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Donald B. Tobin

University of Maryland Francis King Carey School of Law, dtobin@law.umaryland.edu

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Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing

Donald B. Tobin

ABSTRACT

This article argues that there are some quick regulatory fixes the Treasury can implement to ensure that tax-exempt organizations are operating within the rules and that aggressive tax planning is not being used as a way to obfuscate rules for political organizations requiring disclosure. The article recommends that Treasury promulgate new regulations to require disclosure by tax-exempt entities of expenditures and contributions in excess of \$25,000. The article also proposes that Treasury institute procedures to require tax-exempt organizations to file for exempt status, and to provide procedures for ensuring that these organizations meet the requirements in the statute and are not being used as a mechanism to avoid disclosure provisions in the Internal Revenue Code.

IN THE CAMPAIGN FINANCE AREA, money is often analogized to water. The idea is that “money, like water, has to go somewhere.”¹ If money influences outcomes, political operatives will find the best outlet, within the current regulatory framework, to spend money and influence elections.² Continuing this analogy, campaign finance laws can be seen as the regulatory plumbing that helps direct the flow of money in a way that promotes democratic ideals. The fact that money will always find an outlet makes it even more important that we have a sound plumbing system designed to avoid a flood. In recent years, we have seen a major effort by independent groups (IGs) to manipulate the tax classification of their organizations to avoid disclosure provisions in the Internal Revenue Code and in

the Federal Election Campaign Act (FECA). This manipulation, coupled with an often deadlocked Federal Election Commission (FEC) that has been unable or unwilling to strongly enforce disclosure provisions, has created an environment where huge sums of undisclosed contributions are entering the system. Creating secret entities with secret contributors poses serious problems for our current regulatory framework, and is contrary to the intent of Congress in its creation of the current regulatory regime.

For years, political campaign operatives advising IGs interested in influencing elections have been examining campaign finance laws, and advising clients on the best means of achieving their ends. Even before the recent decision in *Citizens United*, which

Donald B. Tobin is Associate Dean for Faculty and Frank E. and Virginia H. Bazler Designated Professor in Business Law at Moritz College of Law, The Ohio State University. A special thanks to Garry Jenkins, Ellen Aprill, Lloyd Mayer, Daniel Tokaji, Marc Spindelman, and Brian Camp, and participants in the LSU workshop series for making comments on earlier drafts and helping me think through many of these issues.

¹Samuel Issacharoff and Pamela S. Karlan, *The Hydraulics of Campaign Finance Reform*, 77 TEX. L. REV. 1705, 1708 (1999)(“Political money, like water, has to go somewhere”); *McCconnell v. Federal Election Commission*, 540 U.S. 93, 224 (2003)(“Money, like water, will always find an outlet”); Lloyd H. Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625, 681 (2007)(describing “trickle” of funds from 527s to 501(c)(4)).

²Issacharoff and Karlan, *supra* note 1, at 1709.

found unconstitutional a statute banning corporations and unions from using their treasury funds to engage in independent campaign expenditures, IGs were examining ways to have an even greater impact on elections. The most recent trend is for IGs to organize as section 501(c)(4) social welfare organizations and thus avoid the disclosure provisions that apply to section 527 tax-exempt political organizations. I have argued elsewhere that proponents of using section 501(c)(4)s as vehicles for independent political advocacy are taking a very aggressive position with regard to the status of their organizations, and that these organizations should not necessarily be treated as section 501(c)(4) social welfare organizations.³ But even if these organizations are properly organized as section 501(c)(4) social welfare organizations, the existing regulatory structure never envisioned the massive use of section 501(c)(4) organizations as a means of avoiding the disclosure of huge donations designed to influence elections. Here I argue that there are some quick regulatory repairs that the Treasury Department can take to ensure that section 501(c)(4) organizations, as well as labor unions (§501(c)(5) organizations) and business leagues (§501(c)(6) organizations), are operating within the rules, but also to ensure that the policies behind the regulation of tax-exempt entities and political campaign intervention are coherent, instructive, and fair.⁴

In the 111th Congress, supporters of campaign finance disclosure proposed the DISCLOSE Act (Democracy is Strengthened by Casting Light on Spending in Elections Act), which among other things required disclosure of contributions and expenditures with regard to independent expenditures.⁵ The legislation passed the House but the bill was filibustered in the Senate, and the Senate failed to invoke cloture on the bill.⁶ Absent further action by Congress, the Treasury should promulgate updated regulations regarding tax-exempt entities, including filing and disclosure provisions, designed to create coherent tax-exempt regulations, protect against abuse of tax-exempt status, and to promote the important government interests of voter information and lack of corruption in our democratic institutions.

The first part of this article summarizes the basic law regulating tax-exempt organizations involved in political campaigns. Part II discusses the current regulatory regime and the Treasury's authority to

issue regulations addressing deficiencies in the current regime. Part III proposes ways the Treasury can improve the regulation of tax-exempt campaign entities without further action by Congress. I argue that further regulation by the Treasury is necessary, especially in the disclosure context, to ensure that the regulatory structure applicable to tax-exempt organizations is enforced in a coherent way consistent with Congress's intent.⁷

I. CAMPAIGN ACTIVITIES AND TAX-EXEMPT ORGANIZATIONS

The law treats groups of people organized to carry on a group activity in different ways. When groups organize, accept money, and pool resources, the government attempts to characterize these organizations so it can regulate and tax the activities of the organization. The tax code and state laws provide for a multitude of different organizational forms. Congress has created a group of organizations that for tax and other reasons it deems should be tax-exempt. These are organizations that are generally not engaged in business activities and,

³Donald B. Tobin, *The Rise of 501(c)(4)s in Campaign Activity: Are They as Clever as They Think?*, ELECTION LAW@MORITZ, Commentary, Oct. 5, 2010, <http://moritzlaw.osu.edu/electionlaw/comments/index.php?ID=7667>.

⁴This article focuses mainly on the regulation of 501(c)(4) social welfare organizations, rather than organizations organized under 501(c)(5) (labor unions) and (c)(6) (business leagues). The reforms discussed in this article could, however, also be applied to those organizations.

⁵H.R. 5175, 111th Congress (2010); S. 3628, 111th Congress (2010).

⁶The cloture motion to cut off debate requires sixty votes. There were only fifty-nine votes for cloture. See 156 CONG. REC. S7383 (Sept. 23, 2010).

⁷This article deals only with the regulation of tax-exempt entities. As discussed *infra* Part III.C, I recognize that further regulation in this area may encourage people to use for-profit corporations as a way of avoiding disclosure, although the regulation of for-profit corporations' campaign activities is outside the scope of this article. For an examination of the use of for-profit corporations as a means of avoiding some campaign finance laws see Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next "Loophole"?*, 6 FIRST AMEND. L. REV. 41 (2007). The benefits of using a for-profit corporation have only increased since *Citizens United* and at least one recent report indicates that individuals are using taxable entities as a mechanism for avoiding disclosure. See Nicholas Confessore, *PAC Linked to Romney Gets a Mystery Gift*, N.Y. TIMES, Aug. 5, 2011, at A13.

because of the tax-exempt status granted by Congress, generally do not have taxable income.⁸

In order to understand the campaign-related tax regulatory rules, it is important to understand the current rules that apply to various categories of tax-exempt organizations. This section briefly summarizes the different types of tax-exempt organizations and the use of these organizations in political campaigns.⁹

A. 501(c)(3) organizations

Section 501(c)(3) organizations are what most Americans think of when they think of tax-exempt organizations. These are charitable, religious, and educational type organizations. Because these organizations have a charitable purpose, Congress has provided not only that the income of these organizations is exempt from tax,¹⁰ but also that contributions to the organizations may be deducted by the donor.¹¹ Thus, section 501(c)(3) organizations receive a dual tax benefit, and these benefits generally are considered a subsidy provided by society to these groups.¹²

Congress has also determined that organizations that wish to receive this preferred status should not participate directly or indirectly in political campaigns on behalf of a candidate.¹³ Section 501(c)(3) organizations often attempt to influence national policy, and thus elections, but the advocacy must be issue based, not candidate based.¹⁴ Thus, section 501(c)(3) provides a context for understanding some of the structural regulation in the tax-exempt area. If an organization engages in political activity, the organization itself may be tax exempt, but unlike section 501(c)(3) organizations, contributions to organizations that engage in political activity are generally not deductible by the payor as charitable contributions.¹⁵

The definition of political intervention under section 501(c)(3) also guides the determination whether something is political intervention under another section of the Code. Thus if an activity is political intervention for purposes of section 501(c)(3), it is also political intervention in determining whether it is an exempt function for political organizations.¹⁶ This is important because it is the Service's regulations and interpretations about political intervention under sections 501(c)(3) and 527 that control here, not the Federal Election Commission's.

B. 501(c)(4) organizations

Section 501(c)(4) organizations are social welfare organizations. Section 501(c)(4) defines social welfare organizations as:

⁸An organization that engages in business activities that are unrelated to the entity's exempt purpose must pay tax on that unrelated business activities. See I.R.C. §§ 512, 513.

⁹This is a brief summary of a more detailed analysis of tax-exempt organizations that appeared in *First Amendment Law Review*. For more thorough discussions, see Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 GA. L. REV. 611, 638 (2003); Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313, 1330, 1342–47 (2007); Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next "Loophole"?*, 6 FIRST AMEND. L. REV. 41 (2007); Daniel Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 FLA. L. REV. 1 (2002); and Ellen Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations after Citizens United*, 10 ELECTION L.J. 363 (2011).

¹⁰Income unrelated to an organization's exempt purpose is subject to tax. I.R.C. §§ 512, 513.

¹¹I.R.C. § 170; Charitable contributions are generally defined by § 170(c) of the Code as, among other things, a donation to a "corporation, trust, or community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes...or for the prevention of cruelty to children or animals." I.R.C. § 170(c)(2)(B). This definition closely parallels the definition for an exempt organization under § 501(c)(3) of the Code. Donations to § 501(c)(3) organizations are deductible by operation of § 170 of the Internal Revenue Code. I.R.C. § 170(c)(2)(D).

¹²See, e.g., MOLLY F. SHERLOCK AND JANE G. GRAVELLE, CONG. RESEARCH SERV., R40919, AN OVERVIEW OF THE NONPROFIT AND CHARITABLE SECTOR 41–43 (2009).

¹³Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) (as amended in 1990) (an organization is an action organization and does not qualify for § 501(c)(3) status if it "participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office").

¹⁴They may lobby, but lobbying may not be a substantial part of their activities. See § 501(c)(3). No substantial part of a § 501(c)(3) organization's activity may be for "carrying on propaganda, or otherwise attempting to influence legislation ... and which does not participate in...any political campaign on behalf of any candidate for public office." I.R.C. § 501(c)(3)(2002). See also Treas. Reg. 1.501(c)(3)(ii) (an organization is an action organization and does not qualify for § 501(c)(3) status if a "substantial part of its activities is attempting to influence legislation by propaganda or otherwise").

¹⁵See I.R.S. Fact Sheet FS-2006-17 (setting out various scenarios indicating impermissible political intervention); Rev. Rul. 78-248, 1978-1 C.B. 154 (non-biased voting records allowed); Rev. Rul. 86-95, 1986-2 C.B. 73-74 (forum for educating voters that does not promote one candidate over another is allowed).

¹⁶See Elizabeth J. Kingsley, *Challenges to "Facts and Circumstances"—a Standard Whose Time has Passed?*, 20 Tax. of Exempts 5, at n.7–9 (Mar./Apr. 2010) (citing Rev. Rul. 81-95, Rev. Rul. 2004-6, and I.R.S. Priv. Ltr. Rul. 9652026 (Dec. 27, 1996)).

Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons...and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Although section 501(c)(4) provides that an organization must be organized “exclusively for promotion of social welfare,” the Treasury regulations provide for more flexibility than those relevant to 501(c)(3) organizations. Specifically, Treasury regulations allow (c)(4) organizations to intervene in political campaigns as long as the organization’s primary purpose is social welfare.¹⁷ Although the regulations do not define “primary,” it is certainly less than the statutory term “exclusively.” Moreover, engaging in a political campaign is not considered a social welfare function.¹⁸ Thus, under current rules, a section 501(c)(4) organization may intervene in political campaigns, but that activity may not be its primary purpose. It is important to emphasize that whether tax-exempt organization’s activity is considered intervention in a political campaign is determined by the tax law jurisprudence not election law jurisprudence.¹⁹

Section 501(c)(4) organizations generally do not have to pay tax on their income, but they do not receive the additional subsidy received by section 501(c)(3)s that flows from the deductibility of contributions from the payor.²⁰ Although there were efforts in Congress to require disclosure for section 501(c)(4) organizations when disclosure provisions were added to section 527, the final version only required disclosure for section 527 political organizations.²¹

Although section 501(c)(4) organizations have no requirement to publically disclose donations, they are required to file an annual information return, Form 990, with the Internal Revenue Service.²² The Form 990 provides significant information regarding the organization’s activities, including the names and addresses of donors who contribute over \$5,000.²³ Organizations and the IRS are required to provide 990s to the public but organizations may and the IRS must redact information regarding donors to the organization.

C. 501(c)(5) and (c)(6) organizations (labor unions and business leagues)

Labor unions and business leagues are tax exempt and regulated in a manner very similar to section 501(c)(4) organizations. Section 501(c)(5) organizations are “labor, agricultural, or horticultural

¹⁷Similar requirements apply to (c)(5) and (c)(6) organizations. They must be primarily engaged in labor or business league activities. Gen. Couns. Mem 34, 233 (Dec. 3, 1969) (political intervention cannot be the primary activity of a 501(c)(5) or 501(c)(6) organization); John Francis Reilly and Barbara A. Braig Allen, *Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5), and (c)(6) Organizations*, EXEMPT ORGANIZATIONS: TECHNICAL INSTRUCTION PROGRAM FOR FY 2003, at L-2 (2002) (same), available at <http://www.irs.gov/pub/irs-tege/eotopicl03.pdf>.

¹⁸I.R.C. § 501(c)(4); Treasury Regulation § 1.501(c)(4)-1(a)(2)(i) provides that an organization qualifies as a section 501(c)(4) organization if “it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.” Treasury Regulation § 1.501(c)(4)-1(a)(2)(ii) (as amended in 1990) provides that “the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.” See also, Rev. Rul. 81-95, 1981-1 C.B. 332 (§ 501(c)(4) organization may participate in a political campaign as long as its primary function (its other activities) are social welfare functions).

¹⁹The regulations do not define “primary purpose.” Democracy 21 and the Campaign Legal Center have recently filed a “Petition for Rulemaking” arguing that the Service should use an “insubstantial amount” test instead of a “primary purpose” test. Many practitioners argue that “primary purpose” is less than 50 percent. As discussed later in this article, the 50 percent standard makes sense when one examines the entire regulatory regime for tax-exempt organizations. See “Petition for Rulemaking,” available at http://www.campaignlegalcenter.org/attachments/IRS_PETITION.FINAL.7-27-2011.pdf.

²⁰They are subject to tax on investment income to the extent of the amount they spend on political activity. See I.R.C. § 527(f).

²¹The original versions of the bills introduced in the House and Senate only dealt with the regulation of 527 political organizations. There were efforts in the Republican controlled House to broaden the disclosure requirements to include all tax-exempt organizations, and the bill reported by the House Ways and Means Committee included broad disclosure requirements. See H. Rep. No. 106-702, at 9–11. It set a very low level for disclosure of contributions and expenditures and did not require disclosure by corporations. There were serious concerns from the tax-exempt community that the provisions in the Committee bill were too broad. The Democrats offered a substitute that would have required disclosure by all organizations (taxable and non-taxable) that spent more than \$10,000 on electioneering activities and required disclosure of donations over \$1,000. H. Rep. No. 106-702, at 40–41. The House ultimately suspended its rules and took up the original pre-committee version of the bill, which provided for disclosure only of contributions and expenditures of § 527 political organizations. The Senate passed the House version of the bill.

²²I.R.C. § 6033(a); Treas. Reg. § 1.6033-2.

²³Treas. Reg. § 1.6033-2(a)(2)(ii)(f).

organizations,” and section 501(c)(6)s are generally business leagues or chambers of commerce. These organizations are also tax-exempt with regard to the organizations’ income. Just as section 501(c)(4)s, donations to these organizations are not deductible by the payor as charitable contributions, and the organizations may intervene in political campaigns as long as it is not the organization’s primary purpose.²⁴ In addition, like section 501(c)(4)s, the Code does not require, except in very limited circumstances, section 501(c)(5) and section 501(c)(6) organizations to disclose publicly the identities of their contributors or, for the most part, of the recipients of their expenditures.²⁵ In addition, if campaign intervention became the primary purpose of the above organizations, the disclosure provisions in section 527 would apply to the organization.²⁶

D. Section 527 organizations

Prior to the passage of section 527, many political organizations did not qualify as tax-exempt under any of the above sections because their primary activity involved intervention in a political campaign. No other type of tax-exempt organization is allowed to have intervention in a political campaign as its primary purpose. Congress’s solution was to create a tax-exempt category under section 527 for organizations whose primary purpose was to influence elections.²⁷ Just like section 501(c)(4), (c)(5), and (c)(6) organizations, a section 527 organization is generally exempt from tax on its income, and donations to section 527 organizations are not deductible by the donor. A section 527 organization is an organization “operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures” to influence the “selection, nomination, election, or appointment of any individual to any Federal, State or local public office...”²⁸ Unlike section 501(c)(4), (c)(5), and (c)(6) organizations, contributions to section 527 organizations are also statutorily exempt from the gift tax.²⁹

Prior to 2001, the major tax regulatory difference between the various tax-exempt organizations (other than section 501(c)(3) organizations) was the purpose of the organization.³⁰ There was very little advantage to using one entity over another so entity planning or entity manipulation based on tax considerations was almost non-existent.³¹ Con-

gress shifted this balance when it added disclosure provisions to section 527. Under the disclosure provisions in section 527, most section 527 organizations are now required to disclose the sources of contributions in excess of \$200 and the recipients of expenditures in excess of \$500 on periodically filed reports that are publicly available through a website maintained by the IRS.³² These provisions were not added to sections of the Code regulating other tax-exempt organizations, so organizations that do not want to disclose this information now have an incentive to try to qualify as another type of tax-exempt organization.

Lastly, one important facet of the regulatory scheme is that section 527 appears to have been written in a way that makes inclusion into its regulatory regime mandatory.³³ Congress would naturally have been concerned that organizations would avoid the disclosure provisions either by not filing as a section 527 organization or by choosing a different tax-exempt form even though those organizations were the type of organization the section was trying to regulate. An organization is subject to section 527 even if it does not apply for section 527 status. Under section 527(i) an organization must give notice to the Secretary that it

²⁴Donations to section 501(c)(5) and section 501(c)(6) organizations may be deductible as business expenses, but the deduction is effectively denied to the extent such donations are used for political intervention or lobbying. *See* Reilly and Allen, *supra* note 17, at L-19 to L-20 (describing this effective denial of deductibility).

²⁵I.R.C. § 501(c)(5), (6), Gen. Couns. Mem 34, 233 (Dec. 3, 1969) (political intervention cannot be the primary activity of a 501(c)(6) organization).

²⁶*See infra* Part I.D (describing provision in § 527).

²⁷I.R.C. § 527(e)(1) (2002).

²⁸26 C.F.R. §1.527-2(a).

²⁹I.R.C. § 2501(a)(5) (2002).

³⁰Pub. L. No. 106-230, 114 Stat. 477 (2000) (codified at 26 U.S.C. § 527 (2001)).

³¹This is not true with regard to the use of (c)(3)s. Because contributions to 501(c)(3)s are deductible by the donor, there is significant planning with regard to whether an organization could organize as a (c)(3) or whether the organization should create a (c)(3) with a connected (c)(4) or 527.

³²I.R.C. § 527(j)(1), (j)(3)(A), (j)(3)(B) (2002).

³³*See* Nat’l Fed’n of Republican Assemblies v. United States, 148 F. Supp. 2d 1273, 1282 (S.D. Ala. 2001); Nat’l Fed’n of Republican Assemblies v. United States, 218 F. Supp. 2d 1300, 1308 n.7. (S.D. Ala. 2002); Field Serv. Adv. 200037040 (indicating that § 527 is not an elective provision); Rev. Rul. 2003-49 (Answer 20: indicating that an organization is subject to 527 if it meets the definition of political organization in § 527(e)).

wishes to be treated as a section 527 organization. A section 527 organization that does not give notice is subject to tax under section 527(i)(4). Thus, according to the IRS, an organization is a political organization if it meets the definition in section 527(e) even if the organization does not notify the Secretary under section 527(i).³⁴ It is simply a political organization that has failed to make disclosures under section 527(i). Thus organizations seeking to avoid section 527's regulatory regime by forgoing tax-exempt status may find themselves forced into 527, resulting in all their contributions and expenditures being subject to tax.³⁵

II. QUICK REGULATORY MEASURES TO PROVIDE TRANSPARENCY WITH REGARD TO TAX-EXEMPT ORGANIZATIONS

The current campaign finance disclosure regime is failing to achieve its goal of requiring disclosure for campaign related spending. In many cases, individuals and organizations are either forming or using tax-exempt organizations (sections 501 (c)(4), (c)(5), and (c)(6) organizations) as a conduit for undisclosed campaign intervention. This regime was not intended by Congress, and the incoherence in our campaign finance disclosure rules will negatively impact both the anti-corruption and voter information interests that are important for a sound election system. Although an ideal system would integrate election law disclosure provisions and tax law disclosure provisions, something less ideal can be done relatively quickly to close current loopholes used by many groups engaged in independent expenditures.³⁶ The Treasury has the power to require further disclosure of tax-exempt organizations through regulations, and the Treasury should seek to do so both to stem the abuse of tax-exempt status by independent organizations and to provide further coherence to the law of tax-exempt organizations.

A. Current problem with campaign finance disclosure provisions

In 2001, Congress sought a mechanism to provide for disclosure of campaign related independent expenditures.³⁷ Under existing law, campaign spending that was funneled through PACs was subject to a fairly extensive disclosure regime.³⁸ Non-PACs, however, were able to spend large sums of money influencing

elections without disclosing those contributions. Entities achieved this end by claiming that the organizations were not PACs because they did not engage in express advocacy as defined by the Court in *Buckley*.³⁹ Because these organizations argued they were not PACs, they claimed they were not subject to any of the disclosure provisions in FECA. In many cases, these organizations engaged in advertisements that were clearly ads aimed at promoting or attacking a particular candidate. The ads avoided using the "magic words" in *Buckley*, like "vote for" or "vote against," but were clearly not merely discussing issues.⁴⁰ By avoiding express advocacy, IGs were able to engage in unlimited advocacy, and the organizations were not required to disclose contributions or expenditures.

Congress took two approaches to close what it saw as a subversion of the disclosure provisions in FECA. First, as discussed earlier, since most of these groups were organized as political organizations under section 527 of the Internal Revenue Code, Congress added disclosure provisions to

³⁴Field Serv. Adv. 200037040.

³⁵In addition to the public disclosure requirements in the statute, § 527 organizations must also file a yearly information return, Form 990, with the Service. I.R.C. § 6033(g).

³⁶Although the Court in *Buckley* indicated that independent expenditures were not corrupting because they were independent of candidates, recent history of political operatives forming independent groups, and the almost party-like activity of these groups, seriously call that assumption into question. Large independent contributions where the donor, recipient, and candidate know of the donation, but are secret from everyone else, pose the most serious risk for corruption.

³⁷For a more thorough discussion of the disclosure provisions in BCRA, see Ciara Torres-Spelliscy, *Hiding Behind the Tax Code, the Dark Election of 2010 and Why Tax-Exempt Entities Should Be Subject to Robust Federal Campaign Finance Disclosure Laws*, NEXUS CHAPMAN'S JOURNAL OF LAW AND PUBLIC POLICY (May 6, 2011), available at SSRN: <http://ssrn.com/abstract=1833484>.

³⁸11 C.F.R. § 104.3(b)(3)(vii)(A); § 104.4(a)-(c).

³⁹The Supreme Court in *Buckley* limited several provisions in the Federal Election Campaign Act to communication that expressly advocates the election or defeat of a candidate. *Buckley v. Valeo*, 424 U.S. 1, 79-80 (1976). Although the jurisprudence is not completely settled on this issue, courts have generally required certain "magic words" for communication to be considered express advocacy. Those words were set out in footnote 52 in *Buckley*. 424 U.S. at 44. (magic words include "vote for," "elect," "support"); see, e.g., Edward B. Foley, *The "Major Purpose" Test Distinguishing Between Election-Focused and Issue-Focused Groups*, 31 N. KY. L. REV. 341 (2004); Richard L. Hasen, *The Surprisingly Complex Case for Disclosure of Contributions and Expenditures Funding Sham Issue Advocacy*, 48 UCLA L. REV. 265 (2000).

⁴⁰*Buckley*, 424 U.S. 1, 44, n.52 (1976).

section 527. These provisions required section 527 organizations to either disclose contributions and expenditures, or pay a tax at the highest corporate rate (now 35%) on any non-disclosed contribution or expenditure.⁴¹ This disclosure provision only applied to 527 political organizations.⁴²

Second, soon after adding disclosure provisions to section 527 of the Code, as part of the Bipartisan Campaign Reform Act of 2001 (BCRA), Congress provided for the disclosure of contributions and expenditures for “electioneering communication.”⁴³ Electioneering communication is defined as broadcast communication that refers to a “clearly identified candidate for Federal office” and is within 60 days of a general election or within 30 days of a primary.⁴⁴ Congress therefore targeted for disclosure both a type of organization (527) and a type of activity (electioneering communications).

The FEC, however, issued regulations in interpreting BCRA that significantly weaken the BCRA disclosure provisions. The regulations also enable donors to use section 501(c)(4) social welfare organizations (and labor unions and business leagues) as a means of avoiding disclosure. The FEC regulations provide that an organization must disclose donations if the donation is made for the purpose of electioneering communication, but if the funds are not designated for electioneering communication they need not be disclosed (even if they are used for such activity).⁴⁵ Organizations wishing to keep donors’ names confidential can achieve that end merely by having the donors make contributions to a section 501(c)(4) (or other, non-527, non-PAC) organization without designating the contribution for a particular advertisement or communication.

Political operatives have therefore designed the following type of plan for engaging in undisclosed political advocacy: Six months before an election a major political operative highly connected with a political party or candidate creates a section 501(c)(4) organization. Upon creation, the organization files its articles of incorporation as a corporation with a state. Although there is an application for exemption (Form 1024) that the organization can file with the Service to seek recognition of section 501(c)(4) status, the organization is not required to do so. The entity is required to file an annual information return (Form 990), but that form is not required to be filed until the fifteenth day of the fifth month following the end of the taxable year.⁴⁶ In addition, an entity can request a six-month extension, which the

IRS routinely grants. So after forming the organization, the entity does not need to file anything with the Service for 22.5 months from the date of formation if it chooses to have its fiscal year begin at the time of its formation and requests the routine six-month extension for filing.⁴⁷ The organization claims to be a section 501(c)(4) social welfare organization and starts engaging in political activity. The organization might actually be more properly classified as a section 527 political organization, but there is no check on the organization until it files its Form 1024 (not required) or its Form 990 (in 22.5 months). The organization’s claim that it will engage in social welfare activities thus qualifies it for section 501(c)(4) status, and there is no immediate validation of this claim by the IRS. Furthermore, the organization does not comply with the disclosure provisions under section 527 because it claims that intervening in an election is not its primary purpose.

The organization then receives money from large political donors that are not earmarked for specific activities. Because these donations are to the section 501(c)(4) for “general” activities of the organization, the donations are considered donations to the organization and not for electioneering communications, so they do not need to be disclosed under the FEC’s interpretation. Given the (claimed) section 501(c)(4) status, there are no provisions in the Code to require public disclosure of the donations.⁴⁸

⁴¹I.R.C. § 527.

⁴²As noted earlier, efforts to extend the disclosure provisions to other tax-exempt organizations were not successful. See DISCLOSE Act, H.R. 5175, 111th Congress (2010); S. 3628, 111th Congress (2010).

⁴³Bipartisan Campaign Reform Act of 2001, H.R. 2356, 107th Cong., Title II, § 201 Cong. (2002). See 2 U.S.C. § 434(f) (providing for disclosure if electioneering communication exceeds \$10,000. Must disclose contributions of \$1,000 and expenditures over \$10,000); see *supra* note 17.

⁴⁴2 U.S.C. § 434(f)(3).

⁴⁵Electioneering Communication, 72 FED. REG. 72899, 72911 (Dec. 26, 2007) (codified at 11 CFR Part 104, 114).

⁴⁶I.R.C. § 6033.

⁴⁷Treas. Reg. § 6033-1(e).

⁴⁸Moreover, if an entity or person wants to give to an independent § 527 political organization, but does not want the contribution disclosed, the party can donate the money to a § 501(c)(4) organization and the § 501(c)(4) organization can donate the money to the § 527 organization, or to several § 527 organizations. The only report disclosed by the § 527 organization would be the donation by a § 501(c)(4) organization. Thus, the company can use a § 501(c)(4) organization as a conduit to avoid disclosure of contributions made to a § 527 organization.

Once it receives an influx of money from large donors, the organization starts spending heavily in an election. It avoids engaging in “express advocacy” as defined by *Buckley v. Valeo* and thus avoids PAC status. Instead, it engages in electioneering communication and therefore has to disclose the expenditures. In this case, the organization discloses that it engaged in various electioneering communication, but as long as its donors avoid designating their contributions for such activities no disclosure of donor identities is required under current FEC rules.

At the end of the election, if it wishes, the organization can close up shop. It still needs to file a Form 990, but it has already succeeded in its goal. It has spent heavily on election activity and may have influenced an election, while being able to keep its donors secret. If it plans on complying with the law, the organization must still engage in a significant amount of social welfare activity to qualify as a social welfare organization. Furthermore, since these organizations do not have to file anything publically or with the Service for 22.5 months, there is no real check on whether these organizations are complying with the law until well after at least the first election in which the organization is involved.

Although there was a significant increase in election activity by 501(c)(4)s in the 2008 election, the increase in available contribution sources post-*Citizens United* caused even more interest in using 501(c)(4) organizations as independent political campaign entities.⁴⁹ While significant information regarding the operation of these entities is not yet available, published reports indicate that at least some of the entities claiming section 501(c)(4) status are probably not complying with the law.

Crossroads Grassroots Policy Strategies (Crossroads GPS) is the 2010 classic example of an organization that claims to be a section 501(c)(4) organization but appears to operate far more like a section 527 political organization. Although nominally a 501(c)(4) organization, Crossroads spent millions of dollars in the 2010 election.⁵⁰ In a 2010 *New York Times* article, Steven Law, President of Crossroads GPS, indicated that the organization was not a political committee because it was promoting “a suite of issues that are likely to see some sort of legislative response.”⁵¹ Mr. Law may be correct that Crossroads GPS is not a political committee as defined by the Federal Election Cam-

paign Act or other election law rules. The organization could still be a section 527 political organization as defined by the Internal Revenue Code, however, and thus subject to the disclosure provisions in section 527.

Mr. Law’s comment that Crossroads GPS is promoting a “suite of issues” that are likely to have a “legislative response” is likely hinting at the idea that the organization’s activities are lobbying, and that lobbying is a social welfare purpose. Thus if Crossroads GPS primarily engaged in lobbying on issues, Crossroads GPS would qualify for section 501(c)(4) status. The actual activities by Crossroads GPS, however, appear far more candidate specific than lobbying. In addition, it is the tax law on political intervention that governs here, not the interpretations of election law by the Federal Election Commission. Since tax jurisprudence applies a facts and circumstances approach, Crossroads cannot satisfy its social welfare purpose under section 501(c)(4) by engaging in electioneering masked as lobbying. Under certain FEC rules, an advertisement can lambast a candidate and state at the end of the advertisement “call Senator Smith and tell him to vote for lower taxes” to avoid the reach of federal election laws because this may be considered grass roots lobbying and not express advocacy, and so not subject to the election law reporting and disclosure requirements. In the tax context, however, this type of communication will almost always be considered intervention in a political campaign.

More specifically, in Revenue Ruling 2007-41, the Treasury provided guidance with regard to what constitutes political intervention and set out examples of political campaigning by tax-exempt entities. The ruling specifically notes that activities short of express advocacy will be considered

⁴⁹Campaign Finance Institute, *Soft Money Political Spending by 501(c) Nonprofits Tripled in 2008 Election* (2009), Campaign Finance Institute, *501(c) Groups Emerge as Big Players Alongside 527s* (2008).

⁵⁰It is impossible to determine exactly how much Crossroads spent because some of its spending was not disclosed. The Center for Responsive Politics collects data on disclosed political contributions and expenditures. It reports that Crossroads GPS spent over \$17 million on campaign activity that it disclosed to the FEC. Center for Responsive Politics, *OpenSecrets.org*, report on Crossroads GPS, available at <<http://www.opensecrets.org/outsidespending/detail.php?cmte=Crossroads+Grassroots+Policy+Strategies>>.

⁵¹Michael Luo and Stephanie Strom, *Donor Names Remain Secret as Rules Shift*, N.Y. TIMES, Sept. 20, 2010.

campaign intervention and that the Service will look at all the facts and circumstances in reaching its determination.⁵² Factors include whether a candidate is mentioned, the statement expresses approval or disapproval of a candidate, the statement is near an election, the issue in the communication is one that is an issue in the campaign and distinguishes candidates, the communication is part of ongoing communication by the organization that is made independent of an election, and whether the timing is related to a non-electoral event.⁵³ The Service takes a fairly strict view of what constitutes campaign intervention when considering these factors. For example, Revenue Ruling 2007-14 explains that discussing an issue that separates candidates near in time to an election and urging people to use their power at the polls is campaign intervention.⁵⁴

In a report in the *Huffington Post*, Crossroads spokesman, Jonathan Collegio, explains that Crossroads is comfortably within the law.⁵⁵ But in his response to the reporter who wrote the report, Collegio appears to be applying election law and not the tax law surrounding section 501(c)(4) status. For example, Collegio is reported as having explained “GPS invested millions of dollars in social welfare issue advocacy advertising before the FEC’s 60 day reporting window last summer.”⁵⁶ He appears to be arguing that since the advertisements were not “electioneering communication,” they were not election advocacy. The key question under the tax law, however, is whether the advocacy outside the reporting window was actually issue advocacy, or whether under the facts and circumstances test it would constitute intervention in a political campaign. Since one component of the facts and circumstances test is the timing of the activity, the fact that the advertisement ran at a certain time is relevant, but it is not determinative. In this case, full consideration of the timing prong actually hurts Crossroads, because Crossroads was formed soon before the election and its communications were closely tied to the election.⁵⁷

For example, on August 25, 2010, a little over 60 days before the 2010 election, Crossroads GPS announced that it was going to spend over \$2 million on “three new issue advertisements . . . in Pennsylvania, California, and Kentucky.”⁵⁸ Whether these are “issue advertisements” for purposes of election law is unclear, but they are clearly political intervention under the facts and circumstances test. One advertisement provided:

We’re hurting but what are they doing in Washington? Congressman Joe Sestak voted for Obama’s big government health care scheme. Billions in job-killing taxes and higher insurance premiums for hard hit families. Even worse Sestak voted to gut Medicare, a \$500 billion dollar cut, [and] reduce benefits for 850,000 Pennsylvania seniors. Higher taxes and premiums, fewer jobs, Medicare cuts—the Sestak/Obama plan costs us too much. Tell Congressman Sestak [to] stop the Medicare cuts.⁵⁹

This advertisement is not electioneering communication, and thus is not subject to disclosure under the electioneering communication provisions because the advertisement was just outside the electioneering communication 60-day window. Crossroads GPS may also be able to avoid disclosure under FECA by claiming that this is not express advocacy under election law standards because it avoids “magic words.” It cannot, however, claim that this is issue advocacy for purposes of justifying a social welfare purpose under section 501(c)(4). Applying the facts and circumstances test leaves no doubt that these advertisements are political intervention. The ad mentions a candidate. The statement expresses clear disapproval of the candidate. The statement is near in time to an election and the issue in the communication is one that is an issue in the campaign and distinguishes candidates. The communication is not part of ongoing

⁵²See Revenue Rule 2007-41 (“Issue Advocacy and Political Campaign Intervention,” Exs. 14–16).

⁵³*Id.*

⁵⁴*Id.* (Fact Sheet ex. 16).

⁵⁵Dan Froomkin, *IRS to Take on Karl Rove? Tax Laws Could Take a Bite out of Secret Political Spending*, HUFFINGTON POST, May 25, 2011, available at http://www.huffingtonpost.com/2011/05/25/irs-karl-rove-crossroads-tax-law-donor-disclosure_n_866428.html.

⁵⁶*Id.*

⁵⁷See *Can’t Afford Patty* (Oct. 4, 2010)(commercial by Crossroads GPS attacking Senator Patty Murray), available at http://www.youtube.com/watch?v=nBJTiXvM3_4; *Hurting for Certain* (commercial by Crossroad GPS attacking Congressman Sestack), available at <http://www.youtube.com/watch?v=NCB1bj9nOMs>.

⁵⁸Crossroads GPS, Press Release, *Crossroads GPS Launches New Issue Ads In Pennsylvania, California and Kentucky*, Aug. 25, 2010.

⁵⁹Crossroads GPS provides a link to the advertisement on its Web site. See <http://crossroadsgps.org/news/crossroads-gps-launches-new-issue-ads-pennsylvania-california-and-kentucky>.

communication that is independent of the election and the timing is not related to a non-electoral event. The fact that the end of the ad tells Congressman Sestak to stop Medicare cuts does not outweigh these other facts, given that the Obama plan had already passed and the votes had already occurred on the alleged cuts. Looking at all of the relevant facts and circumstances, this ad was not an ad lobbying for an issue, but was instead an attack on Congressman Sestak as a candidate for re-election.

Moreover, Collegio explained that American Crossroads GPS raised approximately 43 million dollars in 2010.⁶⁰ Since Crossroads spent a significant amount on electioneering communications, much of which will likely be deemed political intervention by the IRS as well, Crossroads has very little basis for claiming its primary purpose is social welfare. Because of the act of disclosure of its activities, it is impossible to tell the magnitude of Crossroads GPS's activities and how much it spent on social welfare activities versus political campaign activities at this time, but what is clear is that Crossroads GPS cannot import the election law definition into the tax code. Based on the facts and circumstances test, many of Crossroads GPS's so-called issue advocacy advertisements should be deemed intervention in a political campaign. This strongly suggests that it should not qualify as a section 501(c)(4) organization.⁶¹ While not all of Crossroads GPS's activities would be considered intervention in a political campaign, social welfare activities appear to have been a relatively small proportion of Crossroads GPS's efforts. For example, in 2011, Crossroads GPS ran a series of advertisements criticizing unions that support government workers. Although these advertisements mention Obama, they are far from an election and are not candidate specific. These types of advertisements would likely not be considered political intervention.⁶²

Where Crossroads GPS went, it appears that others will soon follow. According to recent reports, Democratic-leaning organizations are forming section 501(c)(4) tax-exempt organizations to operate in a similar fashion to Crossroads GPS.⁶³ It is too early to document their activities, but at least one report indicates that these left-leaning organizations are already attracting significant funds.⁶⁴ If there is no action soon, nominal section 501(c)(4) organizations may become the primary vehicle for independent campaign activity, and large undisclosed

contributions and expenditures may become the norm. Crossroads and other organizations may be willing to take an aggressive position with regard to their tax-exempt status because they know the Service does not want to get involved in these types of political issues. The Service is principally interested in fairly collecting revenue. It is very sensitive to claims that it is acting in a political manner, and the impression of a politicized Internal Revenue Service hurts its overall mission. The moment the Service examines Crossroads or any other politically active 501(c)(4) organization, there will be assertions of political manipulation. Crossroads and others know that such assertions will cloud the Service's intentions and dampen the sting of any enforcement action. It also means that the Service will pay a high price for enforcing the political intervention provision.

⁶⁰*Id.*

⁶¹There are many complaints regarding the facts and circumstances test and practitioners have sought more certainty from the Service with regard to the test. Some have also argued that the facts and circumstances test violates the First Amendment. Although a thorough examination of the constitutionality of the test is outside the scope of this article, most of the complaints regarding the test have involved the application of the test to § 501(c)(3) organizations because the test has the impact of prohibiting the organization from engaging in the questioned speech. Thus some argue that the test is vague and its application to 501(c)(3) organizations restrains organizations from engaging in permissible speech. While I believe the test is constitutional in the 501(c)(3) context, it is certainly constitutional in the 501(c)(4) context where it is solely used as a sorting device. It helps determine whether an organization is a social welfare organization or a political organization. It has no impact on whether the organization can engage in the activity and therefore does not restrict speech. See Elizabeth J. Kingsley, *Challenges to "Facts and Circumstances"—a Standard Whose Time has Passed?*, 20 TAX. OF EXEMPTS 5, at n.7–9 (Mar./Apr. 2010) (arguing that the facts and circumstances standard is unconstitutionally vague as applied to 501(c)(3) organizations and highly problematic with regard to 501(c)(4) organizations).

⁶²Although the advertisements mention President Obama, the Presidential Campaign is not near in time and the commercial is far more of an anti-union advertisement than an attempt to intervene in an election campaign. An example of its anti-union advertisement can be found at <http://crossroadsgps.org/news/crossroads-gps-launches-new-nationwide-issue-ad-government-employee-unions>.

⁶³Froomkin, *supra* note 55 ("If people look at what Crossroads did over the course of the last couple of years, that'll give them a good sense of our activity," quoting Bill Burton, former aide to President Barack Obama co-founder Priorities USA).

⁶⁴Kenneth P. Vogel, *Both Sides Now in Dash for Anonymous Cash*, POLITICO, Aug. 9, 2011, available at <http://www.politico.com/news/stories/0811/60731.html>.

In fact, in May 2011, when it was reported that the Service was examining some taxpayers' returns for failure to pay gift tax on contributions to 501(c)(4) organizations, Republican Senators sent a letter to the Service investigating whether the action was political.⁶⁵ The letter appears to have been effective in that over the summer the Service announced it was dropping those audits.⁶⁶ Similarly when the Service audited the NAACP after comments by its President, the NAACP claimed that the audit was due to criticism of President Bush and, in response, Senator Baucus, Chair of the Senate Finance Committee, sent a letter to the Commissioner of the Internal Revenue expressing his concern about the audit.⁶⁷ Political operatives know that the Service is ill suited to take enforcement action in the political arena, and that in any event, any action will be post-election, after the activities have already occurred.

B. The current statutory framework and the role for regulation

The current regulatory structure that applies to tax-exempt organizations creates incentives for organizations to push the envelope regarding their proper organizational form. The Treasury has the authority to create coherence in the current statutory structure and should do so by, among other things, requiring greater disclosure by non-501(c)(3) tax-exempt organizations.

Under the pre-2001 version of the Code, entities chose the proper tax-exempt classification based on the activities of the organization. For the most part, all tax-exempt organizations, with the exception of 501(c)(3) organizations, received the same benefits. The organizations were not subject to tax on their income, including donations, but donations to the organizations were not tax deductible as charitable contributions. Section 527 was the home for entities that had a primary purpose of intervening in campaigns, section 501(c)(4) was for social welfare organizations, section 501(c)(5) was for labor unions, and section 501(c)(6) was for business leagues. The question was a basketing one—what was the proper home for the organization, given what it was trying to accomplish?

Under a literal reading of the statute, however, there was no home for an organization that wished to engage in some campaign intervention, but for which campaign intervention was not the primary

purpose. (If campaign intervention was its primary purpose it could be a section 527 political organization.) Under section 501(c)(4), social welfare organizations must be “operated *exclusively* for the promotion of social welfare” (emphasis added). Political intervention has not generally been thought of as a social welfare purpose, and the regulations to section 501(c)(4) provide that campaign activities are not social welfare activities. This interpretation made sense because if campaign activities were social welfare activities there would be no need for section 527, which governed political organizations. But this created a problem of classification for organizations that were primarily engaged in social welfare activities, but also engaged in some campaign activities. Such an organization would not be “*exclusively*” engaged in social welfare activities, under the ordinary meaning of “*exclusively*.”

Accordingly, there would be a gap in the statutory structure, with section 501(c)(4) providing entity status to social welfare organizations and section 527 providing entity status to political organizations. An organization that had a mix between social welfare and political activity could organize as a 527 political organization if that was the organization's primary purpose, but there was no entity status for an organization that primarily engaged in social welfare but also engaged in some political

⁶⁵Press Release, United States Committee on Finance, Senators to IRS: Questions Raised by Agency's Recent Actions Into Gift Tax Enforcement; Concern about Political Influence (May 18, 2011) (asking for names of individuals who made the decision to enforce the provision, correspondence between IRS employees, Treasury, and White House on the issue, and any analysis generated by the IRS regarding First Amendment issues related to the collection. The Senate requested the information in 9 business days.), available at <http://finance.senate.gov/newsroom/ranking/release/?id=ec29441e-aefd-4192-a628-d96966cf4231>.

⁶⁶See Memorandum from Steven T. Miller, Deputy Commissioner for Services and Enforcement, July 7, 2011, available at http://www.irs.gov/pub/newsroom/guidance_for_irs_sbse_estate_and_gift_tax_and_tege_exempt_organizations.pdf. For criticism of this IRS decision, see Letter from Marcus Owens to Emily S. McMahon, Aug. 8, 2011, available at <http://big.assets.huffingtonpost.com/McMahonletter.pdf>; Donald B. Tobin, Is Congress Politicizing the Tax Enforcement Process?, TAX NOTES TODAY, 2011 TNT 162-11, Aug. 22, 2011 (letter to the editor).

⁶⁷Press Release, Senate Finance Committee, Baucus Questions IRS's Investigation Regarding the NAACP (Oct. 29, 2004), available at <http://finance.senate.gov/newsroom/ranking/release/?id=f45c7e73-71b7-46e6-9407-0536b8458a7a>.

activity.⁶⁸ Under this reading, the statutory scheme would give tax-exempt status to organizations that exclusively engaged in political activity, to organizations that exclusively engaged in social welfare activities, and to organizations that engaged in a mix of political and social welfare activity where political activity was the primary purpose, but would deny tax-exempt status to social welfare organizations that engaged in a mix of social welfare and political activity where political activity was *not* the primary purpose. The problem with such a scheme is that it makes no sense. There is no good reason why Congress would want one type of mixed social welfare/political organization to be tax-exempt but not the other.

Treasury regulations create statutory coherence by providing more flexibility with regard to the purpose of a social welfare organization. The regulations allow section 501(c)(4) organizations to intervene in political campaigns, so long as the organization's primary purpose is social welfare—even though the statute states that such an organization must be operated “exclusively” for social welfare. Therefore, under the regulations, an organization that has the primary purpose of engaging in social welfare may intervene in political campaigns, so long as that activity is not its primary purpose. This made sense, because a regulatory structure prohibiting all campaign activity by 501(c)(4) organizations (which would arise from a strict textualist reading of the word “exclusively”) would have been inconsistent with other provisions in the Code related to other tax-exempt organizations—principally section 527. There is no good reason for allowing an organization with the primary purpose of intervening in campaigns to be tax-exempt but not allowing a social welfare organization, which would have been tax exempt in the same manner as a 527 political organization, to lose its exemption if it engaged in any campaign activity. The statutory scheme otherwise treated the organizations very similarly.⁶⁹ Until 2001, there was little advantage in choosing one organizational form over the other.

This all changed when disclosure provisions were added to section 527, and changed even more dramatically as corporate money began to flow into independent political groups after the Supreme Court's decision in *Citizens United*. Now there is a significant advantage to being classified as a section 501(c)(4) social welfare organization, because contributions to section 501(c)(4) organizations are not subject to the extensive disclosure provisions in section 527.

Organizations such as Crossroads GPS are therefore trying to claim that even though they engage in significant campaign related spending, their primary purpose is social welfare. The idea is that they will engage in enough social welfare spending to allow social welfare to be their primary purpose. At the moment it is impossible to tell whether these organizations are in fact meeting the primary purpose test, but in light of the magnitude of money they are spending on campaign intervention, it will be very difficult for some of them to credibly claim to be social welfare organizations. This is, however, a very difficult issue to police, and an easier way to address the concerns raised by this manipulation is to promulgate regulations requiring greater political activity disclosure by tax-exempt entities.

C. Justification for regulation

The Treasury has several justifications for seeking to promulgate regulations in this area. First, the Treasury has limited resources and can properly determine that it would rather close loopholes that incentivize entities to improperly organize with regard to tax-exempt form than attempt to audit thousands of organizations. Second, existing Treasury regulations expand the class of organizations that qualify for section 501(c)(4) status. The statute provides that section 501(c)(4) organizations must be exclusively engaged in social welfare activities. It is the Treasury regulation requiring only a primary purpose of social welfare to be a section 501(c)(4) organization, instead of an exclusive purpose, that has allowed some organizations to subvert the disclosure requirements in the Code. If the Treasury regulation expanding the reach of the statute is being abused, the Treasury has the authority to

⁶⁸ Arguably, if a 527 organization spent more than an insubstantial amount on social welfare activities, the social welfare activities would not be considered “exempt function” activities and the amount received for those activities would not be exempt under § 527 and thus might be subject to tax. See Treas. Reg. 1.527-2(b). Amounts spent on those activities, however, might still not be subject to tax because it is not clear that the amounts received to spend on those activities were “income” and thus subject to tax. While a thorough examination of this issue is outside the scope of this article, it is clear that § 527 organizations may engage in both political intervention activities and social welfare activities as long as the political intervention activity is the primary purpose of the organization.

⁶⁹ At that time, there was one major tax difference between 527 and 501(c)(4) organizations: Section 527 organizations are statutory exempt from the gift tax, while 501(c)(4) organizations are not.

limit that abuse. Moreover, the Treasury has an interest in ensuring that its regulations do not provide the basis for organizations to circumvent statutory requirements. Finally, and most importantly, the Treasury has an interest in creating a coherent set of rules governing tax-exempt organizations. The current rules regulating tax-exempt organizations do not provide for a coherent structure, and the Treasury has the authority to step in and create such a structure.

Treasury also has the authority to promulgate such regulations. Section 7805 of the Code provides the Secretary of Treasury with the power to prescribe “all needful rules and regulations for the enforcement of [the Internal Revenue Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.” In *United States v. Correl*,⁷⁰ the Court recognized the breadth of the Secretary’s power under section 7805:

Congress has delegated to the Commissioner, not to the courts, the task of prescribing “all needful rules and regulations for the enforcement” of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations “it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.” *Commissioner v. Stidger*, 386 U.S. 287, 296. The rule of the judiciary in cases of this sort begins and ends with assuring that the Commissioner’s regulations fall within his authority to implement the congressional mandate in some reasonable manner.

Were the Treasury to promulgate new rules for tax-exempt organizations, it would be acting squarely within its core function of enforcing the Internal Revenue Code. The interpretation of the statute embodied in the current regulations is providing a loophole with regard to another provision of the Code. This loophole is both causing enforcement problems and subverting the will of Congress in its enactment of another provision of the Code. The Treasury has the authority to enact regulations that will limit this abuse, reduce enforcement problems, and encourage compliance with congressionally enacted disclosure provisions.

Moreover, the Congress, in passing disclosure provisions in section 527, was providing for a statutory scheme to enhance voter information and decrease corruption and the appearance of corrup-

tion. New regulations will reinforce these goals and help ensure the proper enforcement of the rules. The Treasury therefore can and should use its authority under section 7805 to address the failures in the current regulatory structure.

III. CREATING A COHERENT STRUCTURE FOR THE REGULATION OF TAX- EXEMPT ORGANIZATIONS INVOLVED IN POLITICAL CAMPAIGNS

In the tax policy arena, there is a consistent pattern of legislation and then obfuscation. Legislators, regulators, and lawyers are constantly confronting new tax shelter schemes that are designed to manipulate and circumvent the statutory structure of the Code. We are now seeing the same type of pattern in the campaign finance arena. The problem is that legislative change cannot keep pace with the flexibility and manipulation of many who are involved in trying to win elections. The Treasury should, consistent with its authority under section 7805, step in with new regulations designed to cure some of the current defects. While coherent legislative action would be preferable, Treasury can more expeditiously implement regulations that will at least reduce the manipulation of tax-exempt status as a means of avoiding disclosure.

A. Require application for exemption

Although there is an application that tax-exempt organizations can fill out in order to seek recognition of their status as a tax-exempt organization, section 501(c)(4), (c)(5), and (c)(6) organizations are not required to submit an application.⁷¹ Organizations wishing to apply for tax-exempt status may file a Form 1024 with the Service, but there is no regulatory requirement that they do so. These organizations, however, are required to file an annual information return (Form 990).⁷² There have been administrative problems when organizations have filed a Form 990 but have not filed a Form 1024, so in many cases tax-exempt organizations file the Form 1024 to avoid administrative

⁷⁰389 U.S. 299 (1967).

⁷¹See I.R.C. § 505(c) (requiring 501(c)(9), (17), and (20) organizations to file for recognition). No similar requirement exists for 501(c)(4), (c)(5), or (c)(6) organizations.

⁷²I.R.C. § 6033(a).

headaches. Even if an organization files a Form 1024 to avoid a Form 990 filing issue, however, it can wait until several months after the close of its taxable year to do so.⁷³

Since organizations are not required to file a Form 1024, there is no automatic time at which the Service examines whether an organization meets the regulatory requirements of the statute. While the Form 990 provides significant information to the Service that could be examined by the Service to ensure compliance, that form is often filed too late to be used as a means of guarding against abusive planning by independent groups, particularly in the fast-paced world of campaign activity.

Ellen Aprill, in her recent work arguing for a requirement that section 501(c)(4) organizations file an application for exemption, points out that there are reasons besides bureaucratic ease that favor such regulation.⁷⁴ She notes that section 501(c)(4) organizations that engage in lobbying are only allowed to lobby if it is related to the exempt purpose of the organization, and an organization's purpose is usually set out in the application for exemption. In order to police the lobbying provision, the Service needs to be able to compare the Form 990 to the application for exemption.⁷⁵

For all of these reasons, the Treasury therefore should implement regulations requiring all section 501(c)(4), (c)(5), and (c)(6) organizations with contributions or expenditures above a high threshold (approximately \$100,000) to file a Form 1024.⁷⁶ In those cases, Treasury could require the Form 1024 to be filed within six months of an organization's incorporation. In addition, if an organization has over \$500,000, of contributions or expenditures, the organization should be required to file a Form 1024 within 30 days of its receipt or expenditure of a total of \$500,000 since that level of financial resources indicates both the capacity to complete the form in an expeditious fashion and the possibility for significant abuse absent such a short filing deadline. These limits are intentionally set high so that only sophisticated parties will be subject to the tighter deadlines.⁷⁷

B. Review of Form 1024

To ensure requiring applications leads to actual verification of claimed tax-exempt status, the Service should also set up procedures to quickly review Form 1024s that are filed based on the proposed regulations. If a tax-exempt organization is required to file a Form 1024 because of large donations or expendi-

tures, the IRS should examine the Form 1024 within two weeks, and provide an initial determination with regard to status within 30 days of receiving the Form 1024. This will provide certainty to organizations and reduce the possibility that organizations will later be reclassified as section 527 political organizations. Furthermore, the Service should publish the names of all tax-exempt organization that have been approved by the Service. Such prompt review should not prejudice applicant groups, especially since under existing law, an organization that is denied section 501(c)(4) status has significant administrative and judicial remedies, and can appeal the Service's determination in federal court.⁷⁸

C. Require disclosure of contributions and expenditures over \$25,000

The Treasury should promulgate regulations requiring tax-exempt organizations, excluding 501(c)(3) organizations, to disclose contributions and non-employee expenditures in excess of \$25,000.⁷⁹ Organizations should be required to disclose the

⁷³The Form 990 is due the fifteenth day of the fifth month following the end of the organization's taxable year. This means that an organization formed six months before an election could wait until eleven months after the election to file its Form 990. In addition, an organization can seek a sixth month extension with which to file its 990. See FSA 200046038 (discussing problem of organizations filing Form 990 without having previously filed a Form 1024).

⁷⁴Aprill, *supra* note 9, at 402.

⁷⁵*Id.*

⁷⁶This regulation is well within the Treasury's authority. In addition to the authority under § 7805, § 6033 specifically provides that § 501 organizations must file returns. It also gives the Secretary authority to require "other information" and to require additional "forms or regulations." The Secretary could easily determine that the filing of Form 1024 would assist in "carrying out the internal revenue laws" in this area. See I.R.C. § 6033(a)(1).

⁷⁷Here, as with other proposals in this article, the Treasury will need to create anti-abuse rules to prevent individuals or groups from disaggregating contributions or expenditures in order to avoid these rules, but such rules are common in tax statutes and regulations. See, e.g., I.R.C. § 4911(f) (providing rules for aggregating the finances of affiliated groups for purposes of applying the elective expenditure limit on lobbying by § 501(c)(3) organizations).

⁷⁸For example, see *Christian Coalition International v. U.S.*, 133 F. Supp. 2d 437, 438 (E.D. Va. 2001).

⁷⁹After notice and comment, one might decide that this amount should be set even higher. The point here is to address the information, anti-corruption, and coherence concerns addressed in this article. It might be that an even higher threshold will accomplish those goals. For example, Form 990 currently requires disclosure of employee salaries over \$100,000. Form 990, Part VII.

contribution and expenditure within seven days. The purpose of this regulation is to provide voters with sufficient information regarding the organization's activities, to inform voters about election activities, to enable the Service to enforce provisions dealing with tax-exempt organizations, to help reduce corruption and the appearance of corruption, and to help create a coherent structure for tax-exempt organizations by discouraging organizations from improperly manipulating formation choice in order to avoid the disclosure provisions in section 527.

The Treasury could easily implement regulations regarding the disclosure of expenditures, and the regulation would not be overly onerous with regard to major organizations. Implementation with regard to the disclosure of the name, city, state, and amount of contribution of donors is a little more problematic. The critical question is whether provisions in the Internal Revenue Code designed to protect a taxpayer's privacy would prohibit the Service from issuing regulations requiring an organization to publically disclose its large donors.⁸⁰

Tax-exempt organizations are already required to provide on Schedule B of Form 990 the name, address, and amount of donation of every person who donates over \$5,000 to the organization.⁸¹ Section 6104 also requires tax-exempt organizations to make the Form 990 available to the public, but the organization may redact the donor segment of the Form 990 from its public disclosure (and the IRS apparently must do so before it makes such returns public). An easy statutory fix would be to amend section 6104 and provide that only donors under \$25,000 may be redacted from the publicly released Form 990 for non-section 501(c)(3) tax-exempt organizations, and that disclosure must occur on a more timely basis. But Treasury need not wait for a statutory fix. Instead, it can and should implement a similar (although not identical) rule through regulation.

While there are provisions in the Code that protect taxpayer return information, these provisions do not foreclose the regulations I advocate. Section 6104(b) provides that “[n]othing in this subsection shall authorize the Secretary to disclose the name or address of any contributor to any organization or trust...” (emphasis added). The Treasury regulation explaining section 6104 provides that the “names and addresses of contributors to an organization...shall not be made available for public

inspection *under* Section 6104(b).”⁸² The statute and regulation, therefore, prohibit *the Secretary* from disclosing information obtained by the Secretary under section 6104, and this would clearly prohibit the Secretary (and therefore the IRS) from using section 6104 as authority for disclosing the donor information contained on the Form 990. It does not prohibit the Treasury, through regulation, from requiring *tax-exempt organizations themselves* to make disclosure to the public regarding information that might be contained on the Form 990. The distinction is an important one. The statute prohibits the Secretary or other IRS employees from using section 6104 as authority for disclosing information on the Form 990 that is deemed private. It does not prohibit the promulgation of regulations requiring taxpayers to disclose information to the public, as long as such regulation is within the Secretary's authority.

The limited scope of the prohibition in section 6104 makes sense when read in context. Section 6104 sets out requirements for public disclosure of return information by a taxpayer. It requires taxpayers to make their Form 990s public. Tax-exempt organizations understandably wanted to keep their large donors private. Public availability of Form 990 was designed to promote transparency in tax-exempt organizations and to ensure that tax-exempt status was not abused. When considering the balance between public disclosure of the Form 990 donors and keeping the donors private, Congress chose to allow tax-exempt organizations to redact information concerning donors. That balance, however, was limited to the specific circumstance in section 6104 where broad disclosure was required of all section 501 and 527 organizations. This determination regarding the balance between privacy and public disclosure was made before disclosure provisions were added to section 527 and before some tax-exempt organizations were being used as a mechanism to circumvent congressionally passed disclosure provisions in section 527.

Similarly, section 6103 of the Code, which prohibits the Secretary from disclosing return information, might be read to prohibit a regulation requiring disclosure. Section 6103, with many exceptions,

⁸⁰See I.R.C. § 6103.

⁸¹See Schedule B, Form 990.

⁸²Treas. Reg. § 301.6104(b)-1(b) (emphasis added).

requires the confidentiality of return information, and prohibits the disclosure of return information by the Secretary or his employees to the public. Section 6103 contains numerous exceptions including an exception for disclosure in judicial proceedings, criminal investigations, and for tax administration purposes.⁸³

The definition of return information is very broad. Return information includes:

a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense...⁸⁴

Despite the broad definition of return information, my proposal, which advocates disclosure by the tax-exempt organization of contributions over \$25,000 within seven days of the donation, does not run afoul of section 6103. Although this amount will likely be included on a taxpayer's Form 990, the regulation at issue would require the public posting of the information well before it was filed with the Service. Since the Form 990 will not yet have been filed, the information is not "received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return." The regulation would instead require disclosure of the information before it is return information, so section 6103 is not applicable. The Treasury still needs independent authority to issue the regulation requiring disclosure, but the regulation would not be in conflict with section 6103.⁸⁵

Even if the information at issue is return information, a regulation requiring that a section 501(c)(4) organization publically disclose its donors would not violate section 6103. The circuits are split with regard to cases interpreting the breadth and scope of section 6103. Some circuits have held

that the Service may disclose return information if that information is public. Under these rulings, the Service may disclose the name of a taxpayer involved in a criminal prosecution, if that name has been made public.⁸⁶ Other cases, however, have taken a strict reading of section 6103 and have not allowed the Service to disclose return information even if that information is in the public record.⁸⁷ All of these cases, however, center on the fact that the Service made the disclosure. Section 6103 is written to include disclosure by government employees. There is no violation if the information is not released by the Secretary or his employees.

My proposed regulation would require tax-exempt organizations to disclose the name and amount of contribution of their donors. The donors themselves are not the taxpayer at issue, and those donors are not protected by section 6103. Rather, section 6103 protects the tax return of the tax-exempt organization.⁸⁸

Nothing in section 6103, however, prohibits the Secretary from issuing a regulation requiring a tax-exempt organization to disclose certain information to the public, as long as the Secretary has the authority to issue the regulation. It may appear

⁸³I.R.C. § 6103(h), (i), (k).

⁸⁴I.R.C. § 6103(b)(2)(A). Section 6103 was passed in 1976 in response to fears that the Service was collecting mass amounts of information on taxpayers and that this data might be used for political advantage. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976). See General Explanation of the Tax Reform Act of 1976, Dec. 29, 1976, JCS-33-75, at p. 313.

⁸⁵Since the Form 990 lists all donors who contributed more than \$5,000, once the Form 990 is filed, disclosure by the Service of donors to the organization might violate § 6103 because once the Form 990 is filed, the information regarding the name and amount of a donor's contribution that is on the Form 990 is return information.

⁸⁶These cases generally arise when the Service wants to issue a press release involving a taxpayer who had been convicted of a tax crime. Since the proceedings are public record, Courts have argued that the disclosure of the tax crime is not a violation of section 6103. See *Lampert v. U.S.*, 854 F.2d 335 (9th Cir. 1988)(allowing disclosure).

⁸⁷See *Johnson v. Sawyer*, 120 F.3d 1307, 1323 (5th Cir. 1997) (finding violation even if information is in the public record if the tax return was the source of the information); *Rodgers v. Hyatt*, 697 F.2d 899, 906 (10th Cir. 1983) (finding violation of the disclosure of return information even if the information is public).

⁸⁸As discussed earlier, in my view § 6103 does not apply in this instance because the information being sought is not return information. The Secretary cannot disclose the donor portion of the Form 990, but the information being sought is provided before the taxpayer files a Form 990.

disingenuous to argue that the Secretary can require disclosure through regulation when the Secretary could not disclose the information independently. Section 6103 prohibits any government employee from “disclos[ing] any return or return information obtained by him *in any manner* in connection with his service as such an officer or an employee or otherwise or under the provisions of this section” [emphasis added]. One could argue that “in any manner” would prohibit the Secretary from issuing a regulation requiring section tax-exempt organizations themselves to disclose donors over \$25,000, since such donors appear on the Form 990 (especially in light of section 6103). Thus a regulation requiring disclosure of donors to a section 501(c)(4) organization would be the “manner” by which the government made the disclosure. The “in any manner” provision, however, still requires a disclosure *by an employee of the government*. A regulation issued by the Secretary requiring as a condition of tax-exempt status that organizations disclose donors over \$25,000 is simply not a disclosure by an officer or an employee of the government.⁸⁹

As discussed earlier, the Treasury has the authority to create rules governing section 501(c)(4), (c)(5), and (c)(6) organizations, and is responsible for enforcing these provisions. Current regulations take an expansive view of the statutory term “exclusively.” The Service has an interest in ensuring compliance with this expansive view and can reasonably make the judgment that public disclosure will serve as a better compliance tool than additional audits or further internal compliance. Nothing in sections 6103 or 6104 prohibit the Secretary from taking such action.⁹⁰

Finally, although in my view sections 6103 and 6104 do not prohibit the Secretary from issuing regulations requiring disclosure, the regulation could avoid any conflict with sections 6103 and 6104 by placing the burden of disclosure on the donor to the organization, instead of on the organization itself. This has significant administrative deficiencies, but disclosure by the donor would clearly not implicate section 6103 since it would not involve the disclosure of “return information” under section 6103.

The Treasury should therefore promulgate a regulation that would require all tax-exempt organizations to keep records of donors who contribute more than \$25,000 to the organization. These organizations would also be required to make avail-

able to the public, upon request, the name, city and state of each donor. They would not be required to file this information with the Service, but would be required to provide the information on a timely basis to those requesting the information. The organizations could be relieved of the requirement to provide the information upon request if they made the information available to the public through other means on a timely basis (for example, by posting the information on the Internet).⁹¹

A disclosure requirement at this level has the benefit of ensuring that small organizations are not overly burdened and would not be overly invasive for donors. In order to provide more coherence in this area, the Service could also relax its requirements with regard to the disclosure provisions under section 527. Even though section 527 provides for the disclosure of contributions of \$200, and expenditures of \$500, Treasury could, through regulation, raise the disclosure amounts and indicate that it will not take action against organizations that disclose contributions of \$5,000 or expenditures of \$10,000. Raising these thresholds would reduce the disclosure obligations for section 527 organizations and therefore make section 501(c)(4) status less attractive.

My recommended regulation requiring limited donor disclosure by some tax-exempt entities would provide information to voters regarding the supporters of the organizations and allow for a check on the possibility of corruption from large donors. Although the Supreme Court has indicated

⁸⁹Hrubic v. National R.R. Passenger Corp., 49 F.3d 1269 (7th Cir. 1995) (finding railroad employee not subject to § 6103). In its discussion, however, the court noted that “Congress set out to limit disclosure by persons who get tax returns in the course of public business—employees of the IRS, state employees to whom the IRS makes authorized disclosures, and private persons who obtain return information from the IRS with strings attached.” The idea behind the section is to protect private return information. Section 6103 is concerned about the source of the information and the person involved in the disclosure.

⁹⁰In fact, to the extent § 6103 was designed to prevent the Service from using information it possesses in a negative way, the public disclosure of the information by the tax-exempt organization ensures that everyone had access to the same information and that the information cannot be disclosed by the IRS for political reasons or on a selective basis.

⁹¹Similar regulations already exist with regard to some of the disclosure requirements for tax-exempt organizations. The regulations allow tax-exempt organizations to meet certain public disclosure requirements by making documents publically available on the Internet. See Treas. Reg. § 301.6104(d)-2.

that contributions to independent organizations are not corrupting, the landscape has changed considerably in recent years, especially since *Citizens United* was decided. As independent organizations play a greater role in the election system, the chance of non-coordinated spending having a corrupting influence increases.⁹²

There are obviously ways in which sophisticated parties could seek ways to circumvent the regulations I propose. Any regulation requiring disclosure must have anti-abuse provisions to deal with the aggregation of contributions, tracing of contributions, and the use of trusts to hide contributions. In addition, it is possible that taxable entities could be used as a mechanism for avoiding campaign finance disclosure; those seeking to influence elections while avoiding disclosure may therefore shift from tax-exempt organizations to taxable organizations in order to avoid any new disclosure requirements.⁹³ The Supreme Court's decision in *Citizens United* makes the use of for-profit organizations even more tempting, as exemplified by the recent revelation that a Limited Liability Company made a \$1,000,000 contribution to a SuperPAC supporting Mitt Romney's presidential campaign.⁹⁴ This incident highlights that the availability of alternative vehicles for campaign spending (although in that instance the ultimate source of the funds came to light relatively quickly, albeit not because of legally required disclosure). I recognize that disclosure obligations for tax-exempt organizations may encourage the use of alternative campaign vehicles. My goal in this article is to suggest a quick regulatory fix to the abuse of section 501(c)(4), (c)(5), and (c)(6). More sweeping recommendations for creating a coherent disclosure regime, including further regulation of taxable entities, are beyond the scope of this article but might also be considered by Treasury.

D. Provide safe harbor of "primary" under section 501(c)(4)

If the disclosure provisions apply to other tax-exempt organizations, there will no longer be a strong incentive to take aggressive positions with regard to the term "primary purpose" under section 501(c)(4). Treasury could, however, also promulgate regulations creating a safe harbor for primary purpose under section 501(c)(4). The safe harbor would provide that organizations that spend no

more than some fixed percentage on campaign intervention (say 25%) would be entitled to 501(c)(4) status, removing some of the uncertainty in this area for more cautious organizations seeking to comply with the law in good faith.⁹⁵

E. Allow for external complaints regarding abuse of tax-exempt status

In light of the abusive planning by some tax-exempt organizations, possible accusations of political manipulation by the Service, the secrecy regarding tax administration, and the lack of government resources, the Service should set up a public complaint process that would allow for the filing of complaints about the activities of tax-exempt organizations. The abuse of tax-exempt status has serious implications for the conduct of elections and democratic institutions. There is strong evidence that tax-exempt organizations are being misused as a means of avoiding campaign disclosure provisions, contrary to congressional intent when it added disclosure provisions to section 527. An external complaint process would provide confidence to the public that alleged abuses will be investigated, and that the decisions whether to investigate an entity are not based on partisanship by the Service.

Currently, individuals and organizations wishing to make complaints about an organization's violation of its exempt purpose may write letters to the Service outlining their complaints or file a one-page complaint form (Form 13909). There is, however, no public formal complaint process, no

⁹²The corruption rationale, however, is not required to uphold the constitutionality of a regulation requiring disclosure. See *Citizens United*, 103 S. Ct. at 914.

⁹³See Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next "Loophole"?*, 6 FIRST AMEND. L. REV. 41 (2007).

⁹⁴See Nicholas Confessore, *PAC Linked to Romney Gets a Mystery Gift*, N.Y. TIMES, Aug. 5, 2011, at A13.

⁹⁵Section 501(h) is an example of a safe harbor provision, and it applies to § 501(c)(3) organizations engaged in lobbying. It sets a relatively low threshold and in my view one that is too low in this context. Since my view is that § 501(c)(4) should apply to those organizations that are not § 527 organizations, I would read primary for § 501(c)(4) as the inverse of primary for § 527 political organizations. Thus in my view, the correct reading of primary in § 501(c)(4) for regulatory purposes is a purpose that is the organizations majority purpose. I do, however, believe that money is only one measure of an organization's purpose and that is why I have recommended a safe harbor at 25%.

standing for third parties to bring complaints, and no requirement that the Service investigate or act on the complaints. Indeed, the IRS, bound by section 6103, appears to be of the view it is not permitted to discuss if and how it handles any given complaint, unless that complaint results in actual revocation of tax-exempt status (which revocation the IRS is permitted to publicize). This is problematic from the standpoint of transparency, because interested members of the public have no way of discovering what action the Service has (or has not) taken in response to a complaint, and why. The Service should therefore investigate the feasibility of creating a formal, public complaint process that would allow for the submission of complaints and provide for the review of those complaints in a timely, non-partisan manner.

F. Nonpartisan enforcement process

One of the biggest problems in this area is creating an enforcement process that has credibility and keeps the Service out of partisan politics. The best solution is an independent commission made up of a rotating group of long-term employees from the Service.⁹⁶ Creating a truly independent commission would require congressional action. The Treasury, however, could set up an independent process within the Service to create a formal, non-partisan process for investigating complaints about tax-exempt organizations and political intervention.⁹⁷

Specifically, the Service could set up an independent division within the Service to investigate complaints regarding political intervention by tax-exempt organizations. The division would examine complaints made by taxpayers as well as complaints referred to the division by the Exempt Organizations Division. A rotating group of career employees would investigate complaints and refer credible complaints to a board. The board would consist of a rotating group of career IRS employees with more than 10 years of experience and could also include employees from the Inspector General's Office. The idea is to create non-partisan expertise and also to shield the group from political pressure and intervention.⁹⁸ Using career employees instead of appointments by party representatives helps avoid the deadlock that may happen when there are an equal number of people appointed to a review board from each party.

G. Possible examination of ethical issues

Individuals who practice before the Service are subject to the ethical rules promulgated by the Service. These regulations appear in what is referred to as Circular 230, and these regulations have been used by the Service to reduce aggressive positions by taxpayers, especially in the tax shelter area. Similar regulations could be promulgated with regard to advice given to tax-exempt organizations. In most cases, taxpayers and tax-exempt organizations are receiving assistance by tax professionals. Circular 230 has several current rules that might apply to aggressive planning with regard to formation choice. For example, section 10.22 of Circular 230 requires practitioners to exercise due diligence with regard to filing with the Service. This means a practitioner should not file a Form 990 return for a section 501(c)(4) organization or help create a section 501(c)(4) organization, in circumstances where the organization does not comport with the statute—even if it is unlikely that the Service will challenge the organization's status. A practitioner's signature operates as a type of seal of approval, signifying that he or she believes the organization's activities are proper under the Internal Revenue Code. Moreover, in reaching this conclusion, the practitioner may not simply rely on a client's representation that it will engage in social welfare when the practitioner has reason to know that the information is incorrect. The practitioner has a basic duty to make reasonable inquiries.⁹⁹

In addition, the Service has issued more stringent guidelines for practitioners advising on tax shelter transactions.¹⁰⁰ The Service could create similar guidelines for practitioners forming non-501(c)(3) tax-exempt organizations. These requirements could provide that the practitioner receive clarity regarding the organization's purpose and its activities before

⁹⁶See Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313, 1359–62 (2007).

⁹⁷The Service already sets up independent panels of career employees to investigate political intervention by (c)(3) organizations. See Internal Revenue Serv., *Political Activities Compliance Initiative: Procedures for 501(c)(3) organizations* (2005).

⁹⁸For a more thorough discussion of how this might work in the (c)(3) context see, Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313, 1330, 1361 (2007).

⁹⁹See Circular 230, § 10.34(d).

¹⁰⁰Circular 230, § 10.35.

filing documents with regard to the organization. The regulations could also require practitioners to examine various activities by the tax-exempt entities before filing the Form 990 to be sure that the organization actually complies with its status. Using rules in the tax shelter context as a model, the regulations could require the tax professional to reach a conclusion whether a tax-exempt organization's activities are really social welfare activities. The practitioner would then be required to reach an opinion that the organization was primarily engaged in social welfare activity under 501(c)(4) (or comparable purpose under other sections of the Code).

Such a regulation would be burdensome, but a similar regulation in the tax shelter context has been helpful in limiting tax shelter abuse. Further regulating practitioners may be another means of controlling the abuse in this area.

H. Constitutionality of regulating tax-exempt organizations

The regulations I propose here are constitutional and do not violate the First Amendment. The power of Congress to condition tax-exempt status has been thoroughly examined pre-*Citizens United*,¹⁰¹ and Ellen Aprill addresses this issue post-*Citizens United* in her article appearing in this issue.¹⁰² Because of her full treatment of the constitutional issue, I address it only briefly here.

In creating a comprehensive tax system, Congress had the power to determine that some types of organizations should be treated differently—more preferentially—than others. In deciding which organizations deserved preferential treatment, Congress could set out rules that those entities have to follow in order to receive the preferential treatment.¹⁰³ Therefore, Congress has the power to determine what activities enable an organization to qualify for tax-exempt status, and may require that such organizations meet certain conditions to obtain or retain that status.¹⁰⁴

Moreover, in *Regan v. Taxpayers With Representation*, the Court upheld a restriction in 501(c)(3) that prohibited (c)(3) organizations from engaging in substantial lobbying.¹⁰⁵ Restrictions on lobbying impose a far greater limitation on First Amendment activity than disclosure requirements. In *Taxpayers with Representation (TWR)*, the Court rejected TWR's claims that the restriction in section 501(c)(3) limiting lobbying for section 501(c)(3)

organizations violated the First Amendment. The Court concluded that Congress did not deny TWR the right to receive deductible contributions for other purposes, nor did it deny TWR any independent benefit based on its intention to lobby.¹⁰⁶ Instead, Congress “merely refused to pay for the lobbying out of public monies.”¹⁰⁷

¹⁰¹This section summarizes some of my earlier work on this topic. See Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 GA. L. REV. 611, 638 (2003); Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313, 1330, 1342–1347 (2007); see also Daniel Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 FLA. L. REV. 1 (2002).

¹⁰²Aprill, *supra* note 9.

¹⁰³See *Leathers v. Medlock*, 499 U.S. 439, 450–51 (1991)(power to discriminate is inherent in power to tax); *Regan v. Taxation with Representation*, 461 U.S. 540, 547 (1983)(the legislature has “great freedom” in taxation classification, and “the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination...”).

¹⁰⁴*Bob Jones University v. U.S.*, 461 U.S. 574 (1983). The Bob Jones case involved two churches. Goldsboro Christian Schools admitted that it had racially discriminatory policies. Bob Jones argued that its policy against interracial dating and interracial marriage was not discriminatory because it applied to all races. *Id.* at 605. In addition, the Court specifically rejected taxpayer's argument that since the discrimination was based on a deeply held religious belief, the organization was entitled to tax-exempt status. *Id.* at 603.

¹⁰⁵“We have no doubt but that this statute is within Congress' broad power in this area. TWR contends that § 501(c)(3) organizations could better advance their charitable purposes if they were permitted to engage in substantial lobbying. This may well be true. But Congress—not TWR or this Court—has the authority to determine whether the advantage the public would receive from additional lobbying by charities is worth the money the public would pay to subsidize that lobbying, and other disadvantages that might accompany that lobbying.” *Id.* at 550. Outside of the tax context, the Supreme Court has upheld statutes that condition the grant of federal funds on a recipient's willingness to comply with the restrictions in the grant, even if those restrictions would otherwise violate the First Amendment. See *Rust v. Sullivan*, 500 U.S. 173 (1991) (upholding provisions prohibiting Title X grant recipients from, among other things, referring a pregnant woman to an abortion provider as a method of family planning); *but see LSC v. Velazquez*, 531 U.S. 533 (2001)(finding unconstitutional a condition on legal services funding that prohibited a lawyer who received funds from challenging the validity of welfare laws. Lawyers could argue that the client was entitled to benefits under the law, but could not challenge the validity of the law); *Federal Communications Commission v. League of Women Voters*, 468 U.S. 364 (1984)(finding unconstitutional a ban on editorials by noncommercial broadcasters that received federal funds).

¹⁰⁶*Id.* at 544.

¹⁰⁷*Id.* at 545.

The regulations I propose here mainly involve the disclosure of contributors to and expenditures of tax-exempt organizations. In *Citizens United*, the Court noted that disclosure and disclaimer provisions might burden the ability to speak, but they do not prevent anyone from speaking.¹⁰⁸ The Court explained that disclosure provisions are therefore subject to a lower level of scrutiny, “‘exact[ing] scrutiny,’ which requires a ‘substantial relation’ between the disclosure requirement and a ‘sufficiently important’ government interest.”¹⁰⁹ The Court recognized that there might be situations where disclosure might subject people to threats or harassment and that in such situations the disclosure provisions might be unconstitutional as applied to those individuals.¹¹⁰ It found in that case, however, that the government’s interest in informing voters was sufficient to support disclosure absent concrete evidence of such threats, harassment, or other negative effects.

In reaching its conclusion, the Court recognized that there was evidence in the record in *McConnell* that “independent groups were running election-related advertisements ‘while hiding behind dubious and misleading names.’”¹¹¹ Again quoting its decision in *McConnell*, the Court recognized that the disclosure provisions served an important government interest of helping citizens “make informed choices in the political marketplace.”¹¹² The Court concluded by noting that “disclosure is a less restrictive alternative to more comprehensive regulations of speech.”

Thus, after *Citizens United*, there is even more indication that the Court is willing to accept campaign disclosure provisions. Disclosure provisions are justified by both the corruption concern outlined in *Buckley* and by a more general voter information interest, set out in both *McConnell* and *Citizens United*.¹¹³

In light of Congress’s general taxing power, the decision in *Taxpayers with Representation* upholding conditions on tax-exempt status, and the holding in *Citizens United* upholding the constitutionality of disclosure provisions, the regulations I propose here are constitutional and do not violate the First Amendment.¹¹⁴

IV. CONCLUSION

The Internal Revenue Code is not the ideal place to regulate the campaign activities of organizations. The

Service is not designed well to handle the political thicket that naturally comes from investigating organizations involved in political campaigns. The Service, however, has been placed in the thicket by Congress. Congress passed disclosure provisions in section 527 and those provisions have created incentives for political operatives to manipulate and abuse the system. Instead of having to audit organizations at very sensitive times, the Treasury should create a regulatory system that decreases the need for the Service to investigate tax-exempt entities that intervene in political campaigns. A system that requires broad based disclosure by all tax-exempt organizations except 501(c)(3)s will make it easier for the Service to stay out of politics. To the extent some policing of disclosure provisions is necessary, the reforms I suggest make that enforcement much easier—entities either properly disclosed or they did not. These proposals do not require the Service to engage in the

¹⁰⁸*Id.*

¹⁰⁹*Citizens United*, 130 S. Ct. at 914 (citing *Buckley* 424 U.S. at 64, 66, *McConnell*, 540 U.S. at 231–232).

¹¹⁰*Id.* at 914–15. Historically, such fears have been by under-represented groups who feared reprisal from the majority. See *NAACP v. Alabama*, 357 U.S. 449 (1958)(denied state the right to compel NAACP to turn over membership lists); *Talley v. California*, 362 U.S. 60 (1960)(not required to disclose name on handbill seeking equal rights because plaintiff had legitimate fear of serious reprisal). This historic nature of these cases evidences a concern about serious reprisals that had the risk of serious and even life threatening harm.

¹¹¹*Citizens United*, 130 S. Ct. at 914 (quoting *McConnell*, 540 U.S. at 197).

¹¹²*Id.*

¹¹³For a thorough discussion of Campaign Finance Disclosure post-*Citizens United*, see Richard Briffault, *Campaign Finance Disclosure 2.0*, 9 ELECTION L.J. 273 (2010).

¹¹⁴As discussed earlier, some have argued that the facts and circumstances test violates the First Amendment because it is overly vague. See, e.g., Miriam Galston, *When Statutory Regimes Collide: Will Citizens United and Wisconsin Right to Life Make Federal Tax Regulation of Campaign Activity Unconstitutional?*, 13 U. PA. J. CONST. L. 867, 885 (2011)(examining facts and circumstances test and vagueness issue); Elizabeth J. Kingsley, *Challenges to “Facts and Circumstances”—a Standard Whose Time has Passed?*, 20 Tax. of Exempts 5, at n.7–9 (Mar./Apr. 2010); Benjamin M. Leff, *“Sit Down and Count the Cost”: A Framework for Constitutionally Enforcing the 501(c)(3) Campaign Intervention Ban*, 28 VA. TAX REV. 673, 699 (2009). A constitutional analysis of the facts and circumstances test is outside the scope of this article, but any vagueness concerns apply more in the section 501(c)(3) context where the test is used to prohibit a section 501(c)(3) organization from engaging in the activity. In the sections 501(c)(4) and 527 context the test is used to determine an organization’s primary purpose, which serves as a basketing function, not as a prohibition.

same level of intervention in an organization's activities and thus protect it from accusations of partisan selective enforcement.

The new regulations I suggest will disincentivize those who are seeking an improper organizational form to avoid disclosure from doing so and will provide better information to voters regarding the funding of independent groups. It is not the ideal way of regulating nonprofits' campaign related activities, but it is a step that can be taken quickly, without congressional action. A quick repair to the regula-

tory plumbing will stop the leaks in the current system from becoming a flood.

Address correspondence to:

Donald B. Tobin
Moritz College of Law
The Ohio State University
55 W. 12th Avenue
Columbus, OH 43210

E-mail: tobin.46@osu.edu