization can qualify for exemption under section 501(c)(4) even though it would fail to qualify for exemption under section 501(c)(3) as an “action organization,” an organization that has primary objectives that can only be obtained through legislation and that advocates for those objectives.¹⁵⁰

Similarly, Revenue Ruling 61-177 held that a corporation organized and operated for the purpose of promoting a common business interest is exempt under section 501(c)(6) “even though its sole activity is directed to the influencing of legislation which is germane to such common business interest.”¹⁵¹ The ruling noted that neither the statute nor the applicable regulations prohibit or limit section 501(c)(6) organizations from attempting to influence legislation in order to qualify for exemption.

¹⁴⁷ Treas. Reg. § 1.501(c)(4)-1(a)(2) (1995).

¹⁴⁸ Fishman and Schwarz observe of the conclusion under the regulations for section 501(c)(4) organizations that attempts to influence legislation promote social welfare but are not charitable: “This distinction is rather odd in view of the fact that promotion of social welfare is an example of charitable purpose.” See Treas. Reg. § 1.501(c)(3)-1(d)(2) (1995). JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* (FOUNDATION PRESS: 3RD ED.) 990.

¹⁴⁹ BRUCE HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* (John Wiley & Sons 9th Ed.) 400.

¹⁵⁰ Treas. Reg. § 1.501(c)(3)-1(c)(3)(iv) (1995). See Rev. Rul. 67-293, 1972-2 C.B. 185 (organization that attempts to influence legislation for the welfare of animals denied exemption under section 501(c)(3) as action organization but could qualify under section 501(c)(4)).

¹⁵¹ Rev. Rul. 61-177, 1961-2 C.B. 117.

In contrast, no revenue ruling speaks directly to lobbying as a permissible activity for a section 501(c)(5) organization.¹⁵² As in the case of section 501(c)(6) organizations, neither the statute nor the regulations impose any limits on lobbying in connection with eligibility for exemption. Nonprecedential guidance has confirmed that the same principle applies to section 501(c)(5) organizations. A chapter in a 2003 Exempt Organization Continuing Professional Organization text stated that the rule in Rev. 61-177 applies to organizations described in 501(c)(5) as well.¹⁵³ A General Counsel Memorandum from 1969 concluded that if an organization has as its primary purpose and activity influencing legislation, it may qualify for exemption under section 501(c)(5).¹⁵⁴ As the GCM explained: “The content of specific legislative proposals can be readily identified and related to . . . labor, agricultural, or horticultural interests of an organization claiming exemption under section 501(c)(5).”¹⁵⁵

Thus, under various administrative authorities of various official weights, section 501(c)(4), (5) and (6) organizations can all lobby without limit, so long as they can show that such lobbying is related to their exempt purposes.

2. The Impact of Section 6033(e) and the Definition of Lobbying

Characterization of an activity as lobbying can cause a 501(c)(3) organization to lose its exemption, since such organizations cannot engage in substantial lobbying. This rule, of course, prompted the suit in *TWR*, and the suggestion by both the Court and the concurrence that the section 501(c)(3) organization establish an affiliated section 501(c)(4)

¹⁵² Rev. Rul. 2004-6, 2004-1, C.B. 328 states that section 501(c)(5) and section 501(c)(6) organization may, consistent with their exempt purpose, publicly advocate positions on public policy issues, but does not discuss to what extent they may do so.

¹⁵³ John F. Reilly and Barbara A.B. Allen, *Political Campaign and Lobbying Activities of IRS 501(c)(4), (c)(5) and (c)(6) Organizations*, 2003 EO CPE Text, p. L2, available at <http://www.irs.gov/pub/irs-tege/eotopicl03.pdf>.

¹⁵⁴ Gen. Couns. Mem. 34,233 (December 30, 1969) available on LEXIS, Federal Tax Cases and Administrative Decisions File.

¹⁵⁵ *Id.*

organization to engage in substantial lobbying.¹⁵⁶ To make clear just what is forbidden, at least for those organizations that have made the election under section 501(h) to be subject to an expenditure limit for their lobbying expenses,¹⁵⁷ the Internal Revenue Code and an elaborate set of regulations provide detailed guidance as to what is and what is not lobbying.¹⁵⁸ Section 501(c)(4), (5), and (6) organizations, in contrast, must concern themselves with the definition of lobbying under section 162(e), because of limits on deductions of membership dues and other similar amounts that are attributable to lobbying and political expenditures. Section 501(c)(4) organizations may need to concern themselves with both sets of rules, although in practice, a particular 501(c)(4) organization is likely to be more concerned with one or the other set of lobbying rules. A section 501(c)(4) established as an affiliate of a section 501(c)(3) in order to carry out substantial lobbying the definition of lobbying for purposes of section 501(c)(3) will be particularly important. For a section 501(c)(4) such as an HMO that is a member of a trade group, the section 162(e) definition will have more relevance.¹⁵⁹

Exempt organizations subject to the section 162(e) rules may give notice to their members about the percentage of dues and contributions, if any, allocated to lobbying and political expenditures.¹⁶⁰ If they do not give this notice or if they provide a notice that

¹⁵⁶ 461 U.S. 540.

¹⁵⁷ Section 501(c) organizations that make the affirmative election under section 501(h) are subject to certain dollar limits, on a sliding scale depending on an organization's size, for lobbying expenditures. This sliding scale is measured on the basis of "exempt purpose expenditures." "Exempt purpose expenditures" include all amounts spent by an organization during its taxable year to accomplish its exempt purpose, but excludes capital expenditures, the expenses of a separate fundraising unit, or investment management expenses. For many organizations, however, exempt purpose expenditures are the same as the organization's operating budget, other than lobbying expenditures. The sliding scale is as follows: 20% of the first \$500,000 of exempt purpose expenditures; 15% of the next \$500,000; 10% of the next \$50,000; 5% of the excess over \$1,500,000. In no case, however, may the total amount devoted to lobbying exceed \$1,000,000, a cap that an organization reaches when its exempt purpose expenditures equal \$17,000,000. § 4911.

¹⁵⁸ See Treas. Reg. § 56.4911-1 to -7.

¹⁵⁹ See note 165 *infra* for requirements that section 501(c)(4) organizations must meet to be excepted from section 162 notification and proxy tax requirements.

¹⁶⁰ § 6033(e)(1)(A)(ii). Section 162(e) is entitled "Denial of Deductions for Certain Lobbying and Political Expenditures," Nothing in the statute itself defines political expenditures, leaving for-profit business to guess at what the phrase means. See Gregory L. Colvin, *Political Tax Law After Citizens United: A Time for Reform*, 66 EXEMPT ORG. TAX REV. 71 (2010). Section 162(e)(8) cross references to section 6033 for

underestimates the percentage of dues used for these purposes, a tax is imposed on the section 162(e) expenditures at the highest corporate rate.¹⁶¹ Following directions in the legislative history¹⁶² and in the Code,¹⁶³ the IRS has provided conditions permitting certain organizations to be excepted from these notice requirements and from the proxy tax under certain conditions relating to their membership and dues structure.¹⁶⁴ All section 501(c)(5) labor organizations have been excepted from these requirements.¹⁶⁵

The current set of section 162(e) rules emerged only after a series of twists and turns. Following the decision in *Cammarano*, the IRS in 1960 had promulgated new and broader regulations denying the business deduction for lobbying. They included a requirement of a pro rata disallowance of deductions for dues paid to labor unions, trade associations, or other entities engaging in lobbying.¹⁶⁶ In response, Congress in 1962 enacted a statutory denial of business deduction for lobbying and politicking expenses, section 162(e).¹⁶⁷ As originally enacted in 1962, the statute, unlike the regulations, permitted a deduction for direct lobbying expenses, that is, for the expenses for lobbying

reporting requirements and alternative taxes, including those applicable to dues of tax-exempt organizations under section 162(e)(3). Section 6033(e)(1)(A)(iii) specifies that the subsection does not apply to any amount on which tax is imposed by reason of section 527(f). Tax-exempt organizations that engage directly in politicking will be liable under section 527(f) for amounts so spent. *See infra* Part II.B. Thus, the reporting requirements and proxy tax requirements of sections 162(e) and 6033(e) now apply only to lobbying; section 527(f) applies to expenses for politicking allocable to dues paid to exempt organizations. The taxable amount of lobbying is reported on Schedule C of Form 990 and any proxy tax is reported on Form 990-T, which is a public document. If, however, an organization's overestimates the amount of lobbying and political activities in the pass-through notice given to its members, it cannot take a credit for the excess amounts noticed to members against any section 527(f) tax owed. I thank Gregory Colvin for explaining this interaction to me.

¹⁶¹ § 6033(e)(2).

¹⁶² H.R. 103-213, 103 Cong. at 65-67 (1st Sess. 1993).

¹⁶³ § 6033(e)(3).

¹⁶⁴ Rev. Proc. 98-19, 1998-1 C.B. 547.

¹⁶⁵ *See id.* All section 501(c)(4) veterans organizations are also exempt. *Id.* More generally, a 501(c)(4) organization or 501(c)(5) agricultural or horticultural organization is exempt if (1) more than 90 percent of dues and similar amounts are received from persons paying \$101 or less (currently) or (2) 90% or more of the membership dues come from nondeductible sources, such as section 501(c)(3) organizations or state and local organizations and are nondeductible in any event. Section 501(c)(6) organizations can be excepted if they satisfy a requirement similar to (2), but such is less likely in their case. *Id.*; Rev. Proc. 2009-50, 2009-45 I.R.B. 1.

¹⁶⁶ T.D. 6435, 1960-1 C.B. 79 (1960).

¹⁶⁷ Revenue Act of 1962, P.L. 87-834, §3(a), 76 Stat. 960.

committees or members of legislatures and their staffs.¹⁶⁸ The legislation continued to deny a deduction for the costs of grassroots lobbying, that is, lobbying directed at the public.

In 1993, however, Congress amended the provision to deny the deduction for direct as well as grassroots lobbying, as the original regulations had done.¹⁶⁹ The 1993 legislation for the first time, disallowed a deduction for lobbying of top federal executive branch officials “in an attempt to influence the official actions or positions of such official.”¹⁷⁰

The 1993 legislation introduced the specific rules requiring notification or payment of the proxy tax by exempt organizations on payment of membership dues or other amounts allocated to lobbying or political expenditures.¹⁷¹ For organizations subject to these notification or proxy rules, the definition of lobbying became important. Section 162(e)(4) specifies that “legislation” is to have the meaning given it by section 4911(c)(2),¹⁷² the provision defining legislation for purposes of the tax on excess lobbying

¹⁶⁸ Legislative history of the 1962 provisions expressed concern that the costs of contact with the executive and judicial branches, but not the legislative branch, could be deducted. It recognized that such a deduction “is necessary to arrive at a true reflection of [a business’s] real income.” H.R. Rep. No. 87-1447 (1962) ; *see also* Lloyd Hitoshi Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625, 635 n.45 (2007) (detailing history of legislation).

¹⁶⁹ Omnibus Budget Reconciliation Act of 1993 H.R. 2264, 103rd Cong., 1st Sess. §13222(a) (1993).

¹⁷⁰ *See* § 162(e)(1)(D). Section 162(e)(6) defines covered executive branch official. The legislative history of the 1993 amendments gives little reason for this Congressional change of heart. “The 1993 legislation was accompanied by a conference report that does not cite a single reason for the revision of section 162(e).” Jasper L. Cummings, *Tax Policy, Social Policy, and Politics: Amending Section 162(e)*, 93 TNT 226-163 (Nov. 3 1993). The House Report spoke of revenue concerns: “The Committee has determined that in the context of deficit reduction, it is appropriate to limit the business deduction for lobbying expenses.” H.R. Rept. 103-111, 103rd Cong., 1st Sess. 659 (1993). Earlier that year, Treasury’s explanation of the administration’s revenue proposals stated, “The deduction for lobbying expenses inappropriately subsidizes corporations and special interest groups for intervening in the legislative process.”¹⁷⁰ H.R. Rep. No. 103-111 (1993). Treasury did not explain how the deduction was inappropriate.

¹⁷¹ Regulations under section 162(e) had since their adoption in 1965 provided for such a disallowance. *See* Treas. Reg. §1.162-20(c)(3) (1965). The 1993 legislation, however, provided a mechanism at the entity level to ensure notification to members of the disallowance. These organizations must also report the amounts of these expenditures on their annual information return. § 6033(e)(1)(A)(i).

¹⁷² § 4911(e)(2) provides, “The term ‘legislation’ includes action with respect to Act, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative or constitutional amendment, or similar procedure.”

expenditures by public charities that have made the election under section 501(h) to have their lobbying limited by fixed percentages of their expenditures.¹⁷³ Neither section 162(e) itself nor the regulations under section 162(e) include the exceptions to the definition of lobbying, such as making available the results of “nonpartisan analysis, study or research,” providing “technical assistance” in response to a written request from a government body, or the self-defense exception for communications or appearances that might affect the existence of the organization, found in section 4911.¹⁷⁴ In this regard, “legislation” as used in section 162(e) is broader than “legislation” as used in the charitable context, with one exception. Section 162(e), both as originally enacted and as amended in 1993, permits a deduction for direct lobbying before “any local council or similar governing body” with respect to legislation or proposed legislation of direct interest to the taxpayer.¹⁷⁵ One explanation for this exclusion is the perceived difficulty of distinguishing between legislative and administrative functions at the location level.¹⁷⁶

These two sets of tax definitions, however, are not the only federal definitions of lobbying. The Lobbying Disclosure Act of 1995 (“LDA”) requires that lobbyists lobbying certain specified federal government officials to register and report on their lobbying activities.¹⁷⁷ The LDA in some cases gives reporting entities the option of using either of

¹⁷³ Under section 501(h), the percentage declines as expenditures rise and reaches a maximum of \$1 million for organizations with annual budgets exceeding \$17 million. § 4911(c). Ironically, part of the impetus for enactment of what eventually became section 501(h) and section 4911 was the ability of businesses to deduct the costs of direct lobbying under former section 162(e). Cummings, *supra* note 170.

¹⁷⁴ See § 4911(d)(2). Section 162(e) also specifies that “[a]ny amount paid or incurred for research for, or preparation, planning, or coordination of” lobbying or political expenditure shall be treated as such expenditures.” § 162(e)(5)(C). However, the regulations under section 4911 do include the costs of “preparing” and “researching” a lobbying communication as a lobbying expenditure. Reg. § 56.4911-3(a)(1). Other differences between the regulations under 162 and those under 4911 are beyond the scope of this paper. For a comparison of the proposed 162 regulations and the section 4911 regulations, see comments by Gregory L. Colvin at 94 TNT 171-16 (Aug. 31, 1994).

¹⁷⁵ § 162(e)(2). This exception applies as well to communications between the taxpayer and an organization of which the taxpayer is a member with respect to such legislation or proposed legislation. In addition, there is a de minimis exception from the denial of deduction for in-house expenditures up to \$2,000. § 162(e)(5).

¹⁷⁶ See Mayer, *What Is This “Lobbying,”* *supra* note 36 at 516 n. 238, citing Julian Avakian-Martin, *New Business Provisions Outlined by Congressional Staff Members*, 93 TNT 196-4 (Sept. 22, 1993), LEXIS, TNT file (reporting explanation of Kathleen Nilles, House Ways and Means Committee tax counsel).

¹⁷⁷ 2 U.S.C. §§ 1601-1612. For a discussion of its definitions, see Mayer, *What Is This “Lobbying,”* *supra* note 36, at 501-07. For discussion of LDA and the Honest Leadership and Open Government Act, Pub. L.

the tax definitions for lobbying rather than the definition provided in the LDA. In the late 1990's, Congress asked the GAO to look at all three of these definitions, to consider the impact their differences might have on registration and reporting under the LDA, and to analyze options, including harmonizing the three definitions, to better ensure that the purposes of the LDA are realized.¹⁷⁸

An analysis of the different approaches taken by sections 4911 and 162(e) prepared for Independent Sector in light of the GAO study observed:

Section 4911 categorically bars charities from engaging in legislative activities beyond specified dollar limits – on pain of losing their exemption and qualification to raise tax-deductible contributions. The effect of defining lobbying more broadly in section 4911, therefore, would be flatly to CURTAIL the amount of lobbying charities can do. Section 162(e), by contrast, while requiring businesses to fund their lobbying with after-tax dollars, leaves them free to lobby as much as they wish. A broader definition of business lobbying thus has no preclusive effects; it simply raises the cost of lobbying at the margin by 35%.¹⁷⁹

This analysis treats section 162(e) as relevant only to the for-profit world and alien to the tax-exempt world. Such is far from the case. Section 162(e) matters to both charitable and noncharitable section 501(c) organizations. The legislative history of the 1993 amendments to section 162(e) make much of the need to ensure that charitable exempt organizations are not used as an end-run around these deduction prohibitions, and the legislation included a special charitable contribution rule to that end.¹⁸⁰ Many

No. 110-81, § 121 Stat. 735 (2007), enacted in the wake of the Abramoff scandal, *see* Richard L. Hasen, *Lobbying, Rent Seeking, and the Constitution*, available from author.

¹⁷⁸ *See infra* for further discussion of GAO Report.

¹⁷⁹ Troyer et al., *Analysis of the Differing Definitions of "Lobbying" in Federal Law Prepared for Independent Sector*, 97 TNT 70-45 (April 11, 1997), available on LEXIS, TNT file. (emphasis in the original). At the time of the GAO study, Gregory Colvin wrote to the GAO urging that charities should enjoy the same exception from the definition of lobbying for appearing before city and county councils and other similar bodies on local legislative matters. Gregory L. Colvin, *Give Charities Same Local Lobbying Exception Businesses Enjoy, Says Practitioner*, 97 TNT 155-36 (Aug. 12, 1997), available on LEXIS, TNT file.

¹⁸⁰ To address this issue, Congress added a provision denying a deduction for an organization that conducts activities to which section 162(e)(1) applies on matters of direct financial interest to the donor's trade or business if the principal purposes of that organization was to avoid Federal income tax. P.L. 103-66, §13222(b), codified as § 170(f)(9).

noncharitable tax exempt organizations confront the proxy tax and notifications rules of sections 162(e) and 6033. The burden of the section 162(e) proxy tax should be an important consideration for the question of the extent to which exemption in fact operates as a subsidy for the noncharitable exempt organizations to which it applies.

The analysis quoted above echoes Justice Blackmun's concern in *TWR* that too much lobbying could deny a section 501(c)(3) organization the ability to receive tax-deductible dollars for any of its activities.¹⁸¹ Yet *TWR* itself relied on *Cammarano*, which treated the deduction for business lobbying expenses as a subsidy no different from the deduction for charitable contributions. This analysis for Independent Sector also ignores use of the section 501(c)(4) affiliate so important to the decision in *TWR*. So long as the affiliate structure is available, lobbying by tax-exempt charities is a matter of subsidy, as the analysis in *TWR* would have it; supporters of the tax-exempt organization can make contributions to the charitable endeavors and receive a charitable contribution deduction and contribute to the lobbying efforts without the charitable contribution deduction. Thus, for charitable organizations with such an affiliate, as for businesses, lobbying also becomes largely a matter of additional cost rather than preclusive effect, unless *Citizens United* undermines the use of the affiliate structure, as discussed below. *TWR* emphasized the similarity, not the differences, between for-profit and tax-exempt endeavors in this regard.

B. Politicking

1. Allowing and Defining Politicking

Section 501(c)(4), (c)(5) and (6) organizations, unlike 501(c)(3) organizations, can engage in politicking. They can do so, however, only if politicking does not constitute the organization's primary activity; an organization must be primarily engaged in its exempt purpose. The regulations under section 501(c)(4) require that a social welfare

¹⁸¹ 461 U.S. at 551-553.

organization be “primarily engaged in promoting in some way the common good and general welfare of the people of the community, and operated primarily for the purpose of bringing about civic betterments and social improvements.”¹⁸² They further explain, “The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf or in opposition to any candidate for public office.”¹⁸³

General Counsel Memorandum 34233 extended the rule to 501(c)(5) and (c)(6) organizations.¹⁸⁴ It states that “if the primary purpose or activity of an organization is to engage in political action, then we believe it is not organized primarily as a business league and cannot qualify for exemption under section 501(c)(6). Of course, if the primary purpose and activities of an organization otherwise qualify it under section 501(c)(6), the participation in political activities will not disqualify it from exemption.”¹⁸⁵ The GCM determined that the conclusions were applicable to labor organizations under section 501(c)(5) as well.

The GCM avoided one of the most difficult issues organizations face in complying with these rules by saying that both the primary “purpose and activities” of the organization qualify it for exemption and that it would fail for exemption if its “primary purpose or activity” were to engage in political action. That is, it did not try to distinguish between purpose and activities.

Advisors differ widely in how much politicking they believe organizations, particularly section 501(c)(4) organizations, can undertake without endangering their exempt status. Some are comfortable so long as politicking is less than 50 percent of an

¹⁸² Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (1959).

¹⁸³ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (1959). The regulation echoes the prohibition in section 501(c)(3). A revenue ruling has explained that “all facts and circumstances are taken into account in determining a § 501(c)(4) organization’s primary activity.” Rev. Rul. 68-45, 1968-1 C.B. 259.

¹⁸⁴ Gen. Couns. Mem. 34233 (December 30, 1969), *available on* LEXIS, Federal Tax Cases and Administrative Decisions File.

¹⁸⁵ *Id.* See also Reilly and Allen, *supra* note 153.

organization's total activities.¹⁸⁶ Members of the ABA Tax Section have suggested a 40 percent safe harbor for nonexempt activities.¹⁸⁷ Gregory Colvin has recently urged a 50% test, discussed in more detail below.¹⁸⁸ Professor Miriam Galston has recommended that the IRS undertake a regulations project on the question and perhaps look to the sliding scale of section 501(h) as a model.¹⁸⁹

Whatever the test, to the extent an organization exempt under section 501(c) does engage in politicking using monies from its general funds, the organization is subject to tax under section 527(f) on the lesser of their net investment income or the amount spent on politicking. They can avoid this section 527(f) tax, however, if they maintain a separate segregated fund for all funds to be used for politicking.¹⁹⁰

Under section 527, political organizations, including separate segregated funds, “organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures or both” for politicking will not be taxed on income from political contributions, dues, political fund-raising events or sales, and bingo games used for politicking.¹⁹¹ Section 527 organizations are taxable on other income, most often investment income, but such organizations can be structured to have little, if any, taxable income.¹⁹² Section 527(a) specifies that a “political organization shall be considered an

¹⁸⁶ Fishman and Schwarz, *supra* note 148, at 570.

¹⁸⁷ See Renato Beghe, *Comments of the Individual Members of the Exempt Organizations Committee's Task Force on Section 501(c)(4) and Politics*, 2004 TNT 101-16 (May 25, 2004), available on LEXIS, TNT file.

¹⁸⁸ See Gregory L. Colvin, *Political Tax Law After Citizens United: A Time for Reform*, 66 EXEMPT ORG. TAX REV. 71 (2010).

¹⁸⁹ Miriam Galston, *Vision Service Plan v. U.S.: Implications for Campaign Activities of 501(c)(4)'s*, 53 EXEMPT ORG. TAX REV. 165 (2006).

¹⁹⁰ § 527(f); Treas. Reg. § 1.527-6(f).

¹⁹¹ §527(e). These “political organizations” are not taxed on exempt function income. Income that is not taxed if segregated for use only for an exempt function include political contributions, membership dues, fundraising events or sales, proceeds from bingo games. § 527(c)(3). See *infra* Section II.B.2 for the history of these provisions.

¹⁹² Deductions related to the production of exempt function income are not allowed. There is a specific deduction of \$100. Taxable income is in general taxed at the highest corporate rate. §527(b). Capital gains, however, are taxed at the capital gains rate. § 527(b)(2).

organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.”¹⁹³

To follow these rules regarding politicking, organizations need to know how politicking is defined for these purposes. For noncharitable 501(c) organizations, there is no definition in the statute, and the only definition found in the regulations is that in the regulations under section 501(c)(4). These regulations echo the section 501(c)(3) statutory prohibition by referring to “direct or indirect participation in political campaigns on behalf or in opposition to any candidate for public office.”¹⁹⁴ For section 501(c)(5) and (c)(6) organizations, GCM 34233 reasons that an organization cannot qualify for exemption under either of these provisions if its “primary purpose or activity is to engage in political action,” which the GCM elsewhere describes as “support of a candidate for public office,” because such support “necessarily involves the organization in the total political attitudes and positions of the candidate,” beyond those attitudes and positions related to the organization’s exempt purpose.¹⁹⁵

Section 527 organizations are not taxed on their exempt function income,¹⁹⁶ and the statute defines “exempt function” as

the function of influencing or attempting to influence the selection, nomination, election or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed.¹⁹⁷

¹⁹³ § 527(a).

¹⁹⁴ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (1981). An organization exempt under section 501(c)(3) is described as one “which does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office.”

¹⁹⁵ Gen. Couns. Mem. 34,233 (December 30, 1969), *available on* LEXIS, Federal Tax Cases and Administrative Decisions File.

¹⁹⁶ § 527(c)(1), (3).

¹⁹⁷ § 527(e)(2). In Announcement 88-114, 1988-37 I.R.B. 26, the IRS proposed to characterize attempting to influence the confirmation of a federal judge, an activity in which a section 501(c)(3) organization can participate, as an exempt function activity for purposes of this provision and requested comments on this proposal. No final determination has been made. *See also*. Gen. Couns. Mem. 39,694 (Jan. 21, 1988)

Regulations under section 527 elaborate. “Whether an expenditure is for an exempt function depends upon all the facts and circumstances,” but “[g]enerally where an organization supports an individual’s campaign for public office, the organization’s activities and expenditures in furtherance of the individual’s election or appointment to that office are for an exempt function of the organization.”¹⁹⁸ Indirect expenses include those necessary to support the directly related expenses, such as expenses for overhead and recordkeeping necessary to allow the organization to be established, to engage in political activities and to solicit contributions.¹⁹⁹ Examples of section 527 exempt function expenses in the regulations include the expenses of a candidates’ voice and speech lessons, the expenditures for tickets to a testimonial dinner attendance at which is intended to aid a candidate’s reelection, and the expenses of financing seminars and conferences intended to influence persons who attend to support individuals to public office whose political philosophy is in harmony with that of the organization.²⁰⁰

The regulations include two examples of exceptions from the definition of section 527 exempt function. The first is expenditures by a section 501(c) organization in connection with the testimony of its president in response to a written request from a Congressional committee in support of the confirmation of an individual to a cabinet position.²⁰¹ The other is nonpartisan voter registration and get-out-the vote campaigns, which require that the campaigns “not be specifically identified by the organization with any candidate or political party.”²⁰²

For both purposes of section 501(c) and section 527, the IRS treats “exempt function,” under 527 and “campaign intervention,” under section 501(c) as largely

(proposing that attempts to influence judicial and other executive branch appoints be taxable under section 527(f)).

¹⁹⁸ Treas. Reg. §1.527-2(c)(1) (2003).

¹⁹⁹ Treas. Reg. § 1.527-2(c)(2) (2003).

²⁰⁰ Treas. Reg. § 1.527-5(ii), (iv), and (viii) (2003). One revenue ruling concludes that expenditures for an election night party were exempt function expenditures as an “inherent part of the . . . selection process,” even though they occurred after the outcome was determined. Rev. Rul. 87-119, 1987-2 C.B. 151.

²⁰¹ Treas. Reg. § 1.527-2(d)(vi) (1999).

²⁰² Treas. Reg. § 1.527-6(b)(5) (2003).

equivalent,²⁰³ interprets the terms broadly, and construes them in tandem with the section 501(c)(3) politicking prohibition. Whether activities constitute politicking qualify depends on the facts and circumstances of each situation.²⁰⁴ Revenue Ruling 67-368, for example, held that comparative rating of candidates, even on a nonpartisan basis, is participation or intervention on behalf of candidates favorably rated and in opposition to those less favorably rated and thus cannot be the primary activity of a section 501(c)(4) organization.²⁰⁵ Revenue Ruling 81-95 held that a 501(c)(4) organization primarily engaged in activities that promote social welfare may also carry on lawful politicking.²⁰⁶ For examples of what constitutes politicking, Revenue Ruling 81-95 cited not only Revenue Ruling 67-368, but also a number of revenue rulings involving section 501(c)(3) organizations.

One of the rulings cited, Revenue Ruling 78-248, distinguished voter guides that would be permissible voter education activities for a section 501(c)(3) organization from those that would constitute impermissible campaign intervention.²⁰⁷ The ruling found two situations not to constitute prohibited political activity. In first of these, the organization annually prepared and made generally available to the public a compilation of the voting records of all Members of Congress on major issues involving a wide range

²⁰³ They cannot be identical because section 527 includes appointed offices and offices in political organization.

²⁰⁴ For the most recent guidance applying the facts and circumstances, *see* Rev. Rul. 2007-41, 2007-25 I.R.B. For additional discussion of the IRS treatment of exempt function as equivalent to campaign intervention, *see* Elizabeth Kingsley and John Pomeranz, *A Crash at the Crossroads: Tax and Campaign Finance Laws Collide in Regulation of Political Activities of Tax-Exempt Organizations*, 31 WM. MITCHELL L. REV. 55 (2005).

²⁰⁵ 1967-2 C.B. 194; *cf.* Ass'n of the Bar of New York v. CIR, 858 F.2d 876 (2d Cir. 1988) (bar denied status as 501(c)(3) because rating of elected judges constituted prohibited intervention in political campaign).

²⁰⁶ 1981-1 C.B. 332.

²⁰⁷ 1978-1 C.B. 154. The other examples listed in Rev. Rul. 81-95 were Rev. Rul. 67-71, 1967-1 C.B. 125 (campaigning for school board candidate constitutes politicking by organization created to improve a public education system); Rev. Rul. 74-574, 1974-2 C.B. 160 (air time offered to all legally qualified candidates in compliance with the Federal Communications Act not politicking); Rev. Rul. 76-456, 1976-2 C.B. 151 (publicizing proposed code of fair campaign practices without soliciting the signing or endorsement of code by candidates not politicking); Rev. Rul. 80-282, 1980-2 C.B. 178 (compiling voting records of all incumbents on selected issue and comparing records to organization's views without identifying those who are candidates for reelection with cautions about judging qualifications based on selected votes and distribution only to organization's normal readership not politicking; Rev. Rul. 78-248 distinguished).

of subjects, without editorial opinion and without anything in its structure or contents to imply approval or disapproval of any Member or the Member's voting record.²⁰⁸ In the second, the organization sent a questionnaire asking each candidate for governor of a state the candidate's position on a wide variety of issues and used the responses to prepare a voter guide generally available to the public. The issues were selected by the organization "on the basis of their importance and interest to the electorate as a whole" and "[n]either the questionnaire nor the voters guide, in content or structure, evidences a bias or preference with respect to the views of any candidate or group of candidates."

The third and fourth situations did constitute forbidden section 501(c)(3) campaign intervention. In the third, the questionnaire was structured to "evidence bias on certain issues," although the ruling does not explain how it did so. In the fourth, an organization was primarily concerned with land conservation matters published a voter guide widely distributed during an election campaign that was a factual compilation of incumbent' voting records on selected land conservation issues. However, because it emphasized one area, the ruling concluded that its purpose was not non-partisan voter education but forbidden political intervention.

Relying on revenue rulings that defined politicking for purposes of section 501(c)(3), the IRS in the mid- and late-1990's issued a number of private letter rulings regarding status as a political organization under section 527. These rulings reasoned that activities constituting section 501(c)(3) politicking would also constituted politicking (i.e. exempt function) under 527 for purposes of section 527.²⁰⁹

²⁰⁸ Rev. Rul. 78-248, 1978-1 C.B. 154.

²⁰⁹ In addition to the private letter ruling discussed in the text, the IRS also issued Priv. Ltr. Rul. 98-08-037), Priv. Ltr. Rul. 96-52-026, and Priv. Ltr. Rul. 97-25-036 during this period. For further discussion of these rulings and the issues they raise, see Frances R. Hill, *Probing the Limits of Section 527 To Design a New Campaign Finance Vehicle*, 26 THE EXEMPT ORG. TAX REV. 205 (1999); Rosemary E. Fei, *The Uses of Section 527 Political Organizations*, in 1 STRUCTURING THE INQUIRY INTO ADVOCACY 23 (Elizabeth J. Reid ed. 2000) available at <http://www.urgan.org/advocacyresearch/structuring.html>; Kingsley and Pomeranz, *supra* note 204.

To give one example of these rulings, Private Letter Ruling 199925051²¹⁰ acknowledged that some of the material that it intended to distribute and techniques that it may use “resemble the public education, issue advocacy or grass roots lobbying materials and techniques often used by charitable organizations without violating the political prohibition of section 501(c)(3) of the Code.” The organization also stated that it would be active in ballot measure, referenda, and initiatives, all activities traditionally carried on by section 501(c)(4) organizations. The organization, however, represented that it would require each voter education project to be authorized by a board resolution describing the specific electoral goal and with its likelihood of impact substantiated by the opinion of experts, data collected from voter opinion polls, focus groups, and similar means or project planning sessions with campaign consultants, major donors and political functionaries. Because the format, timing, and targeting of voter education and grass roots lobbying would be based on political considerations, the ruling concluded that these activities would be considered section 527 politicking.

In each of the section 527 private letter rulings, the IRS accommodated organizations that sought to be classified as section 527 political organizations and honored their intent, however subjective that might seem to be from the redacted rulings. The organizations sought assurance of section 527 classification for reasons related both to tax law and election law. The tax law motivation related to the gift tax. While contributors to section 501(c)(3) organizations are not subject to the gift tax,²¹¹ such organizations will not be suitable vehicles for those seeking to influence legislation and elections. No code section, however, permits a deduction from gift tax for contributions to section 501(c)(4) (or other 501(c)) organizations. The IRS takes the position that such gifts are taxable,²¹² although, “[t]here has been no public indications of IRS enforcement of gift tax on donation to § 501(c)(4) entities for at least a decade, even in the obvious cases where individual donors have made very large, publicly-disclosed contributions to §

²¹⁰ Priv. Ltr. Rul. 199925051 (Mar. 29, 1999).

²¹¹ § 2522(a)(2).

²¹² Rev. Rul. 82-216, 1982-2 C.B. 220; Rev. Rul. 67-325, 1967-2 C.B. 113.

501(c)(4) organizations, such as ballot measure committees.”²¹³ In some unusual cases, there may be an argument that such a transfer is not a gift subject to gift tax but a transfer for consideration or a transfer in the ordinary course of business. For transfers to a section 501(c)(4) organization above the annual exclusion amount, such as those needed to run a media campaign, however, there is at best uncertainty.²¹⁴ In contrast, contributions to section 527 political organizations are statutorily exempt from gift tax.²¹⁵ A donor considering a large contribution to a politically-tinged lobbying effort would want such endeavors to be structured as section 527 politicking. Such a shaping of lobbying activities is precisely what we see in these private letter rulings.

The election law motivation emerges from the limited jurisdiction of the Federal Election Commission. The Supreme Court interpreted the Federal Election Campaign Act in *Buckley v. Valeo*²¹⁶ to apply only to express advocacy, that is, to communications that explicitly call for the election or defeat of a clearly identified candidate. At the time of these private letter rulings, organizations that instead engaged only in issue advocacy, that is, stopped short of express advocacy,²¹⁷ were free to do so, without being subject to requirement to FEC reporting or disclosure requirements or to source or amount

²¹³ Comments of the Individual Members of the Exempt Organizations Committee’s Task Force on Section 501(c)(4) and Politics, May 25, 2004, *supra* note 187 at 13. Frei, *supra* note 209 at 32 n. 32, reported that she was “aware of two major accounting firms that are willing to take a reporting position that a gift to a 501(c)(4) ballot measure committee is not a taxable gift.” I understand from private practitioners that recent audits of section 501(c)(4) organizations have lead to gifts tax audits of their contributors.

²¹⁴ *Cf.* Carson v. CIR, 71 T.C. 252 (1978) *aff’d* 641 F.2d 864 (10th Cir. 1981) (holding that campaign contributions not “gifts” within meaning of gift tax law prior to enactment of statutory exemption for contributions to political organizations); Stern v. United States, 436 F.2d 1327 (5th Cir. 1971) (gifts to campaign in ordinary course of business). See generally Barbara K. Rhomberg, *The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions*, 15 TAX’N EXEMPT 62 (2003); Barbara K. Rhomberg, *Constitutional Issues Cloud the Gift Taxation of Section 501(c)(4) Contributions*, 15 TAX’N EXEMPT 164 (2004). It would seem that cases where a quid pro quo is most plausible would be the same cases in which corruption or the appearance of corruption would be a concern, and the Supreme Court in *Citizens United* has now held that neither the possibility nor the appearance of corruption exists in the case of independent expenditures.

²¹⁵ § 2501(a)(4). That both section 501(c)(3) organizations and 527 organizations are free from gift tax, but section 501(c)(4) organizations strikes many as inconsistent.

²¹⁶ 424 U.S. 1 (1976).

²¹⁷ The provisions about electioneering communications that were at issue in *Citizens United* were enacted later, as part of the Bipartisan Campaign Reform Act of 2002.

limitations as to funding. Neither, at the time, were they subject to reporting or disclosure rules to the IRS under section 527 itself.²¹⁸ Thus, while political organizations regulated by the FEC were one category of organizations subject to section 527, organizations that engaged only in issue advocacy, such as some of those that sought and received these private letter rulings,²¹⁹ created a new category of section 527 organizations, one free to raise large amounts of money for politicking, subject only to the tax laws. They were the entities known in the press as 527 organizations, with the political entities regulated by the FEC known as PACs (although PACs are also in fact subject to tax under section 527).

The favorable response of the IRS in these private letter rulings further encouraged such section 527 organizations, and they soon were dubbed “stealth 527 organizations.” The private letter rulings also signaled that “contrary to much legal advice . . . any and every activity engaged in by a 501(c)(4) organization that was too political to be carried on by a 501(c)(3) charity was, in theory, subject to the Section 527(f)(4) tax unless carried on in an SSF [separate segregated fund].”²²⁰ That is, the space between nonpartisan activity and politicking within which many advisors thought noncharitable 501(c)s could operate disappeared. It became especially important for organizations interested in becoming politically active to give careful thought to section 527 and whether to establish a separate segregated fund. And, as these section organizations subject only to section 527 grew as the 2000 election approached, the pressure on Congress to act grew as well. As described in the next section, Congress reacted by requiring registration, reporting and disclosure for these tax-regulated 527 organizations, but drafted the amendments to section 527 in way that has made it hard to interpret section 527 coherently.

²¹⁸ *Id.*

²¹⁹ The organization in Priv. Ltr. Rul. 19-925-051 stated that it planned as a minor part of its activities to make expenditures reportable under the Federal Election Campaign Act and parallel state campaign finance laws. It also described convening planning sessions with candidates and responding to requests from candidates in some cases.

²²⁰ Frei, *supra* note 209, at 27. See also Task Force on Section 501(c)(4) and Politics, *supra* note 187 at 27: “By pushing the lines delimiting § 527 and § 501(c)(3) activities together, at least in the sphere of candidate elections, those rulings seem to have eliminated any margin of safety available to § 501(c)(4)s. . . . Under the reason of these rulings, it is necessary to know the characterization of every activity carried out so there can be less tolerance for uncertainty.”

Private letter rulings, of course, are not precedential. In Revenue Ruling 2004-6, the IRS gave guidance to whether public advocacy communications conducted by section 501(c)(4), 501(c)(5) and 501(c)(6) organizations directly, that is, paid for from general treasury funds and not a separate segregated fund, constitute section 527 politicking subject to the section 527(f) tax. The test, as might be expected, is a facts and circumstances test. The ruling identifies a number of factors that tend to show that such communications will be deemed section 527 politicking. They include the timing of the communicating shortly before an election and targeting the voters in the election, factors that figured in the 1990's private letter rulings. In all the examples in the revenue ruling, the communication also identifies a candidate in an election. These factors alone, however, are not enough to render the communication section 527 politicking. Other important factors include whether the communication issue is one that has distinguished the candidate from others in the campaign and whether the communication is part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.²²¹

Thus, in the revenue ruling, a section 501(c)(4) organization opposing the death penalty that regularly prepares and finances television advertising opposing the death penalty shortly before any scheduled execution in a state can, without incurring any liability under section 527(f) for section 527 politicking, do so shortly before an election in which the incumbent governor is a candidate for reelection, even if the advertisement notes that the governor has supported the death penalty and calls for viewers to call or write the governor to stop the upcoming execution. In contrast, the ruling reaches the opposite conclusion if shortly before an election at a time when the incumbent governor is

²²¹ Another factor tending to show that the communication is section 527 politicking is whether the communication identifies the candidate's position on the issue; factors tending to show that the communication on the public policy issue is not section 527 politicking include identifying specific legislation or an event, outside the organization's control, which the organization hopes to influence; timing of the communication coinciding with an event outside the organization's control, such as a legislative vote; the communication identifying the candidate solely as a government official in a position to act on the policy issue in connection with a specific event; and the communication identifying the candidate solely in the list of key or principal sponsors of legislation. *Id.*

a candidate but at a time when no executions are scheduled, a 501(c)(4) organization that opposes the death penalty without a history of such advocacy airs a television advertisement opposing the death penalty, noting that the governor has supported the death penalty in the past, could have saved the lives of individuals who had been executed in the state, and calling upon viewers to contact the governor to demand a moratorium.

As is always the case with a multi-factor test illustrated with examples, the ruling gives help but no certainty. The intent of the organizations is not among the factors listed in determining whether the advocacy constitutes section 527 politicking. It is not clear how the organizations approved by the private letter rulings from the 1990's would fare under the factors listed in Revenue Ruling 2004-6 had they undertaken activities like those undertaken by the section 501(c)(4) organizations in the revenue ruling. But like the private letter rulings, the revenue ruling's reliance on facts and circumstances reaches broadly, gives discretion to the administrators, and leaves many organizations and their advisors with little certainty on how to conduct their activities day to day.

Both the private letter rulings from the 1990's and Revenue Ruling 2004-6 define section 527 politicking broadly. The set of private letter rulings was issued at the request of organizations that wished to be classified under section 527; the 2004 revenue ruling made explicit the implications of such a broad definition of section 527 politicking for section 501(c) organizations subject to the tax under section 527(f). This broad definition of section 527 politicking prompted Congress to amend section 527 in ways that complicate how to view it now in light of *Citizens United*.

2. History of Section 527

Prior to Congressional codification of the treatment of political organizations in section 527, the IRS struggled with how to treat them. The first official pronouncement on the tax status of a political organization appears to have been I.T. 32766 in 1939,²²²

²²² 1939-1 C.B. 108. For other discussion of this history, see William P. Streng, *The Federal Tax Treatment of Political Contributions and Political Organizations*, 29 TAX LAW. 139, 139 (1975); Donald B. Tobin,

which stated that “a political gift received by an individual or by a political organization is not taxable income to the recipient.” Revenue Ruling 54-80 concluded that a “political gift” is not taxable income to the recipient if used or held for political purposes, such as for use in the candidate’s political campaign, but became income if diverted to personal use.²²³

In 1967, the IRS argued in *Communist Party of the USA v. Commissioner*²²⁴ that all political parties were taxable associations and that member dues were taxable income. The Appellate Court held that the Communists Party was entitled to an adjudication in the Tax Court of its contention that the statute was not to be so construed; the government then conceded virtually all of the asserted tax, based on past practices, and the Tax Court did not rule on the issue.²²⁵ The IRS then issued Rev. Proc. 68-19, stating that income on unexpended funds held in a bank account directly by individual candidates “may” be reported on a federal tax return.”²²⁶

As the IRS became aware that political organizations were receiving gifts of appreciated property and earning investment income, it reconsidered its position further. After opportunity for public comments and a public hearing, the IRS announced in 1973 that political parties and committees would be required to file “appropriate” tax returns for the years 1972 and following, as associations taxable as corporations or as trust, depending on specific facts and circumstances.²²⁷ The announcement it issued described a particular focus on the treatment of contributions of appreciated property that were subsequently sold by the recipient political organization.²²⁸ The announcement also

Political Advocacy and Taxable Entities: Are They the Next “Loophole”? 6 FIRST AMENDMENT REVIEW 41 (1997); Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 GA. L. REV. 611 (2003); Roger Colinvaux, *Regulation of Political Organizations and the Red Herring of Tax Exempt Status*, 59 NATIONAL TAX. J. 531 (2006).

²²³ 1954-1 C.B. 11.

²²⁴ 373 F.2d 682 (D.C. Cir. 1967).

²²⁵ *Id.*

²²⁶ Rev. Proc. 68-19, 1968-1 C.B. 810.

²²⁷ Ann. Rev. Proc. 73-84, 1973-2 C.B. 461.

²²⁸ Streng, *supra* note 222 at 143 (citing IRS News Release, Oct. 3, 1972).

anticipated Congressional action. It called attention to the Ways and Means Committee listing the tax status of political organizations as a major subject for consideration and to the Secretary of Treasury calling for Congressional action in the area.²²⁹

Nonetheless, the IRS issued several revenue rulings following the 1973 announcement. Revenue Ruling 74-21, for example, concluded that an unincorporated organization established and operated exclusively for political purposes was not exempt from taxation, would be required to file a tax return, should include as income interest dividends and net gains from sale of securities. Campaign contributions, however, were not included in income.²³⁰

While the language of earlier pronouncements had seemed to suggest that the Service viewed such contributions as being excluded from income on the basis that they were gifts, General Counsel Memoranda from the mid-1970's took a different view. A 1974 General Counsel Memorandum observed that "the precise justification . . . has never been clearly articulated." According to the memorandum, "It is clear, however, that the justification for excluding political campaign expense contributions from income is not that the contributions are gifts within the context of Code § 102."²³¹ A 1973 General Counsel Memorandum described the relationship for contributions given directly from donors to a candidate as that of a "quasi-trust relationship between the donor and the candidate."²³²

The IRS also faced controversy over the gift tax treatment of transfers to political organizations. In 1972, it published Revenue Ruling 72-355, which stated that it had been the position of the IRS since the enactment of the present gift tax in 1932 that contributions to a political campaign were taxable and giving a series of examples.²³³ In

²²⁹ *Id.*

²³⁰ 1974-1 C.B. 14. Rev. Rul. 74-23, 1974-1 C.B. 17 applied these rules to funds received by a candidate who maintained personal control of such funds.

²³¹ Gen. Couns. Mem. 35664 (Feb. 8, 1974).

²³² Gen. Couns. Mem. 35462 (Aug 31, 1973), citing Gen. Couns. Mem. 33622.

²³³ 1972-2 C.B. 532.

1971, it lost at the appellate level, as it had at the trial court, *Stern v. United States*.²³⁴ The Fifth Circuit in *Stern* concluded that the transferor did not make gifts within the meaning of the gift tax when Mrs. Stern made contributions to a political campaign because they were bona fide, at arms's length and free from donative intent. They were considered to be made for an adequate and full consideration in money or money's worth when Mrs. Stern made the contributions in order to promote a slate of candidates to protect and advance her personal and property interests.

Congressional action in 1974 codified the taxation of political organizations by enacting section 527 and related provisions. Both the Senate Finance and House Ways and Means Committee Reports explained that “the questions involved in the area require a delicate balance between the need to protect the revenue and of the need to encourage political activities which are the heart of the democratic process.”²³⁵ Committee Reports assumed that the IRS had historically not required the filing of income tax returns from political organization on the basis that “the receipts of political organizations were from gifts,”²³⁶ reasoning the IRS in fact had rejected. The Congressional committees concluded that “political activity (including the financing of political activity) as such is not a trade or business which is appropriately subject to tax.” Like the IRS, Congress decided that any income from investment, less direct expenses incurred in earning that income should be subject to tax.

As codified, section 527 defined a number of terms, clarified and, in some cases, expanded the IRS decisions. “Political organization” was defined as “a party, committee, association, fund or other organization (whether or not incorporated) organized and primarily for the purpose of directly or indirectly accepting contributions or making

²³⁴ 436 F.2d 1327 (5th Cir. 1971). *See also* Rev. Rul. 72-583, 1972-2 C.B. 534 (announcing that case will be followed only in 5th Circuit). In *Carson v. Commissioner*, 641 F.2d 864 (10th Cir. 1981), the Tenth Circuit agreed with the Tax Court not to impose gift tax on tax years before 1975 on political contributions, reasoning that such contributions were “simply not ‘gifts’ with the means of the gift law.” *Id.* at 866. The IRS, concerned about the implications of the case for contributions to other 501(c) organizations, acquiesced in the result, but not the reasoning of the case Rev. Rul. 82-216, 1982-2 C.B. 220.

²³⁵ S. Rep. No. 1357, at 25 (1974).

²³⁶ *Id.*

expenditures, or both, for an exempt function.”²³⁷ An entity that met this definition was a political organization under section 527, subject to tax only to the extent provided in section 527, and considered an organization exempt from income taxes under 527(a). There was no requirement that the organization apply for exemption; neither was the classification voluntary, except by meeting the description.²³⁸

Under section 527 as originally enacted, the taxable income of a political organization was a political organization’s gross income, excluding exempt function income, over the deductions directed connected with production of the gross income.²³⁹ Exempt function income included not only “a contribution of money or property,”²⁴⁰ but also “membership dues, fees or assessments; and proceeds from political fundraising events or sales.”²⁴¹

Congress also introduced the tax on political activities of 501(c) entities codified at section 527(f). The legislation was intended to treat “these organization on an equal basis for tax purpose with political organizations”²⁴² by taxing them on their investment income to the extent of their political expenditures. The Senate Committee Report observes in language that now seems to us idealistic or naive:

The committee expects that, generally, a section 501(c) organization that is permitted to engage in political activities would establish a separate organization that would operate primarily as a political organization, and directly receive and disburse all funds related to nomination, etc., activities. In this way, the campaign-

²³⁷ Act of Jan 3, 1975, Pub. L. No. 93-625, 88 Stat. 2108, 2117 (1975), codified as § 527 (e)(1).

²³⁸ FSA 20037040 confirms that section 527 status is not voluntary. As Colinvaux points out, the FSA was published September 15, 2000, after effective date of 2000 amendments to section 527, but its issue date of June 19 “indicates that its discussion is relevant with respect to the pre-2000 section 527 and nothing in the FSA can be read to the contrary.” Colinvaux, *supra* note 222 at 541 n. 23.

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

²⁴⁰ § 527(c)(3)(A); § 527(e)(3) specifies that the term contributions given to it by section 271(b)(2). Act of Jan 3, 1975, Pub. L. No. 93-625, 88 Stat. 2108, 2117 (1975).

²⁴¹ Act of Jan 3, 1975, Pub. L. No. 93-625, 88 Stat. 2108, 2117 (1975).

²⁴² *Id.* at 2118.

type activities would be taken entirely out of the section 501(c) organization, to the benefit both of the organization and the administration of the tax laws.²⁴³

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

Congress resolved the uncertainty about gift tax treatment of contributions to political organizations by enacting section 2501(a)(4), which excepts transfers to political organizations within the meaning of section 527(e)(1) from the gift tax. Congress believed that it was “inappropriate to apply the gift tax to political contribution because the tax system should not be used to reduce or restrict political contributions.”²⁴⁴ At the same time, Congress provided that transfer of appreciated property to a political organization would be treated as a sale,²⁴⁵ and stated in the legislative history “if a decedent includes a political organization as a beneficiary of his estate, the amount so transferred is to be included in his estate.”²⁴⁶ Thus, contributions to section 527 organizations had some protection from gift tax, but did not enjoy the same kind of shelter from transfer tax liability granted to charitable contributions.

²⁴³ S. Rep. No. 93-1357, at 30 (1974). As Professor Frances Hill has written, when section 527 was enacted, “Little thought was given to the relation between section 527 and the new FECA, although there appears to have been at least an implicit assumption that section 527 organization would be subject to the FECA. One explanation for the minimal requirements for exemption under 527 is that it was assumed that all section 527 organization would be subject to the limitation under the FECA, which would have made further elaboration of limitations or positive requirements redundant.” Frances R. Hill, *Probing the Limits of Section 527 To Design a New Campaign Finance Vehicle*, 26 EXEMPT ORG. TAX REV. 205, 207 (1999). Statements from Senator Lieberman confirm this insight. Shortly before amendments to section 527, Senator Lieberman wrote, “Section 527 has traditionally been understood to apply only to those organization that registered as political committees under, and complied with FECA, unless they focused exclusively on state and local political activities.” Senator Joseph Lieberman, *Introduction to Campaign Finance Symposium*, 49 CATH. U. L. REV. 5, 8 (1999). During debates on the amendments he spoke more forcefully, asserting that “section 527 formerly had been generally understood to apply only to those organization that register as political committees under, and comply with FECA, unless they focus on State or local activities or do not meet certain other specific FECA requirements.” 146 Cong Rec S5995 (June 28 2000).

²⁴⁴ S. Rep. No. 93-1357 at 30 (1974).

²⁴⁵ P.L. 93-625, § 13(a) (codified as section 84).

²⁴⁶ S. Rep. No. 93-1357 at 30 (1974).

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

Over the next two decades Congress made only small changes to section 527. In 1978, for example, proceeds from bingo games became a category of exempt function income²⁴⁷ and the rate of tax on taxable income of political organizations became the highest corporate rate.²⁴⁸

The growth of the tax-regulated 527 organizations, which became known as “stealth” 527 organizations, prompted Congress to make substantial changes to section 527 in 2000. As Richard Briffault has described, “Public concern with the use of section 527 to fund issue advocacy while avoiding disclosure of the identity of the donors sponsoring the issue ads came to a head in early 2000” with millions of dollars spent on issue advocacy by section 527 organizations.²⁴⁹ Within three months of their introduction, amendments to section 527 adding notification and disclosure requirements became law,²⁵⁰ without formal legislative history.²⁵¹

²⁴⁷ Pub. L. No. 95-502, § 302(a) (1978), (codified as §527(c)(3)(D)).

²⁴⁸ Pub. L. No. 96-600, § 301(b)(6) (1979) (codified as 527(b)).

²⁴⁹ Richard Briffault, *The 527 Problem . . . and the Buckley Problem*, 73 GEO. WASH. L. REV. 949, 959 (2005).

²⁵⁰ Act to Amend the Internal Revenue Code of 1986 to Require 527 Organizations to Disclose Their Political Activities, Publ. L. No. 106-230, 114 Stat. 477 (2000).

²⁵¹ See Mayer, *The Much Maligned 527*, *supra* note 168.

Under these provisions, including the 2002 amendments,²⁵² an organization is not to be treated as an organization described in section 527 unless it gives electronic notice that it is to be so treated within 24 hours after the date on which it is established or not later than 30 days after any material change. Failure to give the required notice renders exempt function income taxable.²⁵³ This registration notice must include the names and addresses of the organization, its officers, directors, highly compensated employees, and related entities. Once registered, it must periodically file reports disclosing the names and addresses of contributors of \$200 or more per year and the amount, date and purpose of expenditures of \$500 or more per year.²⁵⁴ Failure to make required disclosures in the time and manner described exposes the organization to a payment equal to the highest corporate tax rate multiplied by the amount to which the failure relates.²⁵⁵ Section 527 organizations are also required to file Form 990.²⁵⁶ The IRS and section 527 organizations must make these materials publicly available.²⁵⁷

The disclosure requirements are strikingly similar to some of those imposed by FECA.²⁵⁸ A House Committee Report on a similar but somewhat broader bill that did not become law acknowledged frankly, “Under the bill, the reporting periods and deadlines generally are the same as those required for reports under 2 U.S.C. 434(a) codifying the

²⁵² The 2002 amendments provided that section 527 organizations engaged solely in state and local electoral activity that report and disclose their contributions and expenditures under a qualifying state law regime need not file with the IRS, required that the registration notice be filed electronically, required that reports of expenditures include the purpose of each expenditure, and required that the IRS make the registration notice and reports of expenditures and contributions available for public inspection on the Internet not later than 48 hours after such notice has been filed. Pub. L. No. 107-276, 116 Stat. 1929 (2002).

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

²⁵⁴ § 527(j)(3).

²⁵⁵ § 527(j)(1).

²⁵⁶ § 6033(g).

²⁵⁷ § 6104. Form 1120-POL, the income tax return of political organizations, was originally also to be made public, but Pub. L. No. 107-276, § 1931, 116 Stat. 1929 (2002) repealed that requirement.

²⁵⁸ See Mayer, *The Much Maligned 527*, *supra* note 168, at 646 n. 103 (comparing provisions). His suggestion in the article that the FEC rather than the IRS administer these provisions would strengthen even further the argument that these provisions are in fact campaign finance regulations, not tax regulations. The Treasury Inspector General recently issued a report criticizing IRS enforcement efforts in connection with the required disclosure filings by section 527 organizations. *TIGRA Says IRS Hasn't Fully Addressed Political Organization Noncompliance*, 2010 TNT 165-23 (August 26, 2010).

Federal Election Campaign Act of 1971 (FECA).”²⁵⁹ Statements in the Congressional Record leading up to the legislation identify it with campaign finance reform. Senator Reed asserted that section 527 organizations “exemplify the failure of our existing campaign finance laws” and “skirt existing campaign finance laws,” but predicted that mandated disclosure “will close yet another legal loophole.”²⁶⁰ Both Representative Castle and Senator Feingold described the legislation as “campaign finance reform,”²⁶¹ For Senator Lieberman, as for others, concerns about constitutionality also figured in shaping the legislation.²⁶² He asserted that *Buckley v. Valeo* permitted Congress to require disclosure by organizations whose major purpose is to elect candidates.²⁶³ Important for our purposes, Senator Lieberman went on to say that the bill would be constitutional apart from *Buckley* on the basis of *TWR* because “any group not wanting to disclose information about itself or abide by the election laws would be able to continue doing whatever it is doing now – it would just have to do so without the public subsidy of tax exemption conferred by section 527.”²⁶⁴ Nonetheless, he also described the debate and vote on the legislation as “the beginning of finally returning some limitation, some sanity, some disclosure, some public confidence to our campaign finance laws.”²⁶⁵

Thus, the amendments to section 527 are campaign finance laws in tax clothing. Congress so clothed them both because the broad IRS interpretations of section 527

²⁵⁹ H.R. Rep. No. 106-702 (2000). This bill would have imposed additional disclosure obligations on 501(c) organizations engaged in politicking as well as on 527 organizations. Contributors to section 501(c)(4), (5), and (6) organizations would have to be disclosed, unless the organization set up a segregated fund for earmarked contributions for politicking, in which case only contributors who earmark contribution would have been disclosed.

²⁶⁰ 146 Cong. Rec S4921 (June 9, 2000) (Statement of Sen. Reed).

²⁶¹ 146 Cong. Rec E 149 (June 29, 2000)(remarks of Rep. Castle); 146 Cong Rec S5994 (June 28, 2000) (remarks of Sen. Feingold).

²⁶² 146 Cong. Rec. S5996 (June 29, 2000) (Statement of Sen. Lieberman).

²⁶³ *Id.*

²⁶⁴ *Id.* The House Committee Report on the related bill, identified the exemption from the gift tax as a particular tax benefit conferred upon section 527 organizations and stated of *TWR*, “It is difficult to imagine that the Supreme Court would conclude that it is constitutional to eliminate a tax subsidy for certain activities, but not constitutional to require that organizations comply with reporting requirements with respect to those activities so that the IRS can monitor compliance with the law.” H.R. Rep. No. 106-702.

²⁶⁵ *Id.*

politicking produced a problem that Congress was determined to address and because TWR seemed to offer additional constitutional protection for solving the problem through a tax provision. The Eleventh Circuit easily accepted the TWR approach in the *Mobile Republican Assembly*.²⁶⁶ Some scholars question the court's reasoning, and, as discussed below, *Citizens United* calls upon us to reevaluate such arguments.

III. The Impact of *Citizens United* on Noncharitable Tax-Exempt Organizations

When put in the context of noncharitable tax-exempt organizations, *Citizens United* raises questions about limits and burdens on their political speech, about how tax law defines political speech, and about the use of affiliates to engage in politicking. In so doing, it encourages us to reconsider as well TWR and its assumptions about exemption as a subsidy.

A. Definitions of Political Activity

1. Politicking

The Court's opinion in *Citizen's United* is sharply critical of multifactor tests for defining politicking.²⁶⁷ The IRS, however, defines politicking based on facts and circumstances and a multifactor test.²⁶⁸ Many in the exempt community have long called for greater clarity and a bright line test for the definition of politicking,²⁶⁹ often looking to the case of *Big Mama Rag*.²⁷⁰ *Citizens United* gives renewed energy and urgency to this plea.²⁷¹

²⁶⁶ See *supra* Part I.C.3.

²⁶⁷ See *supra* Part I.D. *supra*.

²⁶⁸ See *supra* Part II.B.1.

²⁶⁹ See Kingsley and Pomeranz, *supra* note 204.

²⁷⁰ See *Big Mama Rag, Inc. v. Commissioner*, 631 F.2d 1030 (D.C. Cir. 1980).

²⁷¹ See Galston, *supra* note 105.

Gregory Colvin has made a thoughtful and thorough suggestion for defining politicking for purposes of section 162(e), section 501(c)(3) and other section 501(c) exempt categories, based on the definition of lobbying adopted in 1990 under sections 501(h) and 4911.²⁷² To the extent this suggested definition is a definition for purposes of section 501(c)(3), it is relevant in the first instance to section 501(c)(3) and politicking. That is, as described above,²⁷³ the definition of politicking for other tax-exempt organizations is currently derivative of the definition of the politicking forbidden for section 501(c)(3) organizations.

Importantly, however, the proposal offers a specific line for “primary purpose” applicable to noncharitable 501(c) organizations in testing for politicking: “If the political intervention, including the allocable share of overhead is more than 50% of (a) annual expenditures or (b) annual staff time (both employee and independent contractors), the organization would be presumed to fail the primary purpose test.”²⁷⁴ Whether this is the correct line is, of course, subject to debate; that some line needs to be drawn seems to follow from the tenor of *Citizens United*. It would be important for any such regulation to clarify whether separate segregated funds established under section 527(f)(3) are considered part of the 501(c) organizations for these purposes.²⁷⁵ Perhaps a bright line definition would permit and encourage greater guidance in the Form 990 as well, since both understanding about and required disclosure about politicking on the form seems lacking.²⁷⁶

²⁷² Gregory L. Colvin, *Political Tax Law After Citizens United: A Time for Reform*, 66 EXEMPT ORG. TAX REV. 71 (2010).

²⁷³ See *supra* Section II.B.1.

²⁷⁴ Colvin, *supra* note 272.

²⁷⁵ Hill and Mancino note that SSFs are described as “separate organization” [f]or purposes of this subsection and subsection (c)(1),” not for other purposes. See FRANCES R. HILL & DOUGLAS M. MANCINO, TAXATION OF EXEMPT ORGANIZATIONS, ¶ 18.09[4]. However, an SSF is required to file Form 990 and 1120-POL as a separate organization.

²⁷⁶ Stephen R. Weissman and Kara D. Ryan, *Nonprofit Interest Groups’ Election Activities and Federal Campaign Policy*, 2006 TNT 195-39 (Oct. 10, 2006). The glossary to Form 990 defines political campaign activities as follows: “All activities that support or oppose candidates for elective federal, state or local office. . . . Political campaign activity does not include any activity to encourage participation in the electoral

What I would like to emphasize, however, is that any such definition would also have broad implications. A bright line test under section 501(c)(3) could reintroduce a space between nonpartisan activity and politicking in which noncharitable 501(c)s organizations could operate and put the classification of some existing entities as section 527 organizations in doubt. The 2000 amendments to section 527 were premised on the IRS broadly defining “exempt function” under section 527, based on such a definition of politicking under section 501(c)(3). That is, the amendments were enacted because the broad definition of exempt function permitted “stealth” 527 organizations. They assume the existence of these “stealth” section 527 organizations, organizations that engage in issue advocacy designed and intended to influence elections, as evidenced in private letter rulings. Revenue Ruling 2004-6 applied a facts and circumstances test to define exempt function activities for purposes of section 527(f).

If regulations provide a bright-line but narrow definition of “politicking” for purposes of section 501(c), the definition of exempt function for purposes of section 527 as used by the IRS will need to be coordinated with it. The policy reasons that produced the 2000 amendments and Revenue Ruling 2004-6 may well call for a broader definition of politicking for purposes of section 527 than for section 501(c). That is, consistent with the policy underlying section 527 as amended, a broader definition for purposes of section 527 will include more organizations in the definition of a political organizations and subject more organizations to the disclosure regime of the provision. It will subject more activities to tax under section 527(f). A narrow definition of politicking for purposes of section 501(c) and a broad definition of politicking for purposes of section 527 could mean that certain activities that would not be counted in determining whether an organization’s primary purpose was politicking would nonetheless subject the organization

process, such as voter registration or voter education, provided that the activity does not directly or indirectly support or oppose any candidate.” Citizens United apparently took the same position on its Form 990 that it took before the Supreme Court, that the movie *Hillary* was a factual documentary, even though the IRS defines politicking so much more broadly than does the FEC. Citizens United on its 2008 Form 990 answered “no” to the question, “Did the organization engage in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office?”

to tax under section 527. Such a result seems a bit odd, to say the least. In any case, the First Amendment concerns that call for a clear definition of politicking for purpose of section 501(c) apply as well to the definition under section 527.

Other of the regulations under section 527 urgently need updating. The current section 527 regulations specify that for purposes of the section 527(f) tax “[e]xpenditures of a section 501(c) organization which are otherwise allowable under the Federal Election Campaign Act or similar State statute are for an exempt function only to the extent provided in paragraph (b)(3) of this section.”²⁷⁷ Section (b)(3) is currently reserved, and thus the regulations currently treat no expenditure permitted by the Federal Election Campaign Act as being for an exempt function subject to the section 527(f) tax. Since *Citizens United* is understood to mean that section 501(c)(4), section 501(c)(5), and 501(c)(6) organizations may make independent expenditures, all of these expenditures would seem to be permitted by the Federal Election Campaign Act and thus not subject to tax under section 527(f) until and unless regulations are promulgated.²⁷⁸

2. Lobbying

As discussed earlier, the issue for lobbying is not the lack of definition but the plethora of definitions – the definition for purposes of section 162(e), which has an impact on noncharitable 501(c) organizations, the definition under section 4911 for electing charities, and the definition under the LDA. The GAO study of the three definitions in the context of the LDA rejected the call for harmonizing the three rules because of the different purposes for the different provisions: “In our opinion, the trade-offs involved in the option of harmonizing the definitions are disproportionate to the problem of LDA

²⁷⁷ Treas. Reg. § 1.527-6(b)(1)(i).

²⁷⁸ I thank Gregory Colvin for this important insight.

registrations and reporting not being aligned with LDA’s purposes.”²⁷⁹ It recommended more modest changes to the lobbying definition under the LDA.²⁸⁰

More recently, Professor Lloyd Mayer has argued that while the different rules used different methods--taxing versus disclosure, they all served the same ultimate purpose of limiting the influence of interest groups on government actions when that influence is likely to be detrimental to the overall public interest.²⁸¹ He urged a single definition, one that would change the tax applicable to tax-exempt organizations enormously in two ways. First, it would exclude grassroots lobbying from the definition of lobbying²⁸² Second, it would add to its definition attempts to influence the official actions or positions of a large group of senior executive branch officials, as the definition under section 162(e) currently does.²⁸³ Professor Mayer drew on recent scholarship regarding the operation of interest groups to make these suggestions.²⁸⁴

Congress had no appetite for even the modest changes to the lobbying definition under the LDA suggested by the GAO. It thus seems unlikely that Congress would decide to remove grassroots lobbying from the definition of lobbying subject to regulation under tax provisions. As explained further below, I propose a new category of tax exempt organizations, those that engage primarily in lobbying. If such a proposal were to be further pursued, I would not wish to exclude grassroots lobbying from the definition of lobbying.

Professor Mayer also argues that a single definition “has the benefit of reducing the administrative burden on those subject to these laws.”²⁸⁵ Do these inconsistent sets of rules

²⁷⁹ U.S. GEN. ACCOUNTING OFFICE, FEDERAL LOBBYING: DIFFERENCE IN LOBBYING DEFINITIONS AND THEIR IMPACT, 24 (1999).

²⁸⁰ It suggested eliminating the option to use a tax definition for LDA purposes or requiring that only expenses related to federal-level lobbying under the tax definitions be used for LDA purposes. *Id.*

²⁸¹ Mayer, *What Is This ‘Lobbying,’ supra* note 36 at 495-96.

²⁸² *Id.* at 490.

²⁸³ *Id.* at 490-491.

²⁸⁴ *Id.*

²⁸⁵ *Id.* at 565.

impose a burden inconsistent with the First Amendment under *Citizens United*? Conceivably such a question might arise for a section 501(c)(4) organization required to comply with all these sets of rules. However, the burden of detailed lobbying reporting and disclosure relate to the LDA, which is beyond the scope of this piece.²⁸⁶

B. No Duty To Subsidize Versus No Limits on Political Speech

As discussed earlier, politicking cannot be the primary purpose of section 501(c)(4), (c)(5) and (c)(6) organizations. Even if we do not know precisely what “primary purpose” means, we know that these organizations are limited in the amount of politicking in which they engage and that that must engage in other activities that are their primary purpose. The assertion in *Citizens United* that “[n]o sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporations”²⁸⁷ seems difficult to reconcile with the statement in the Court’s opinion in *TWR* that “Congress is not required by the First Amendment to subsidize lobbying,”²⁸⁸ an approach that permitted limitations on one type of political speech, namely lobbying, in the context of the case.

The quotation from *Citizens United*, however, must be understood to mean that the government in the case had not supplied an interest sufficient to meet the strict scrutiny test that the Court applied there. A government interest insufficient to justify limits on the political speech of corporations in *Citizens United* because it is not compelling could easily suffice for a tax provision under the rational relation test of *TWR*. A decision by Congress to have a different set of rules for tax exempt organizations with a primary purpose of politicking, because, for example, of the needs of the citizenry for additional disclosure would seem sufficient to pass the rational relation test.

²⁸⁶ See Hasen, *supra* note 177.

²⁸⁷ 130 S.Ct. at 913. We must also remember that the political speech at issue in *Citizens United* is express advocacy or its equivalent, speech much narrower than politicking for purposes of the tax laws, even under any proposed bright line definition.

²⁸⁸ 460 U.S. at 546, citing *Cammarano U.S.*, 358 U.S. 498, 513 (1959).

The rational relation test applies to a tax provision, however, only if it does not violate the First Amendment. The Court’s opinion in *TWR* cautioned, “The case would be different if Congress were to discriminate invidiously in its subsidies in such a way as to ‘aim[] at the suppression of dangerous ideas.’”²⁸⁹ The quoted language traces back ultimately to *Speiser v. Randall*,²⁹⁰ where the Court had held unconstitutional a California rule requiring those who sought a property tax exemption to sign a declaration stating that they did not advocate the forcible overthrow of the government. The Court in *TWR* rejected the organization’s contention that the limitation on lobbying for section 501(c)(3) organizations imposed an unconstitutional condition like that in *Speiser*. It explained that the Code did not deny *TWR* “any independent benefit on account of its intention to lobby.”²⁹¹

Justice Kennedy in *Citizens United* quoted the seemingly absolute statement from Justice Scalia’s dissent in *Austin*: “It is rudimentary that the State cannot exact as the price of those special advantages [granted corporations, such as limited liability and perpetual life] the forfeiture of First Amendment rights.”²⁹² To understand the import of this quotation, it is important to go back to its source. In *Austin*, Justice Scalia cited *Speiser* as authority for the statement, the same case on which *TWR* relied.²⁹³ Thus, it, too, is a statement of the unconstitutional conditions doctrine. The state cannot deny an independent benefit, such as state law corporate privileges, as a condition of the forfeiture of First Amendment rights. Status as a nonprofit as well as a for-profit corporation carries state law privileges.

But not all conditions are unconstitutional. Refusing to subsidize a First Amendment right, according to the Court’s opinion in *TWR*, did not deny that right and

²⁸⁹ 460 U.S. at 548, quoting *Cammarano*, 358 U.S. at 513, quoting *Speiser v. Randall*, 357 U.S. 513, 518 (1958).

²⁹⁰ 357 U.S. 513 (1958).

²⁹¹ 460 U.S. at 545.

²⁹² 905, quoting Justice Scalia’s dissent in *Austin v. Michigan Chamber of Commerce*, 494 U.S. 653, 680 (1990).

²⁹³ 484 U.S. at 680.

was not an unconstitutional condition.²⁹⁴ If exemption is a subsidy, granting exemption can be conditioned on limiting the extent of the organization's politicking. *TWR*, however, took for granted that both tax exemption and the charitable contribution deduction provide subsidies. Because the organization bringing the case was a section 501(c)(3) organization with donors entitled to take deductions for charitable contributions, there was little occasion for the organization to test the assumption regarding exemption, to point out, for example, that the tax expenditure budget lists the charitable contribution deduction but not exemption as a tax expenditure.²⁹⁵

If we focus on the limits on politicking applicable to noncharitable section 501(c) organizations, however, the question of whether exemption itself provides a subsidy cannot be avoided. Contributions to none of these organizations are eligible for an income tax deduction (either as a charitable deduction or a business deduction). There is no statutory basis for a gift tax deduction. Exemption is the only candidate for possible subsidy. Thus, we must ask whether we view the exemption from tax on income in the same way and as a subsidy for all noncharitable section 501(c) organizations.

Scholars who have considered the issue have taken very different views. In their classic article, *The Exemption of Nonprofit Organizations from Federal Income Tax*, Bittker and Rahdert classified political organizations and section 501(c)(4) organizations along with section 501(c)(3) organizations as public service organizations that should be exempt from income tax because there is no satisfactory way either to define and compute their income or to fit the tax rate to the ability of their beneficiaries to pay.²⁹⁶ They viewed unions and business leagues along with social clubs and consumers' cooperatives as mutual benefit organizations operated to provide goods and services to their members at

²⁹⁴ 461 U.S. at 545.

²⁹⁵ See Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012, Oct. 31, 2008 at 53, 55, 56 (estimates of charitable tax deduction for education (35.9 billion) for social services (204.9 billion), and for health (23.2 billion)).

²⁹⁶ Boris L. Bittker and George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Tax*, 85 YALE L. J. 299, 306 (1976).

cost.²⁹⁷ Exempting the accumulated income of a business league or union was “ the equivalent of currently imputing its income to its members but allowing them to deduct these amounts when they are ultimately used,” allowing members to pay lower dues in future years, or allowing the organization to expand activities without additional cost in future years, all activities that “will compensated the Treasury, albeit belated, for the revenue lost by exempting the . . . income when realized . . . except for the time value of money.”²⁹⁸ Moreover, the authors did not seem especially concerned with the time value of money lost to the Treasury.

Henry Hansmann in *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation* famously disputed Bittker and Rahdert’s contention that we cannot construct a workable definition of income for nonprofits.²⁹⁹ Even for nonprofits that depend on donations, such as the Red Cross, he urged conceptualizing the donor as buying the product or service the organization provides. In the case of the Red Cross, for example, the services provided would be disaster relief.³⁰⁰ Without exemption, tax would apply to earnings saved for expenditures in future years and net capital investment, which Hansmann called retained earnings. Exemption thus operates as a subsidy for capital that nonprofit exempt organizations cannot raise from private investors. Under Hansmann’s analysis, it would seem that exemption of tax on retained earnings of section 501(c)(4) organizations would also be seen as a subsidy. Hansmann criticized the exemption for social clubs because the members themselves could provide capital,³⁰¹ but did not discuss 501(c)(5) or (6) organizations as such.

²⁹⁷ *Id.* at 348.

²⁹⁸ *Id.* at 354-55. The authors express more concern about the time value savings in the case of business leagues. *Id.* at 357.

²⁹⁹ Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L. J. 54, 56 -62 (1981).

³⁰⁰ *Id.* at 61.

³⁰¹ *Id.* at 94.

Daniel Halperin built on Hansmann's work to undertake such an analysis for section 501(c)(5) and section (6) organizations.³⁰² He viewed the goal in taxing such entities to be the proper measure of income rather than provision of any special subsidy. He largely accepted Bittker and Rahdert's analysis, but, unlike them, assigned far greater significance to the time value of money. "Since member dues, and for that matter investment and other income, might not be used for business expenses until a future taxable period, then failure to tax such income when received results in tax deferral for the association."³⁰³ He reviewed a number of mechanisms to end the deferral: permitting deductions only when expenditures were incurred; allocating excess of current income over deductions back to members, and a 2000 Treasury proposal to tax the investment income of section 501(c)(6) organizations. He determined the taxation of investment income to be less accurate but simpler to administer than other alternatives, dubbing it "an indirect way of eliminating the benefit of deferral."³⁰⁴

Halperin acknowledged that, one on hand, if we eliminate or mitigate the deferral benefit for trade associations exempt under section 501(c)(6), we should do the same for labor unions exempt under section 501(c)(5), but, on the other, the 2% floor on miscellaneous itemized deductions under section 67 complicated the issue.³⁰⁵ Because of the 2% floor, most union dues are not in fact deductible and the deferral provided at the entity level might be seen as providing a kind of rough justice for the denial of the deduction. He ultimately concluded that it is probably best to "ignore the 2% floor in determining the treatment of unions on the grounds that it an anomaly in the Code that should be modified rather than offset on an ad hoc basis."³⁰⁶

³⁰² Daniel Halperin, *Income Taxation of Mutual Nonprofits*, 59 Tax. L. Rev. 133 (2006). Unlike Bittker and Rahdert, he categorizes political organizations as mutual nonprofits.

³⁰³ *Id.* at 155.

³⁰⁴ *Id.* at 165.

³⁰⁵ *Id.* at 163.

³⁰⁶ *Id.* at 163.

Yet, it is difficult to ignore the 2% floor in the context of lobbying and politicking when unions' exception from the section 6033(e) notification and proxy tax requirement is premised on the effect of the 2% floor.³⁰⁷ Moreover, not all investment income of unions, if distributed to their members, would be returned to the union as a deductible expense. Unions often invest income to build up strike funds, and strike funds distributed to members are generally treated as taxable income to the recipient.³⁰⁸ Although there may well be a time delay between the investment and the receipt of the income and union membership does change over time, when investment income is distributed as taxable strike fund income, there is no matching offsetting deduction for the payment of membership dues.

Thus, it is particularly difficult to characterize the exemption from tax for the investment income of unions. Although it can be viewed as providing rough justice for denial of the deduction for dues under the 2% floor of section 67, exemption existed long before the 2% floor. We can do as Halperin suggests: ignore the 2% floor as an anomaly and assume that investment income is used for purposes that would be deductible to the members. If so, exemption of investment income gives that income the benefit of deferral. We could also accept the 2% floor and treat dues as nondeductible, but assume as well that a large proportion of investment income is received by members in the form of taxable strike fund distributions. In this case as well, the investment of the strike funds would benefit from deferral.³⁰⁹

If we accept taxation of investment income as an indirect way of eliminating the benefit of deferral, the decision not to tax the investment income can be seen as a subsidy

³⁰⁷ See *supra* Part II.A.2.

³⁰⁸ See *Gregory v. United States*, 637 F. Supp. 624 (E.D. N.C. 1986).

³⁰⁹ Other permutations are also possible. For example, more difficult is the implication of ignoring the 2% floor as administrative convenience in order to treat the dues as in theory deductible and also assuming that considerable amounts of investment income are received as taxable strike fund payments. In such a case, much of the investment income for this category of exempt organizations would already be indirectly taxed, and exemption would provide little subsidy. Data on the size and duration of strike funds in comparison to unions' total investments and the length of membership in unions of those who receive payments from them would be helpful in evaluating this issue.

for section 501(c)(5) and (c)(6) organizations, as can exemption from tax on the retained earnings on section 501(c)(4) organizations. Courts, moreover, are less likely to be concerned about theories of proper measurement of income and more likely to take a simpler approach, one like that expressed in *TWR*: Taxable corporations are subject to tax on any retained earnings, including any investment income. Exemption of such income from tax enjoyed by section 501(c)(4), (c)(5) and (c)(6) organizations is likely to be viewed as a subsidy for purposes of constitutional analysis, even if not for purposes of tax theory. Recall Justice Douglas's concurrence in *Cammarano* – for constitutional purposes, a deduction for lobbying expenses did not define business income, but provided a subsidy for lobbying.

Under such an approach, the structure of our tax laws regarding politicking might nonetheless pose a constitutional conundrum. Under section 527(f), to the extent these organizations engage in politicking, they are taxed on the lesser of amount spent on politicking or their net investment income. While intended to treat these organizations in the same way as section 527 organizations, the impact of the provision falls on those noncharitable 501(c) organizations with a significant amount of investment income. A noncharitable section 501(c) organization without investment income can engage in politicking without incurring any tax under section 527(f). But such an organization with a significant amounts of investment income will be taxed on that investment income up the amount spent on politicking. Thus, section 527(f) can be seen either as directly taxing the exercise of First Amendment rights or ending the organization's subsidy to the extent it exercises its First Amendment rights. Either characterization seems constitutionally suspect. Without the subsidy, the protection of *TWR* for limits on First Amendment Activity is lost. One law firm has in fact suggested that the section 527(f) tax is vulnerable after *Citizens United*.³¹⁰

³¹⁰ Covington and Burling, LLP (Robert K. Kelner, Bob Lenhard, Kevin Shorthill, and Scott Gast), *Citizens United: What It Means for Trade Associations*, (Feb. 17, 2010), available at <http://www.lexology.com/library/detail.aspx?g=6700c029-994f-4ed0-873c-e6828c2346dd>.

If we focus on Justice Blackmun’s concurrence in *TWR*, these organizations have available a tax-free alternative of establishing separate segregated fund (“SSF”) under section 527(f) that will have little or no taxable investment income – certainly not investment income equal to every dollar spent for politicking. Such a tax-exempt or nearly tax-exempt alternate channel would seem to suffice under the *TWR* concurrence. As described in the next section, however, it raises, however, additional questions under *Citizens United*.

C. The Validity and the Burden of the Alternate Channel After *Citizens United*

As discussed earlier, *Citizens United* asserted both that a PAC, as a separate association, could not speak for its affiliated corporation and that even if it could, the burdens of establishing and maintaining a PAC themselves pose First Amendment challenges.³¹¹ Thus, we must ask whether the same conclusions hold for a separate segregated fund (“SSF”), established by a noncharitable tax exempt organization, that functions as a section 527 organization.³¹² Can this affiliated SSF speak for the section 501(c) organization under *Citizens United* and does *Citizens United* require the conclusion that maintaining the SSF is too great a burden under *TWR*?

For the description of the burdens of operating a PAC under the campaign finance laws, *Citizens United* quoted from *Massachusetts Citizens for Life (“MCFL”)*,³¹³ and the case helps to answer these questions. *MCFL* involved some of provisions at issue in *Citizens United*, in particular the provisions in the Federal Election Campaign Act prohibiting corporations from using treasury funds to expressly advocate for candidates in a federal election and requiring that any expenditures for such purpose be financed by voluntary contributions to a separate segregated fund. The Court in *MCFL* held that the provision could not apply constitutionally to an organization, such as MCFL, that 1) is

³¹¹ See *supra* Part I.D.

³¹² See § 527(f)(3) and Treas. Reg. § 1.527-6(f).

³¹³ *Federal Election Commission v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238, 107 S.Ct. 616 (1986).

formed for the express purpose of promoting political ideas and prohibited from engaging in business activities; 2) has no shareholders or others with a claim to its assets or earnings; and 3) was not established by a business corporation or labor union and does not accept contributions from such entities.³¹⁴ According to the MCFL Court, the concerns that prompted the statutory prohibition, such as potential for corruption and protecting minority interests, were not present in regard to such organizations.³¹⁵

Nonetheless, for the MCFL Court, the practical effect of the burden of speaking through a PAC even if organized as no more than a SSF, made “engaging in protected speech a severely demanding task.”³¹⁶ The government in *MCFL* looked to *TWR* to argue that the requirement that independent spending be conducted through a SSF did not burden MCFL’s First Amendment rights.³¹⁷ The Court’s opinion in *MCFL* rejected the government’s argument and distinguished *TWR*.³¹⁸ A result such as the one in *TWR*, it explained, “would infringe no protected activity, for there is no right to have speech subsidized by the Government. By contrast, the activity that may be discouraged in this case, independent spending, is core political speech under the First Amendment.”³¹⁹

Thus, if we accept exemption of investment income from taxation as a subsidy, the alternate channel of a SSF under section 527 for noncharitable 501(c) organizations continues to pass muster after *Citizens United* because of *Citizens United*’s endorsement of *MCFL* and because *MCFL*, which expressed First Amendment concerns like those in *Citizens United*, in turn confirmed the continuing viability of *TWR*.

Similarly, the reporting scheme that section 527 requires of the SSF and other section 527 organizations probably does not pose so great a burden as to invalidate the affiliate structure under *TWR*. For the *TWR* burden analysis of the affiliate structure, the

³¹⁴ *Id.* at 264.

³¹⁵ *Id.* at 262.

³¹⁶ *Id.* at 256.

³¹⁷ *Id.* at 256 n. 9.

³¹⁸ *Id.*

³¹⁹ *Id.* at 256 n. 9 (citation omitted).

standards in the Court's *TWR* opinion are more difficult to satisfy than those of the *TWR* concurrence. Justice Blackmun in his *TWR* concurrence worried about control of the alternate channel; nothing in section 527(f) limits control of the SSF by the section 501(c) that establishes it.³²⁰ The Court's opinion in *TWR* discussed the purpose and burden of recordkeeping requirements needed to show that no tax deductible contributions supported lobbying.³²¹ The disclosure and recordkeeping required under section 527 do not relate to the nature of the subsidy, as in *TWR*.³²² But they do relate to the purpose of the section 527 exemption. The 2000 amendments to section 527 were designed to link exemption to disclosure, to satisfy a perceived need of the public for information related to political speech. Thus, the match between burden and purpose in section 527 as amended satisfies *TWR*.

TWR alone, however, may not resolve the question of whether the burden of section 527 is a permissible burden. Language in *MCFL* and *Citizens United* itself is helpful as to whether the burden of the recordkeeping and disclosure under section 527 is undue. When the government in *MCFL* expressed concern that the inapplicability of the prohibition regarding use of treasury funds to *MCFL* "would open the door to massive undisclosed political spending by similar entities and to their use as conduits for undisclosed spending by business corporations and unions,"³²³ the Court saw no such danger because of another set of disclosure provisions in the campaign finance laws applicable to contributors who provide an aggregate of \$200 in funds intended to influence elections and recipients of independent spending amounting to more than \$200.³²⁴ According to the Court, "The state interest in disclosure therefore can be met in a manner less restrictive than imposing the full panoply of regulation that accompany

³²⁰ 461 U.S. at 551-56.

³²¹ *Id.* at 543.

³²² *Id.* at 553.

³²³ 479 U.S. at 262.

³²⁴ *Id.*

status as a political action committee under the [Federal Election Campaign] Act.”³²⁵ It was the “full panoply of regulations that accompany status as a political action committee” that *Citizens United* described as so burdensome. *Citizens United* upheld less onerous and detailed disclosure requirements regarding contributors 8-1 against constitutional challenge.³²⁶

The disclosures required under section 527(j) parallel the less onerous of the campaign finance law disclosure regimes described in *MCFL*.³²⁷ It is only the more onerous regime that campaign finance law applies to political action committees that *Citizens United* scorned. Thus, it would seem that the burden of the section 527(j) disclosure would similarly not violate First Amendment rights, and the rational relation test is the appropriate test to apply in judging the validity of section 527(j). A SSF, however, is treated as a political organization under section 527.³²⁸ Thus, in order to gauge fully the burden of the required disclosures under section 527(j) and the penalties applied for failure to make the required disclosures, we must determine how we view section 527 itself, rather than just the establishment of a separate segregated fund by section 501(c) organizations, and it is to that subject the article now turns.

D. *Citizens United* and the 2000 Amendments to Section 527

The assertions in *Citizens United* that “[n]o sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporations” and that “PACs are burdensome alternatives”³²⁹ also call upon us to reconsider section 527 itself. Section 527 is not easy to characterize. Congress saw the 2000 amendments to section 527 as

³²⁵ *Id.* Justice O’Connor in her concurrence saw as the organizational requirements FECA imposed on SSF as a far more significant burden than the disclosure requirements. *Id.* at 265 (O’Connor, J., concurring in part and concurring in the judgment).

³²⁶ 130 S.Ct. at 914. That is, such disclosure was justifiable on First Amendment grounds even under the strict scrutiny required for testing campaign finance laws.

³²⁷ *Id.*

³²⁸ § 527(f)(3).

³²⁹ 130 S.Ct. at 913, 897.

campaign finance reform but relied on *TWR* for their being constitutional as part of a tax subsidy³³⁰ That is, to satisfy the *TWR* analysis, Congress sought to structure section 527 so that organizations subject to the burden of the new registration and disclosure provisions, with the substantial additional tax for failure to comply with disclosure requirement, would choose to be exempt under section 527 on the basis of the offered tax subsidies. The Eleventh Circuit in *Mobile Republican Assembly v. United States* viewed the statutory scheme as voluntary in this way – only by accepting these burdens would political organizations enjoy income tax exemption on their exempt function income.³³¹ The IRS has also indicated that if an organization meeting the definition of a political organization in section 527(e)(1) fails to file the registration notice, its taxable income will include exempt function income pursuant to section 527(i)(4).³³² That is, according to these authorities, status as a political organization is not voluntary, but after the 2000 amendments to section 527, tax-exempt status as a political organization is voluntary. They take this position despite the statement in section 527(a) that “[a] political organization shall be considered exempt from income taxes for the purposes of any law which refers to organizations exempt from income taxes.”

A number of scholars disagree with such a reading.³³³ Roger Colinvaux believes that while it is unclear whether the historical basis for excluding the income of political organizations is a gift theory or a conduit theory,³³⁴ section 527 as enacted in 1975 did no more than clarify and codify the result that “generally inured at the time under applications of normal tax principles to political organizations by the IRS.”³³⁵ He suggests that the court in *Mobile Republican Assembly* reached its decision without sufficiently examining the scope of the subsidy section 527 provides. He reads the 2000 amendments

³³⁰ See *supra* Part II.B.2.

³³¹ See *supra* Part I.C.3..

³³² Rev. Rul. 2003-49, 2003-1 C.B. 903.

³³³ See Colinvaux, *supra* note 222 at 543-44; Gregg D. Polsky, *A Tax Lawyer's Perspective on Section 527 Organizations*, 28 *Cardozo L. Rev.* 1773 (2007).

³³⁴ Colinvaux, *supra* note 222 at 535-56.

³³⁵ *Id.* at 533.

to section 527 as giving political organizations a choice between filing a notice under section 527(i) and subjecting itself to the section 527 regime or not filing the notice and returning to the taxation under pre-1975 law. He reaches this result by pointing to the language of section 527(i)(4), which describes the effect of a failure to file the notice referred to in section 527(i)(1). Section 527(i)(4) provides: “In the case of an organization failing to meet the requirements of [section 527(i)(1)] for any period, the taxable income of such organization shall be computed by taking into account any exempt function income (and any deductions directly connection with the production of such income). . . .” He suggests that either of two interpretations of this language “resuscitate” pre-1975 law for organizations that opt out of section 527 treatment.³³⁶ First, section 527(i)(4) is subordinate to section 527(i) and thus applies only to organizations that at some point file the section 527(i) notice but not organizations that never do so. Second, taking income into account, as section 527(i)(4) requires, does not mean that it will be taxed; it means only that it will be treated properly under applicable tax principles.

Gregg Polsky relies on the principle that the federal income tax laws operate to ensure that funds used for politicking consist only of dollars that have already been taxed.³³⁷ Money contributed to 527 organizations has already been taxed; to tax it again upon contribution is to impose an extra layer of tax because the money has been pooled with money from others, a result he finds inconsistent with tax principles.³³⁸ To him, section 527(i), properly viewed, is not a condition attached to a subsidy but a penalty on disclosure. He also rejects the notion that status as section 527 organization is voluntary. “An organization either is or is not a political organization for tax purposes based strictly on its activities.”³³⁹

³³⁶ *Id.* at 543-44.

³³⁷ Polsky, *supra* note 333 at 1775.

³³⁸ *Id.*

³³⁹ *Id.* at 1784. See also 73 Gregg D. Polsky & Guy-Uriel E. Charles, *Regulating Section 527 Organizations*, 73 GEO. WASH. L. REV. 1000, 1015-1016 (2005).

As often is the case, many of Colinvaux and Polsky's arguments follow from their choice of baseline.³⁴⁰ Rather than comparing organizations described in section 527(e) that do register to those that do not, they compare the treatment of such organizations in the presence and absence of any legislation. They argue that in the absence of such legislation, organizations that engage primarily in politicking or taxable organizations that engage in politicking short of such activities being their primary purpose would not be subject to income tax on contributions, primarily on a conduit or pooling of income theory. They suggest that such contributions may also be free of gift tax.³⁴¹ If such is the case, their argument continues, the burdens of the 2000 amendment to section 527 so exceed the benefits of exemption that they could represent an unconstitutional penalty.

It is never easy to determine the appropriate base line from which to make comparisons and on which to make tax policy arguments. Nonetheless, as discussed earlier,³⁴² when courts do make decisions about the reach of Congressional powers, arguments based on legislative decisions seem more likely to carry the day than arguments going to basic tax principles. Again, *Cammarrano* may be the best illustration of a court's approach: What matters is the Congressional decision of whether or not to allow a

³⁴⁰ Donald Tobin, writing before these other scholars, has also made the point that the possibility of a subsidy must be measured against "what Congress has the authority to do, not what it should do" and that exempt status must be compared to current law." Donald B. Tobin, *Anonymous Speech*, *supra* note 222 at 643-44. He argued that section 527 as amended in 2000 does provide a meaningful subsidy. *Id.* at 644-53. He found the conduit theory an inadequate as a basis for shielding contributions to political organizations from income tax because of the degree of control the organization exercises over contributed funds and the gift theory inadequate because many such contributions lack detached and disinterested generosity. He also rejected a capital contribution theory. *Id.* at 674-78. Since under section 162(e) no deductions will be available for expenditures to influence or participate in political campaigns, he reasoned that a political organization would have taxable income in the absence of registering as a tax-exempt section 527 organization. In a more recent article, considering the possibility of taxable organizations that engaged substantially but not primarily in politicking, he is far more sympathetic to the gift theory. Tobin, *Political Advocacy*, *supra* note 222 at 85-90. Professor Simmons also has argued that section 527 provides a subsidy, but on the theory that contributors are maximizing influences and the political organization are providing services that would be taxable compensation in the absence of the section 527 exclusion for exempt function revenues. Simmons, *supra* note 60 at 98-99.

³⁴¹ Because the gift tax exemption in section 2501(a)(4) refers explicitly to section 527(e), the IRS has rules that a political organization does not have to register under section 527(i) for gifts to it to be eligible for the gift tax exemption. Rev. Rul. 2000-49, 2000-2 C.B. 430.

³⁴² See *supra* III.C.

deduction, not whether the deduction, as a matter of theory defines income or is intended as subsidy to encourage charitable giving. Under such an approach, section 527 provides a subsidy, as *Mobile Republican Assembly* concluded, and thus it can impose limits and burdens. As discussed in the preceding section, the burdens do not appear undue.

Congress structured the campaign finance regulation embodied in section 527 as a tax law because the sponsors of the legislation believed the constitutional protection afforded by a *TWR* analysis was necessary. Today, in light of the statement in *Citizens United* that an important government interest supports disclosure provisions under exacting scrutiny even for speech that is not the functional equivalent of express advocacy,³⁴³ it may be that an elaborate justification on the basis of the *TWR* subsidy theory for the registration and disclosure requirements that sponsors of the amendments to section 527 thought necessary in 2000 and which I have just undertaken is no longer required.

Nonetheless, Congress added sections 527(i) and (j) to the Code in 2000 without amending the rest of section 527, and the section lacks coherence. Questions remain in particular about how to reconcile the statement in section 527(a) that a political organization “shall be considered an organization exempt from tax” with the requirements of section 527(i) that the organization file a registration notice in order for exempt function revenue to be exempt from tax and about how to treat organizations that meet the definition of a political organization in section 527(e) but fail to register under section 527(i) or make the required reports under section 527(j).³⁴⁴ Thus, a restatement of the

³⁴³ 130 S.Ct. at 915.

³⁴⁴ The government argued in *Nat'l Fed'n of Republican Assemblies v. United States*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001), that an organization registered under section 527(i) had the choice of disclosing all contributions and expenditures or choosing which to disclose. Tobin, *Anonymous Speech*, *supra* note 222 at 635. The Court of Appeals rejected this reading, interpreting section 527(j) as required not optional for those who have elected to be tax-exempt under section 527 by registering under section 527(i). *See supra* Part I.C.3. Moreover, because section 527(j) imposes tax at the highest corporate rate on both undisclosed contributions and expenditures,, there is a possibility that the penalty tax under section 527(j) could exceed the value of the section 527 exemption. This result is unlikely, *id.* at 675-76, and the appellate court rejected the argument that a penalty intended to enforce a regime chosen voluntarily undermined the subsidy. Although the government has represented that it does not read criminal penalties under section

section and related provisions to eliminate current inconsistencies and uncertainties would be a worthy and welcome endeavor. Even without Congressional clean-up of section 527, the IRS might consider issuing further guidance on interpretation of the 2000 amendment so section 527 in the form of regulations rather than revenue rulings in order to ensure the greatest possible deference in any judicial review.³⁴⁵

IV. New Requirement for Noncharitable Tax-Exempt Organizations That Engage in Political Speech

Citizens United did not overrule *TWR sub silentio*. It did remind us how ambivalent we as a society are about speech involving lobbying and politicking. We cherish the ability to engage in such speech as a precious First Amendment right. Yet we fear faction as well as corruption. We look to disclosure to help us evaluate political speech, but we also value the ability to engage in anonymous speech.

In the case of tax-exempt organizations, including those that engage in lobbying and politicking, the impulse in favor of disclosure and its benefits dominates. Congress has required that exempt organizations make public their annual Information Return on Form 990, their application for exemption, and even their Form 990-T reporting any taxable activities public as part of the conditions for exemption. But public disclosure has its limits. Congress has allowed public disclosure of contributors only for private foundations and political organizations.³⁴⁶ Below, I make a series of suggestions for more

7203 as applying to section 527(f), Tobin, *Anonymous Speech*, *supra* at 675 n. 331, statutory clarification of this point would be welcome as well, particularly in light of the importance *Citizens United* placed on criminal penalties in the election law.

³⁴⁵ See Kristin E. Hickman, *No Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537 (2006).

³⁴⁶ § 6104(b). Private foundations generally are section 501(c)(3) organizations that receive their support from a single individual or corporate source or close knit family group. More specifically, they are not traditional public charities, such as schools, churches, and hospitals; broadly supported section 501(c)(3) organizations; or section 501(c)(3) organizations with a close and defined relationship with traditional charities or publicly supported section 501(c)(3) organizations. See § 509(a)(1)-(3). In contrast to public charities, private foundations, as a result of the excise tax on taxable expenditures, which includes lobbying, are for all practical purposes prohibited from lobbying. Section 4945(e).

timely or additional disclosures and additional changes that might improve lobbying and politicking by noncharitable tax-exempt organizations. The millions of dollars being spent in the 2010 election by noncharitable exempt organizations without disclosure of their contributors may prompt Congress to act on proposals such as the ones outlined here.

A. Require Notice of Application for Exemption Within Specified Time Period

Currently, section 508(a) requires that most organizations that seek recognition as tax-exempt under section 501(c) notify the IRS that they are applying for exemption and obtain a favorable determination of their exempt status.³⁴⁷ If a section 501(c)(3) organization files its application for exemption within 27 months from the end of the month in which it is organized and is granted exemption, it will meet the notice requirement and be exempt from its date of organization.³⁴⁸ In addition, if the 27-month deadline is met, contributions made from its date of organization will be treated as deductible.

No similar requirement applies to section 501(c)(4), section 501(c)(5) or section 501(c)(6) organizations.³⁴⁹ Thus, whenever the application for exemption for such an entity is filed and approved, exemption is retroactive to its date of formation. Moreover, such organizations are not required to file an application for exemption. However, all organizations exempt under section 501(a) are, with limited exceptions, such as for churches or organizations other than private foundations with gross annual receipts normally not more than \$25,000, required to file the annual information return, Form 990, under section 6033.³⁵⁰ If the Form 990 is filed for an organization when no Form

³⁴⁷ This requirement does not apply to churches, their integrated auxiliaries, convention and associations of churches and organizations other than private foundations that normally have gross receipts of \$5,000 or less. §508(a), (c)(1); Treas. Reg. § 1.508-1(a)(3) (1973).

³⁴⁸ See Instructions to Form 1023.

³⁴⁹ Such a requirement, however, does apply to section 501(c)(9), section 501(c)(17) and section 501(c)(20) organizations. See § 505(c) and Treas. Reg. § 1.505(c)-1T.

³⁵⁰ Congress also recently added the requirement that even the smallest organizations file a very short information return, Form 990N. § 6033(i).

1024 application for exemption has been filed, the IRS Service Center experiences a bureaucratic quandary.³⁵¹

Reasons besides easing the bureaucracy favor requiring at least section 501(c)(4) organizations and possibly also section (c)(5), and (c)(6) organizations to apply for exemption and receive a favorable determination in order to be treated as exempt. Section 501(c)(4) is close in its permitted purpose to section 501(c)(3), for which application is already required. For those section 501(c)(4) organizations that are formed in order to engage in substantial lobbying, the lobbying must be related to the organization's exempt purpose. Such purpose will be described in detail in the application for exemption, and only by comparing a Form 990 to the application can tax administrators, the public, or journalists consider whether an organization's activities are consistent with its exempt purpose.

Extending the requirement of applying for exemption beyond section 501(c)(3) organizations, which also have the additional tax benefit of being eligible to receive tax-deductible contributions, does not seem problematic. Congress has already made application for exemption a requirement for some noncharitable section 501(c) organizations. Requiring organizations to apply for exemption seems well within the *TWR* holding of permissible conditions on the subsidy of exemption, assuming, as discussed earlier, that courts would see organizations choosing to be tax-exempt as voluntarily choosing a subsidy.

³⁵¹ In 2000, the IRS issued FSA 20046038 to deal with the "recurring problem" of organizations that have not filed and are not required to file for recognition of exemption but have filed Form 990. Without an application for exemption, the organizations are not included on the IRS Master File, and the Form 990 returns are unpostable. The Ogden Service Center had proposed substituting a Form 1120 for these Form 990s, on the assumption that the organizations that had not filed an exemption application must not be tax-exempt. The FSA, however, recognized that most section 501(c) organizations "are legally exempt under section 501(a) if they are described in those sections regardless of whether they applied to the Service for recognition of that status." It thus questioned the concept of treating the returns as unpostable Form 990s and suggested that they be returned to a separate system or classification specifically for Form 990s filed by organizations that have not applied for recognition of tax-exempt status.

B. Create a New Category for Tax-Exempt Organizations Engaged Primarily in Lobbying

If, however, our concerns about exempt purpose and registration focus primarily on organizations that engage in lobbying or claim to be engaged primarily in lobbying, we could consider creating a new category of exempt organizations for those organizations that primarily do so and require only organizations that fall into this new category to apply for exemption.

A special category for organizations that primarily lobby seems appropriate given that lobbying, like politicking, is core First Amendment speech. Yet Congress has not to date addressed lobbying as an exempt activity, other than to limit it as an activity for section 501(c) organizations. All the authority regarding lobbying as appropriate for exempt organizations is administrative, not statutory. Such important issues merit Congressional consideration.

Creating this new category of lobbying exempt organizations would also help to cure the schizophrenia that currently infects section 501(c)(4). Today, under section 501(c)(4), organizations formed to promote social welfare that do not qualify under section 501(c)(3) because of they do not benefit a broad enough charitable class³⁵² inhabit the same space as organizations with the same exempt purposes as section 501(c)(3) organizations but which fall under section 501(c)(4) only because of their substantial lobbying activities. These two groups do not logically belong in the same category

Any organization formed within such a new category would need to specify an exempt purpose, and lobbying activities, as under current law, would be required to carry out the exempt purpose. With a stated exempt purpose, it would be possible to apply the flow through notification or proxy tax as required for organizations formed under this new category to lobby on issues for trade associations or unions.

³⁵² See, e.g., Rev. Rul. 75-286, 1975-2 C.B. 210 (Jan. 1, 1975) (organization engaged in beautifying a city block).

Admittedly, establishing such a new category for lobbying exempt organizations would heighten the tension already identified regarding the different definitions of lobbying applicable under section 501(c)(3) and 162(e). If a class of exempt organizations were to be established based primarily on lobbying activities, a consistent definition of lobbying would take on added importance. A new class for lobbying entities, however, would be especially useful for expanded disclosure requirements, as discussed in the next section.

C. Increase Public Disclosure of Contributors to Noncharitable Exempt Organizations

Currently, public disclosure is required under the tax law only for contributors to private foundations and to section 527 organizations. Legislation reported out of the Ways and Means Committee prior to the adoption of the 2000 amendments to section 527 would have required disclosure of contributors to section 501(c) organizations subject to section 527(f), at various levels, depending on whether the organization set up a special account to receive politicking contributions.³⁵³ The recent DISCLOSE bill considered by Congress³⁵⁴ would have established a similar disclosure regime for noncharitable tax exempt organizations that make independent expenditures for express advocacy or electioneering communications. Neither bill became law. Given the strong sense of many in Congress of the importance of disclosure to an informed electorate and the language in *Citizens United* endorsing such disclosure, such efforts can be expected to be renewed and could at some point become law.

Congress, however, might also look to a simpler disclosure scheme, for example, by requiring public disclosure of Schedule B to the annual Form 990³⁵⁵ for all organizations

³⁵³ See *supra* Part II.B.2.

³⁵⁴ Democracy is Strengthened by Casting Light on Spending in Elections (DISCLOSE) Act, H.R. 5175, 111th Cong. §§ 201-214, 301 (2010); Democracy is Strengthened by Casting Light on Spending in Elections (DISCLOSE) Act, S. 3295, 111th Cong. §§ 201-214, 301 (2010).

³⁵⁵ Schedule B requires disclosure of any one contributor to a noncharitable tax exempt organization who gave \$5,000 or more in money or property during the taxable year.

that pay section 527(f) or section 6033(e) tax above a certain threshold. As another option, Congress could choose to follow more closely the model of the private foundation disclosure. We require public disclosure of contributors to private foundations out of concern that this is subset of section 501(c)(3) organizations with their narrow base of contributors may serve only their contributors' narrow interests. We could do the same for noncharitable exempt organizations: develop a public support test applicable to each category and require public disclosure of contributors only for those organizations that do not meet the applicable public support test.

Both these suggestions could be also limited to the new category of lobbying tax exempt organizations. That is, public disclosure of Schedule B could be required solely for this category of noncharitable tax exempt organizations, without any public support test, or a public support test could be developed only for this new category, and we could require public disclosure of Schedule B only for those lobbying tax exempt organizations that do not meet this newly developed public support test.

If we limit this set of rules to this new category, we might consider additional and more frequent disclosures, including disclosure of expenditures or even an elaborate regime that resembles the section 527 regime. Such expanded disclosure for lobbying tax exempt organizations would seem to pass constitutional muster even if not tied to tax exemption. As this piece has often noted, the Court in *Citizens United* upheld disclosure and spoke approvingly of disclosure requirements for speech that was not express advocacy. Moreover, the Supreme Court in *U.S. v. Harriss* held that disclosure of lobbying information to legislators was constitutional.³⁵⁶ *Citizens United* spoke approvingly of *Harriss*: “[T]he Court has upheld registration and disclosure requirements on lobbyists, even though Congress has no power to ban lobbying itself.”³⁵⁷ While *Harriss* involved disclosure to lawmakers, a recent District of Columbia Circuit opinion rejected a challenge to a disclosure provision of the Honest Leadership and Open Government Act

³⁵⁶ *U.S. v. Harriss*, 347 U.S. 612 (1954).

³⁵⁷ 130 S.Ct. at 99.

on the grounds that the government had a compelling interest in revealing to the public those who were behind the funding of lobbying activities.³⁵⁸

Of course, requiring expanded disclosure would entail the difficult task of a penalty structure for failure to elect exemption or failure to comply with required disclosure.³⁵⁹ Moreover, unless some kind of tax similar to that of section 527(f) is imposed, organizations may well take care to engage in lobbying just short of meeting the primary purpose test developed for this new category.

D. Tax Politicking Conducted Directly by Noncharitable Tax-Exempt Organizations Whether or Not They Have Investment Income

Although Congress sought in the section 527(f) tax to put organizations that engage in politicking on an even playing field with section 527 organizations, such has not necessarily been its effect in practice. Section 527 organizations, although subject to tax on their investment income, can easily avoid having any significant amounts of taxable investment income, either because they are short-lived or because they choose tax-favored investments, such as municipal bonds. Some noncharitable tax exempt organizations, however, will have little in the way of investment income and others, such as section 501(c)(5) unions maintaining strike funds, will have large amounts of investment income. (Of course, noncharitable tax exempt organizations can and do establish new affiliates to engage in politicking and avoid section 527(f) tax.)

We might, however, also consider applying the section 527(f) tax to the politicking (i.e. exempt function activities under section 527) of any noncharitable exempt organization, whether or not it has any investment income. Such a tax would encourage these entities to channel their politicking activities into separate segregated funds subject to

³⁵⁸ National Association of Manufacturers v. Taylor, 582 F.3d 1(D.C. Cir. 2009).

³⁵⁹ Expanded disclosures for lobbying tax exempt organizations might even include considerable detail about any politicking in which they engage, again relying on the dicta in *Citizens United* approving disclosure for speech that is not express advocacy.

section 527 with its disclosure and reporting regime. It would fall directly on core First Amendment activities, but, as discussed earlier,³⁶⁰ the availability of the tax-free section 527 alternative of a separate segregated fund appears sufficient for constitutional purposes under *TWR*, so long as we treat exemption itself as a subsidy.

All of these suggestions are offered to prompt further discussion. A number of them could be combined in various permutations. Some ask for small changes, others greater ones, to how we approach lobbying and politicking under the tax laws. Our willingness to consider them depends on whether we view exemption itself as a subsidy, how we value disclosure, and whether we think changes to the tax laws, even if desirable, are politically feasible.

V. Conclusion

Noncharitable 501(c) organizations that engage in lobbying and politicking must attend to a number of tax laws. They must ensure that their primary purpose is not politicking, without knowing what “primary purpose” means. They must decide whether to conduct any politicking directly and be subject to the section 527(f) tax on the lesser of their investment income or their politicking expenditures or whether set up a separate segregated fund subject to the full panoply of section 527 disclosure and reporting requirements. At the same time, the 2000 amendments to section 527 that established the disclosure and reporting requirements do not mesh neatly with the original version of section 527.

If noncharitable tax exempt organizations lobby, they must ensure that their lobbying activities relate to their exempt purpose. They must consider either the definitions of lobbying applicable to organizations exempt under section 501(c)(3) (which itself has two sets of definitions of lobbying) or to the definition of lobbying under section 162(e) applicable to for-profit organizations denied a deductions for lobbying for expenses

³⁶⁰ See *supra* Part II.B.

related to lobbying and political activities both for some organizations, particularly section 501(c)(4) organizations, both sets of definitions could be implicated. Those subject to the section 162(e) definition must comply with the rules of section 6033(e), requiring either notification to members of the share of dues and fees that are not deductible or pay a proxy tax on the organization's lobbying expenditures.

Case law has relied on *TWR* to uphold both the section 6033(e) and the 2000 amendments to section 527(f). Dicta in *Citizens United* suggested that the reasoning of *TWR* and reliance on a separate segregated fund under section 527 might be vulnerable to constitutional attack. Close examination of *Citizens United* reassures that it did not undermine the holding or reasoning of *TWR*. Government continues to have no duty to subsidize political speech. Courts are likely to reach the conclusion that exemption represents a subsidy for noncharitable tax exempt organizations as well as section 527 organization, even if tax theory arguably calls for a different result.

Nonetheless, *Citizens United's* underscores the importance of avoiding uncertain, multifactor tests when core political speech is at stake and endorses disclosure as advancing an important government interest in enabling citizens to make informed political choices. The case thus reinforces calls to develop clearer definitions of politicking in the tax law as well as to restate section 527 and encourages us to explore additional public disclosures for tax exempt organizations engaged in political speech.

Even if additional disclosure requirements are adopted, however, to the extent that concerns relate to campaign finances, as much of the recent outcry indicates, tax law is an awkward instrument for addressing them, as experience with section 527 has taught. Most disclosure to the IRS takes place only annually. IRS examinations and other enforcement efforts are few in number and not designed to respond quickly to alleged violations taking place during an election cycle related to activity designed to affect that election. We can make improvements to the tax rules governing politicking by noncharitable exempt organization that will benefit both the organizations and the public, but we must not expect tax regulation to take the place of campaign finance regulation.