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THE INTERNAL REVENUE SERVICE AND A CRISIS OF CONFIDENCE: A NEW REGULATORY APPROACH FOR A NEW ERA

by

Donald B. Tobin*

Abstract

The Internal Revenue Service is not usually thought of as the agency charged with enforcing the nation's campaign finance laws. It has found itself, however, at the center of a firestorm over both its involvement and its ineptitude in enforcing certain rules that regulate the campaign activities of tax-exempt organizations. For historical, legal, and practical reasons, the Internal Revenue Code regulates the political activity of tax-exempt groups, in some instances providing for disclosure of campaign donors and expenditures, and in other instances limiting the amount of political activity engaged in by tax-exempt organizations. As campaigns become more sophisticated and complicated, pressure is placed on the rules regulating the political activity of tax-exempt organizations. The current structure regulating the political activity of tax-exempt organizations is unworkable, and the recent crisis resulting from the IRS's use of partisan criteria to determine what applications for exempt status should come under further inquiry highlights the breakdown in the current regulatory regime.

Just as it is wrong for the IRS to use partisan criteria in an unbalanced way to examine the applications of social welfare organizations, so too is it wrong for the IRS to refuse to enforce provisions in the Code regulating tax-exempt entities. To the extent that tax-exempt organizations are abusing their tax exempt status or are circumventing congressional intent with regard to the disclosure of campaign contributions, lax enforcement by the IRS also impacts our confidence in the agency. Unfortunately, under enforcement or over enforcement may have a partisan bias if groups engaging in one type of activity or another are dominated by one ideology.

* Dean, University of Maryland Francis King Carey School of Law. The author wishes to thank Ellen Aprill, Theodore P. Seto, Katherine Pratt, Paul Caron, participants in the Moritz College of Law Workshop series and the participants in the Loyola Tax Policy Colloquium for their thoughtful comments, and his research assistants Megan Venerick Griffin, Dare Heisterman, and Ross Bomholt for their assistance. A special thanks to Alan Michaels, Dean of the Moritz College of Law, for all his support.

In order to restore confidence in the fair and equitable treatment of groups engaged in political activity, Congress must take a broad approach that reforms the statutory framework for regulating tax-exempt organizations, fixes a broken enforcement process, and provides for greater transparency for actions taken by the IRS. This article explores the first step in the reform process, namely reform of the statutory framework regulating tax-exempt organizations involved in political campaign activity. Part II of this article outlines the current regulatory environment facing tax-exempt entities that wish to engage in political activities. Part III discusses the current crisis, including the IRS's actions and the abusive activities of tax-exempt organizations that caused many academics and politicians to call for better enforcement of the rules regarding political campaign intervention and tax-exempt entities. Part IV suggests reforms in the legal and regulatory rules governing tax-exempt entities.

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I. INTRODUCTION

The Internal Revenue Service is not usually thought of as the agency charged with enforcing the nation's campaign finance laws. It has found itself, however, at the center of a firestorm over both its involvement and its ineptitude in enforcing certain rules that regulate the campaign activities of tax-exempt organizations. For historical, legal, and practical reasons, the Internal Revenue Code regulates the political activity of tax-exempt groups, in some instances providing for disclosure of campaign donors and expenditures, and in other instances limiting the amount of political activity engaged in by tax-exempt organizations.¹ Historically, almost all campaign activity was conducted by tax-exempt entities, be they political organizations regulated under section 527, social welfare organizations regulated under section 501(c)(4), labor unions regulated under section 501(c)(5), or business leagues regulated under section 501(c)(6).² As campaigns become more sophisticated and complicated, pressure is placed on the rules regulating the political activity of tax-exempt organizations. The current structure regulating the political activity of tax-exempt organizations is unworkable, and the recent crisis resulting from the IRS's use of partisan criteria to determine what applications for exempt status should come under further inquiry highlights the breakdown in the current regulatory regime.³ This

1. Corporations organized under section 501(c)(3) are prohibited from participating in, or intervening in any political campaign on behalf of (or in opposition to) any candidate for public office. I.R.C. § 501(c)(3). Political organizations organized under section 527 are required to register with the IRS, publicly disclose their donors, and file periodic reports of contributions and expenditures. I.R.C. § 527(j). Social welfare organizations, labor unions, and business leagues, organized under sections 501(c)(4), (5), and (6) respectively, may intervene in political campaigns but must be primarily engaged in social welfare, labor, or business league related activities.

2. Independent groups have traditionally been tax-exempt organizations because they generally have no business purpose and because election law significantly limited the activities of corporations. After the Supreme Court's decision in *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010), corporations can now make political campaign expenditures out of corporate treasury funds. As regulation of tax-exempt entities expands, independent groups may use taxable entities as a means of avoiding rules that govern tax-exempt organizations. See Donald Tobin, *Political Advocacy and Taxable Entities, Are They the Next "Loophole"?*, 6 FIRST AMEND. L. REV. 41 (2007) [hereinafter Tobin, *Political Advocacy*].

3. There is debate whether the IRS only targeted conservative groups or used partisan terms as a means of sorting whether an entity was engaged in partisan activity. It is clear, however, that the IRS used partisan terms in conducting its inquiries. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, 2013-10-053, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR

breakdown has serious repercussions for not only efficient regulation of tax-exempt organizations and campaign activity, but also for our nation's confidence that the IRS is operating as a nonpartisan fair enforcer of the internal revenue laws.

Just as it is wrong for the IRS to use partisan criteria in an unbalanced way to examine the application of social welfare organizations, so too is it wrong for the IRS to refuse to enforce provisions in the Code regulating tax-exempt entities. To the extent that tax-exempt organizations are abusing their tax exempt status or are circumventing congressional intent with regard to the disclosure of campaign contributions, lax enforcement by the IRS also impacts our confidence in the agency. Unfortunately, under enforcement or over enforcement may have a partisan bias if groups engaging in one type of activity or another are dominated by one ideology. Thus action and inaction may both be used for partisan advantage.

Many have argued that the IRS is the wrong agency to enforce campaign-related restrictions and that the agency is not well suited to deal with these thorny political questions.⁴ In a previous article, I outlined what I referred to as “a quick repair to the regulatory plumbing” for campaign disclosure and tax-exempt entities.⁵ Some of these reforms may have reduced the likelihood of the current crisis, but it is now clear that patchwork solutions will just lead to another crisis. Congress needs to completely overhaul the current regime that regulates the political activity of tax-exempt organizations. These reforms should be designed to restore people's faith in the nonpartisan enforcement of our internal revenue laws while also ensuring that tax-exempt entities are not circumventing laws designed to ensure that tax-exempt status is not abused.

There are important policy justifications for regulating the political activity of tax-exempt organizations, but to the extent regulation and enforcement of laws related to the political activity of tax-exempt organizations is necessary, that enforcement should be assigned to an

REVIEW (May 14, 2013), www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf [hereinafter TREASURY INSPECTOR].

4. See Lloyd H. Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625, 628 (2007) (“Congress should shift jurisdiction over the disclosure of political activity by 527s from the IRS to the FEC. . . . The IRS's history of effectively enforcing tax classifications is suspect”); Ellen P. Aprill, *Why the IRS Should Want to Develop Rules Regarding Charities and Politics*, 62 CASE W. RES. L. REV. 643 (2012) (stating that the IRS has minimal resources to devote to auditing 501(c)(3)'s, the IRS's Political Activity Compliance Initiative has “fizzled away,” and a large percentage of 501(c)(3)'s are unlikely to devote scarce resources to engage professionals to help interpret IRS standards).

5. Donald Tobin, *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, 10 ELECTION L.J. 427 (2011) [hereinafter Tobin, *Campaign Disclosure*].

independent entity that is structured to ensure nonpartisan enforcement of these rules.

There is no simple fix for reforming the current regulatory regime. In order to restore confidence in the fair and equitable treatment of groups engaged in political activity, Congress must take a broad approach that reforms the statutory framework for regulating tax-exempt organizations, fixes a broken enforcement process, and provides for greater transparency for actions taken by the IRS.

This Article explores the first step in the reform process, namely reform of the statutory framework regulating tax-exempt organizations involved in political campaign activity.⁶ The current statutory framework is completely broken. It encourages tax-exempt organizations to improperly engage in political campaign related activities without disclosing their donors. Under current law, political organizations are required to disclose their donors, but other tax-exempt organizations are not required to do so. The differential treatment with regard to donor disclosure that applies to political organizations versus other tax-exempt organizations encourages organizations to be very aggressive with regard to their view of what constitutes political intervention. In addition, entity-based regulation encourages groups to search for alternative entities that may allow the groups to avoid regulation.⁷ The regulatory structure thus needs to be reformed to rely less on entity-based regulation and more on a statutory structure that can be applied regardless of entity status.

Part II of this Article outlines the current regulatory environment facing tax-exempt entities that wish to engage in political activities. Part III discusses the current crisis, including the IRS's actions and the abusive activities of tax-exempt organizations that caused many academics and politicians to call for better enforcement of the rules regarding political campaign intervention and tax-exempt entities. Part IV suggests reforms in

6. Because of taxpayer privacy rules, it is often difficult for even Congress to obtain information regarding audits, examinations, and treatment of tax-exempt organizations. As a result of these privacy rules, it is difficult to determine how the rules surrounding the political activity of tax-exempt organizations are enforced, including whether they are enforced at all or whether they are being enforced in a partisan way. The public interest concerns that surround the secrecy of taxpayer information do not apply with the same force in the tax-exempt context, especially since much of this information is disclosed if an entity's exempt status is approved. Transparency in the decision making process increases public confidence that the regulations are being enforced in an even-handed and equitable manner. For an excellent recent discussion of this issue see George K. Yin, *Saving the IRS*, 100 VA. LAW. REV. ONLINE 22 (April 2004). Professor Daniel Tokaji and I will address the third necessary component of reform, reform of the enforcement process, in future work.

7. Tobin, *Political Advocacy*, *supra* note 2.

the legal and regulatory rules governing tax-exempt entities. Practitioners have long been seeking clearer rules with regard to the political activity of tax-exempt organizations, and this crisis highlights that the current regulatory structure is flawed.

II. CURRENT REGULATORY ENVIRONMENT FACING TAX-EXEMPT ORGANIZATIONS

Nearly all political campaign-related activities are engaged in by tax-exempt organizations.⁸ The increased complexity of political campaigns necessarily increases the complexity of the rules regulating tax-exempt entities engaged in political campaigns. The increased activity and regulatory complexity puts the IRS in the unenviable position of having to make difficult determinations regarding the political activity of tax-exempt entities. This section explains the current regulatory environment facing tax-exempt entities and discusses how the current regulations are designed to create a coherent regulatory structure of tax-exempt entities.

In general, the Code recognizes various organizations as tax-exempt because they do not have a profit motive, and often do not have “income” in the way that it is traditionally defined in the tax context.⁹ These organizations are deemed tax-exempt in that the income of the organization is exempt from tax. However, unlike public charities and religious organizations defined under section 501(c)(3), donations to other tax-exempt organizations are not deductible by the donor. Thus, section 501(c)(3) organizations receive special status—not only are the organizations’ income exempt from tax, but donations to the organizations are tax deductible. Other tax-exempt

8. Candidate committees are section 527 political organizations. Independent groups primarily engaged in campaign advocacy are supposed to be organized as section 527 political organizations. So called “super PACs” accept unlimited contributions and engage in activities that subject them to rules and regulations. After *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310 (2010), corporations are now allowed to engage in independent advocacy on behalf of a candidate. In the 2012 cycle, it appears that corporations still mainly chose to direct contributions to independent third-party tax-exempt groups instead of engaging in direct advocacy. See OPENSECRETS.ORG, last accessed Mar. 11, 2014, www.opensecrets.org.

9. The main revenue source for most tax-exempt organizations is donations to the organization. There is a real question whether these donations are income for tax purposes. Daniel I. Halperin, *Is Income Tax Exemption for Charities a Subsidy?*, 64 TAX L. REV. 283 (2011); Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 ELECTION L.J. 363 (2011) [hereinafter Aprill, *Regulating the Political Speech*]; Tobin, *Political Advocacy*, *supra* note 2, at 67.

organizations are exempt from tax on their income but contributions to the organizations are not tax deductible.

A. *Regulations of Section 501(c)(3) Religious Entities and Charities*

Section 501(c)(3) organizations are what most Americans identify as tax-exempt or non-profit organizations. These organizations are religious, educational, and charitable organizations that are formed for the public good.¹⁰ Contributions to section 501(c)(3) organizations are tax deductible by the donor, and organizations are not subject to tax on income that is related to the organization's exempt purpose.¹¹ Section 501(c)(3) organizations receive a dual tax benefit and these benefits, especially the deductibility of contributions by the donor, are generally considered a subsidy provided to the organizations by society. With the exception of religious entities, organizations seeking section 501(c)(3) tax-exempt status must file a Form 1023 and must be recognized by the IRS as a 501(c)(3) organization.¹²

Congress determined that organizations wishing to receive this special status must meet certain statutory requirements. As a starting matter, the organizations must be organized for a charitable or religious purpose.¹³ Section 501(c)(3) organizations are also prohibited from engaging in political

10. I.R.C. § 501(c)(3) (“Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals.”)

11. Income unrelated to an organization's exempt purpose is subject to tax. I.R.C. § 511(b)(1). Charitable contributions are generally defined by section 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 to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.” I.R.C. § 170(c)(2)(B). This definition closely parallels the definition for an exempt organization under section 501(c)(3) of the Code. Donations to section 501(c)(3) organizations are deductible by operation of section 170 of the Code. I.R.C. § 170(c)(2)(D).

12. I.R.C. § 508(c)(1)(a) (“[C]hurches, their integrated auxiliaries, and conventions or associations of churches” need not notify the Secretary that they are applying for recognition of Section 501(c)(3) status.). The term “church” applies to all religious institutions.

13. Section 501(c)(3) provides that an organization must be “operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals”

campaigns on behalf of a candidate. Specifically, section 501(c)(3) prohibits an organization from “participat[ing] in, or interven[e] in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”¹⁴ In addition, a section 501(c)(3) organization may not engage in more than an insubstantial amount of lobbying.¹⁵ Finally, section 501(c)(3) organizations must be formed for the public benefit and not to support a private interest,¹⁶ and income generated by the organization may not inure to the benefit of any individual or shareholder.¹⁷

These three restrictions—the prohibition on political intervention, the lobbying restriction, and the prohibition on private inurement—often require the IRS to investigate politically sensitive activities of an organization and to make decisions that have consequences on organizations involved in political activity. In addition, since a section 501(c)(3) organization may be an educational organization, the IRS must often determine whether an organization’s activities are in fact educational or are instead political intervention or lobbying.

B. Regulation of Section 501(c)(4) Social Welfare Organizations, Section 501(c)(5) Labor Unions, Section 501(c)(6) Business Leagues, and Section 527 Political Organizations

Social welfare organizations, labor unions, and business leagues [hereinafter SLB organizations or SLBs] are also tax-exempt entities, but donations to these organizations are not deductible by the donors. These organizations are allowed to engage in an unlimited amount of lobbying as long as it is related to the organizations’ exempt purpose, and may intervene in political campaigns as long as the primary purpose of the organizations is still consistent with the organizations’ exempt purpose (*i.e.*, social welfare, labor, or promotion of business).

14. I.R.C. § 501(c)(3).

15. I.R.C. § 501(c)(3) (“no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . .”).

16. Reg. § 1.501(c)(3)-1(d)(1)(ii). In *Am. Campaign Acad. v. Commissioner*, 92 T.C. 1053 (1989), the Tax Court determined that an organization formed by Newt Gingrich was not entitled to exempt status because the organization was operated for a private benefit. The court determined that the organization was operated to assist Republican candidates.

17. I.R.C. § 501(c)(3).

1. *Social Welfare Organizations (Section 501(c)(4) Organizations)*

Social welfare organizations are organizations that are not organized for profit but “operated exclusively for the promotion of social welfare....”¹⁸ Although Congress used the word “exclusively” in the statute, a Regulation provides that an organization qualifies as a social welfare organization if “it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.”¹⁹ Included within this definition is an organization “operated primarily for the purpose of bringing about civic betterments and social improvements.”²⁰ Lobbying is considered a social welfare activity as long as the lobbying is related to the organization’s exempt purpose.²¹ Intervention in a political campaign, however, is not a social welfare purpose.²² Thus, to the extent that groups seek to engage in significant campaign-related activities, the groups do not qualify as social welfare organizations. Unlike section 501(c)(3) organizations, social welfare organizations are not required to file with the IRS seeking recognition of their exempt status.²³ Social welfare organizations may seek recognition by filing a Form 1024, but such recognition is not required.²⁴

In addition, unlike political organizations, social welfare organizations are not required to publically disclose their donors. Social welfare organizations are required to disclose to the IRS donors who contribute \$5,000 or more as part of the organization’s Form 990 Schedule B information return that the organization must file with the IRS.²⁵ The Schedule B donor disclosures are not made public.²⁶

Because social welfare organizations must have social welfare as their primary purpose and because political intervention activities are not social welfare activities, the IRS is charged with determining whether a

18. I.R.C. § 501(c)(4) (“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 in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.”)

19. Reg. § 1.501(c)(4)-1(a)(2)(ii).

20. *Id.*

21. *See* Rev. Rul. 2004-6, 2004-1 C.B. 328.

22. Reg. § 1.501(c)(4)-1(a)(2)(ii).

23. *See* Reg. § 1.6033-1(e) (Social welfare organizations can be “nondeclaring” social welfare organizations. Even if an organization does not file for recognition, it is required to file a Form 990 information return.).

24. *Id.*

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

26. Reg. § 301.6104(b)-1(b).

social welfare organization is in fact primarily engaged in social welfare. This once again requires the IRS to investigate the various activities of the organization. In fact, the IRS's inquiry is even more invasive in the section 501(c)(4) context than for section 501(c)(3)'s because the IRS must have a full understanding of what a section 501(c)(4) is doing and how it operates in order to make a determination regarding an organization's primary purpose. If an organization is engaged in political intervention activities, then the IRS must determine how pervasive those activities are within the organization, and then determine the organization's primary purpose.

In addition, just as with section 501(c)(3) organizations, section 501(c)(4) social welfare organizations are prohibited from engaging either private inurement transactions or private benefit transactions.²⁷ Thus, for example, the IRS has determined that an organization formed to promote women who are interested in running for public office as democrats was formed "primarily for the benefit of a political party and a private group of individuals, rather than the community as a whole."²⁸

2. *Labor Unions (Section 501(c)(5) Organizations)*

Labor, agricultural, or horticultural organizations are exempt from tax under section 501(c)(5). The statute and regulations are vague regarding the definition of section 501(c)(5) organizations, but the regulations provide that they must "have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a high degree of efficiency in their respective occupations."²⁹ Unlike the statute and regulations defining social welfare organizations, the statute and regulations for labor organizations do not indicate the extent of the organization's activity that must be for the exempt purpose. In a General Counsel Memorandum (GCM), the IRS indicated that, in order to qualify for exempt status, section 501(c)(5) organizations must be primarily engaged in the exempt activity, here labor, agricultural, or horticultural activities, and that intervention in a political campaign is not a

27. I.R.C. § 501(c)(4)(B).

28. LETTER DENYING TAX-EXEMPT STATUS (April 4, 2011). A redacted version of the letter has been posted on the IRS's website, <http://www.irs.gov/pub/irs-wd/1128032.pdf> (last visited Mar. 11, 2014). The Group was later identified as Emerge American, an organization that supports democratic women interested in running for office. See Stephanie Strom, *3 Groups Denied Break by the IRS Are Named*, N.Y. TIMES, July 20, 2011; Stephanie Strom, *Political Advocacy Groups Denied Tax-Exempt Status*, N.Y. TIMES, July 19, 2011. See also *Am. Campaign Acad. v. Commissioner*, 92 T.C. 1053 (1989) (denying an organization tax-exempt status because it served a private benefit of helping republican candidates).

29. Reg. § 1.501(c)(5)-1.

labor, agricultural, or horticultural activity.³⁰ Thus, just like section 501(c)(4) organizations, labor unions may intervene in a political campaign for or against a candidate for public office, but the primary purpose of the organization must remain labor, agricultural, or horticultural. Although the GCM does not carry the force of law, its conclusion is consistent with the statutory framework. If the organization's primary purpose is intervention in a political campaign, then the organization should be classified as a section 527 political organization and not as a section 501(c)(5) organization.³¹

Contributions to section 501(c)(5) organizations are not deductible by donors as charitable contributions. Also, an organization does not qualify for exemption under section 501(c)(5) if any of its net earnings inures to the benefit of any member.³² In addition, like other tax-exempt organizations, labor organizations are required to file a Form 990 information return, which among other things, requires the organization to disclose to the IRS donors who contribute \$5,000 or more.³³

Section 501(c)(5) organizations are also not required under the Code to publically disclose their donors, but labor unions are required to make certain donor disclosures to the Department of Labor.³⁴ Labor unions must file an information report, copies of their constitution and bylaws, and annual financial reports with the Office of Labor-Management Standards of the U.S. Department of Labor.³⁵ Labor organizations must also disclose the identity of any contributor giving in aggregate \$5,000 or more in a 12 month reporting period, as well as the purpose, date, and amount of the contribution to the Department of Labor.³⁶

3. *Business Leagues, Chambers of Commerce, Boards of Trade (Section 501(c)(6) Organizations)*

Business organizations are exempt from tax under section 501(c)(6) of the Code. The regulations define a business league as a group organized to

30. G.C.M. 34,233 (Dec. 3, 1969).

31. The term "political organization" means a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function. I.R.C. § 527(e)(1).

32. I.R.C. § 501(c)(5).

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

34. 29 U.S.C. § 401 et seq.

35. Labor-Management Reporting and Disclosure Act of 1959 (LMRDA), (as amended at 29 U.S.C. § 401 et seq.); 29 C.F.R. pts. 401-453.

36. 29 U.S.C. § 431; 29 C.F.R. § 403. See Dep't of Labor, Form LM-2. For a thorough discussion of the requirement see Labor Organization Annual Financial Reports, 68 Fed. Reg. 58,374, 58,388-89, 58,430 (Oct. 9, 2003) (to be codified at 29 C.F.R. pt. 403, 408).

promote common business interests.³⁷ The organization may not be engaged in a business activity that is normally carried on for profit, and the benefits of the organization must not inure to the benefit of an individual or shareholder.³⁸ Its activities should be similar to a chamber of commerce or a board of trade and should be directed to the improvement of business conditions.³⁹

As with labor organizations, the statute and regulations do not specifically indicate the percentage of the organization's activity that must be for the exempt purpose. In GCM 34233, the IRS indicated that "support of a candidate for public office necessarily involves the organization in the total political attitudes and positions of the candidates." The IRS concluded that "political action" is therefore not part of a business league's exempt activity, and that an organization that is primarily involved in political action does not qualify as a business league.⁴⁰ In addition, if the organization's primary purpose was intervention in a political campaign, then the organization would likely be classified as a section 527 political organization and not as a section 501(c)(6) organization.

Just as with social welfare organizations, section 501(c)(6) organizations are not required to publicly disclose donors, but like other tax-exempt organizations, business leagues must file Form 990 and disclose donors of \$5,000 and more to the IRS.⁴¹ These disclosures, however, are not released to the public.

4. *Section 527 Political Organization*

A political organization is an organization whose primary purpose is to influence elections.⁴² Specifically, a political 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"⁴³

The tax treatment of political organizations under section 527 is similar to that of social welfare organizations, labor unions, and business leagues. The income of political organizations is generally exempt from tax,⁴⁴ but unlike other tax-exempt organizations, political organizations

37. Reg. § 1.501(c)(6)-1.

38. *Id.*

39. Reg. § 1.501(c)(6)-1.

40. G.C.M. 34, 233 (Dec. 3, 1969).

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

42. I.R.C. § 527(e)(1).

43. Reg. § 1.527-2(a).

44. Section 527 exempts a political organization from tax by providing that amounts spent for an "exempt function" are not subject to tax. "Exempt

wishing to remain exempt from tax must publicly disclose the source of contributions in excess of \$200 and the recipients of expenditures in excess of \$500.⁴⁵ If a section 527 organization chooses not to comply with the disclosure provisions in section 527, then its income, which includes contributions to the organization, is subject to tax at the highest corporate rate.⁴⁶

An organization seeking status as a section 527 political organization acknowledges that its primary purpose is intervening in elections, and there is therefore very little need for the IRS to investigate the political activities of these organizations.⁴⁷ The IRS would still need to determine if the organization met the other requirements entitling the organization to tax-exempt status and theoretically it would need to ensure that the organization is actually engaged in political activity. In practice, however, because obtaining section 527 political organization status is more onerous than social welfare status, groups only seek section 527 status when their activity clearly involves intervention in a political campaign, so abuse in this area is very unlikely.

The IRS would have to determine whether an organization claiming to be exempt under another provision of section 501(c) was in fact a section 527 political organization, but it is unlikely that the IRS will need to examine the political activity of a section 527 political organization to determine if it meets the requirements of section 527.⁴⁸

function” is defined as “the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to [public office].” I.R.C. § 527(e)(2).

45. I.R.C. § 527(j)(1), (j)(3)(A)–(B).

46. Under I.R.C. § 527(b)(1), an organization that fails to file with the Secretary and disclose contributions and expenditures is taxed at the highest corporate tax rate, currently 35 percent. If an organization files with the Secretary and fails to disclose a particular contribution or expenditures, then the organization must pay tax at the 35 percent on the amount that the organization failed to disclose. See I.R.C. § 527(i)(4), (j)(1).

47. See Edward B. Foley & Donald Tobin, *Tax Code Section 527 Groups Not an End-Run Around McCain-Feingold*, 72 U.S.L. WK. 2403, 2404–05 (2004).

48. Section 527 is designed to be non-elective in that an organization is a section 527 organization if it meets the definition contained in section 527. 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 section 527 is not an elective provision); Rev. Rul. 2003-49, 2003-1 C.B. 903 (Answer 20: indicating that an organization is subject to 527 if it meets the definition of political organization in section 527(e)).

C. *The Current Statutory Structure Requires The IRS to Make Decisions That Have Political Ramifications*

Although on its face the IRS examining the political beliefs and activities of organizations is antithetical to the proper role of the IRS, there are several reasons why under the current statutory structure the IRS is required to examine an organization's political activity or to make decisions about an organization that have political ramifications. With regard to religious organizations and charities organized under section 501(c)(3), the deductibility of donor contributions makes it far more advantageous for entities to organize as charitable or religious organizations under section 501(c)(3) than under other provisions for other tax-exempt entities. As part of the condition of the preferential tax-exempt status, tax-exempt section 501(c)(3) organizations are prohibited from intervening in a political campaign or in engaging in more than an insubstantial amount of lobbying.⁴⁹ Organizations are also prohibited from organizing for the "private benefit" of individuals or a group of individuals, and the benefits of the organization may not inure to an individual or a group of individuals.⁵⁰ In addition, many organizations claim exemption under section 501(c)(3) as educational organizations. There is a fine line between activities that are educational for section 501(c)(3) charity status, and activities that are in fact political activities.⁵¹ After all, it is easy to argue that a political advertisement is designed to educate the populace on issues. The IRS is charged with ensuring that organizations do, in fact, qualify for section 501(c)(3) status and examinations of an organization's tax-exempt status may require the IRS to make sensitive judgments regarding an organization's political activity.⁵²

With regard to the political activities of other tax-exempt organizations, the IRS is charged with regulating the dividing line between political organizations regulated under section 527 and other exempt-organizations that may engage in some political campaign activity but must

49. I.R.C. § 501(c)(3).

50. *Id.*

51. Reg. § 1.501(c)(3)-1(d)(3)(i) (An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion.); Daniel L. Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 FLA. L. REV. 1, 58 (2002) [hereinafter Simmons, *Campaign Finance Reform*] ("The distinction between nonpartisan education on a broad range of issues, and biased education intended to influence the outcome of an election is anything but clear.").

52. See also *Ass'n of the Bar of the City of N.Y. v. Commissioner*, 858 F.2d 876, 877 (2d Cir. 1988) (holding that the bar association's ranking of judicial candidates violated the ban on "political activity"); Rev. Rul. 78-248, 1978-1 C.B. 154; Rev. Rul. 80-282, 1980-2 C.B. 178; Rev. Proc. 86-43, 1986-2 C.B. 729.

primarily engage in activities consistent with their exempt purpose. Section 527 political organizations are required to either disclose contributions and expenditures or pay a tax. Organizations have sought to avoid the disclosure provisions that are applicable to political organizations by organizing as tax-exempt entities under another provision of the Code—usually as section 501(c)(4) social welfare organizations, section 501(c)(5) labor unions, or section 501(c)(6) business leagues. These tax-exempt organizations are allowed to intervene in political campaigns but the primary purpose of these organizations may not be political campaign activity and must be consistent with their exempt status. The IRS is therefore charged with examining whether a tax-exempt organization is engaged in significant campaign activity to determine whether the organization must be regulated as a section 527 political organization and thereby be subject to the disclosure provisions in section 527.

The IRS's primary role in this regulatory structure is to ensure that (1) only religious and charitable organizations that meet the requirements in section 501(c)(3) receive the tax subsidy of allowing donors to deduct contributions, and (2) organizations that engage in political advocacy as their primary function comply with the disclosure provisions in the Code that apply to political organizations. As the Code is currently structured, these provisions require the IRS to either inquire into the political activities of tax-exempt organizations or avoid enforcement of these provisions and thereby be in dereliction of its duties to enforce provisions of the Code.

1. The Use of a "Primary Purpose" Standard Encourages Abuse by Organizations and Raises Concerns of Manipulation by the IRS

Although section 501(c)(4) provides that an organization must be operated exclusively for the promotion of social welfare, a Regulation only requires that the organization be "primarily engaged in promoting in some way the common good and general welfare of the people of the community."⁵³ Thus, under the existing rules, SLBs are allowed to engage in some amount of campaign intervention, but the organizations must still primarily engage in activities related to their exempt function. Regulations and IRS decisions indicate that intervention in a political campaign is not consistent with a section 501(c) SLB's exempt purpose and is therefore not counted for purposes of determining a group's primary activity.⁵⁴ Current law, however, is unclear regarding how much campaign-related activities an organization may engage in and still be considered primarily engaged in activity related to its exempt purpose. Some practitioners argue that the word

53. Reg. § 1.501(c)(4)-1(a)(2)(i).

54. Reg. § 1.501(c)(4)-1; G.C.M. 34, 233 (Dec. 3, 1969).

“primary” in the regulation only requires that more than half of the group’s expenditures be consistent with its exempt purpose.⁵⁵ Others argue that the Code’s interpretation of “primary” is far more limited and only allows an insubstantial amount of the non-primary activity.⁵⁶ The IRS has not released guidance⁵⁷ indicating how much extraneous activity an organization may engage in while maintaining its exemption.⁵⁸

55. See *Comments of the Individual Members of the Exempt Organizations Committee’s Task Force on Section 501(c)(4) and Politics*, AMERICANBAR.ORG 9, May 25, 2004, <http://www.americanbar.org/content/dam/aba/migrated/tax/pubpolicy/2004/040525exo.authcheckdam.pdf>; Aprill, *Regulating the Political Speech*, *supra* note 9, at 382 (citing academic support for a fifty percent threshold, the ABA Tax Section recommendation of a “40 percent safe harbor,” and a proposed sliding scale approach); Trevor Potter & Bryson B. Morgan, *The History of Undisclosed Spending in U.S. Elections & How 2012 Became the “Dark Money” Election*, 27 NOTRE DAME J.L. ETHICS & PUB. POL’Y 383, 465 (2013) (recognizing that some practitioners argue for a 50 percent threshold).

56. *Petition for IRS Rulemaking Submitted by Democracy 21 and the Campaign Legal Center*, DEMOCRACY21.ORG, July 27, 2011, http://www.democracy21.org/uploads/D21_and_CLC_Petition_to_IRS_7_27_2011.pdf.

57. Acting Commissioner of Internal Revenue Daniel Werfel, *Charting a Path Forward at the IRS: Initial Assessment and Plan of Action*, IRS.GOV 25, June 24, 2013, <http://www.irs.gov/pub/newsroom/Initial%20Assessment%20and%20Plan%20of%20Action.pdf>. In his report, Commissioner Werfel explained a new safe harbor that was set up to deal with tax-exempt groups whose applications were delayed. The safe harbor requires groups to certify that no more than 40 percent of their activities were campaign intervention and that more than 60 percent of their activities were for social welfare. Members of the ABA Tax Section made a similar proposal in 2004. See *Comments of the Individual Members*, *supra* note 55, at 9. In a presentation on this issue, the then Director of the IRS’s Exempt Organizations Division indicated “[w]hen it comes to political activities, that is, giving money to a candidate, telling people to vote for a certain candidate, the rule is that it has to be less than primary. If it’s 49 percent of their income, that is less than primary.” Marcus Owens, *Practicing Law Institute Program on Corporate Political Activities*, 3 EXEMPT ORG. TAX REV. 471 (June 1990). See also Lindsey McPherson, *EO Training Materials Suggest 51 Percent Threshold for Social Welfare Activity*, 142 TAX NOTES 394 (Jan. 27, 2014).

58. In *Better Bus. Bureau v. United States*, 326 U.S. 279, 283 (1945), the Court explained that a single non-exempt purpose, if substantial, would disqualify an organization from exemption. Some courts appear to have applied that standard in the section 501(c)(4) context, see *Contracting Plumbers Coop. Restoration Corp. v. United States*, 488 F.2d 684 (2d Cir. 1973). In *Contracting Plumbers Cooperative*, however, the holding relies more on the fact that the activity was not for the common good but was for the benefit of the particular members of the cooperative. *Id.* at 687. The IRS has not followed this approach. See IRM 7.25.4.6 (“Since the test for exemption under IRC 501(c)(4) is one of primary activities, an organization exempt under IRC 501(c)(4) may engage in substantial non-exempt activities.”).

The regulations at issue were promulgated in 1959, and regulations governing sections 501(c)(3) and (c)(4) organizations were promulgated on the same day.⁵⁹ The regulations governing section 501(c)(3) also deal with the word “exclusively,” and at times define “exclusively” as “primarily.” The section 501(c)(3) regulations, however, more clearly define “primarily” to allow only an insubstantial amount of non-exempt activity. In a number of subsections, the regulations define “exclusively” to be “not more than an insubstantial amount of a certain activity.”⁶⁰ The regulations also indicate that “[a]n organization will be regarded as ‘operated exclusively’ for [an exempt purpose] only if it engaged primarily in [activities consistent with the exempt purpose].”⁶¹ The regulations have also indicated that an organization will not qualify for exemption if more than an “insubstantial part of its activities is not in furtherance of an exempt purpose.”⁶² Accordingly, in the section 501(c)(3) context, the move from “exclusively” to “primarily” only allows an organization to engage in an insubstantial amount of the non-exempt activity. The regulations governing social welfare organizations, and the IRS determinations governing labor unions and business leagues, however, provide very little guidance regarding whether “primarily” in the section 501(c) SLB context should also be read to allow only an insubstantial amount of non-exempt activity.⁶³

In fact, in 2013, the Treasury released a new proposed rule clarifying the extent to which social welfare organizations may engage in political activity. The regulation does not address the primary purpose standard but instead requests comment with regard to what amount of non-exempt social welfare activity is appropriate.⁶⁴

Some commentators have argued that, in the section 501(c) SLB context, the regulation defining “exclusively” as “primarily” is necessary to

59. 24 Fed. Reg. 5217–19 (June 26, 1959); Reg. § 1.501(c)(3)-1; Reg. § 1.501(c)(4)-1.

60. See Reg. § 1.501(c)(3)-1(b)(1)(iii) (defining exclusively as not carrying on an insubstantial part of its activities; an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes”); Reg. § 1.501(c)(3)-1(c) (An organization will not be regarded as being operated for an exempt purpose “if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.”).

61. Reg. 1.501(c)(3)-1(c)(1).

62. *Id.*

63. *Petition for IRS Rulemaking*, *supra* note 56 at 15.

64. Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

cover unrelated business income tax activities of various organizations.⁶⁵ Others have noted that if “exclusively” is interpreted literally, then there is no organizational category for hybrid organizations that engage in some political advocacy and social welfare activity (or some other exempt activity), or for that matter an organization that engages in some activity that would qualify as social welfare and some activity that would qualify as a business league.⁶⁶ Because social welfare organizations, labor unions, business leagues, and political organizations are all tax-exempt, a coherent regulatory structure would allow an organization to engage in both tax-exempt non-political activity and tax-exempt political activity.⁶⁷

Unfortunately, there is no guidance from the IRS regarding how much campaign intervention is permissible, and it is unclear if the IRS has determined what standard it uses in evaluating whether an organization is engaged in permissible activities. If the IRS has not determined the definition of “primarily,” even internally, then it is extremely difficult for the IRS to determine whether an organization is operating “primarily” for an exempt purpose. These unclear standards increase the likelihood that the IRS will be accused of being politically motivated whenever it reaches a decision regarding whether an organization is “primarily” engaged in social welfare activities.

65. I.R.C. §§ 511, 512. Brian Galle, Roger Colinvaux, and Ellen Aprill have pointed out that the primary language was also likely used to recognize that organizations might engage in UBIT transactions that were not related to the organizations exempt function—except to the extent that revenue from the activities supported the organization’s exempt purpose. See Roger Colinvaux, *Political Activity Limits and Tax Exemption: A Gordian’s Knot*, (forthcoming Virginia Tax Review), <http://ssrn.com/abstract=2476435>; Ellen P. Aprill, *The IRS’s Tea Party Tax Row: How “Exclusively” Became “Primarily,”* Pacific Standard, The Science of Society (June 7, 2013), <http://www.psmag.com/navigation/politics-and-law/the-irss-tea-party-row-how-exclusively-became-primarily-59451>. See also *Comments of the Individual Members*, *supra* note 55, at 38, n.80.

66. Tobin, *Campaign Disclosure*, *supra* note 5.

67. This justification is post-hoc in that the regulations were issued in 1959, and at the time there was no official organizational form for political organizations. The IRS had simply been treating political organizations as tax-exempt entities, presumably under the theory that the organizations had no income. Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 GA. L. REV. 611, 620 (2003) [hereinafter Tobin, *Anonymous Speech*].

2. *Facts and Circumstances Test for Determining What Constitutes “Intervention in a Political Campaign” Encourages Abuse by Organizations and Raises Concerns of Manipulation by the IRS*

Section 501(c) SLBs may engage in some political campaign activity, but the primary activity of the organization must be consistent with its exempt purpose, and section 527 organizations must be primarily engaged in campaign activity. Unlike under federal election law, there is not a bright-line test for whether an activity is considered intervention in a political campaign. The express advocacy standard from *Buckley v. Valeo*, 424 U.S. 1 (1976), does not apply. Instead, the IRS uses a facts and circumstances test to determine whether an activity is improper intervention in a political campaign.

a. *Facts and Circumstances Test*

Unlike in the election law context, in the tax context, the IRS uses a facts and circumstances test to determine whether an organization’s particular communication or activity is “intervention in a political campaign.” The IRS basically uses the same political intervention test for all section 501(c) organizations.⁶⁸ If it is “intervention in a political campaign,” then a section 501(c)(3) may not engage in the activity and section 501(c) SLBs cannot count the activity as part of the groups primary purpose. There

68. In general, the IRS applies the same test in determining whether an activity is political intervention for purposes of determining the prohibition under section 501(c)(3) and primary purpose for other exempt organizations. See P.L.R. 1998-08-037 (Feb. 20, 1998) (It follows that any activities constituting prohibited political intervention by a section 501(c)(3) organization are activities that must be less than the primary activities of a section 501(c)(4) organization, which are, in turn, activities that are exempt functions for a section 527 organization.”). See also Elizabeth J. Kingsley, *Challenges to ‘Facts and Circumstances’—a Standard Whose Time has Passed?*, 20 TAX’N OF EXEMPTS 43, at nn.7–9 (Mar./Apr. 2010) [hereinafter Kingsley, *Whose Time has Passed?*] (citing Rev. Rul. 81-95, 1981-1 C.B. 332, Rev. Rul. 2004-6, 2004-1 C.B. 328, and P.L.R. 1996-52-026 (Dec. 27, 1996)). The IRS has indicated that, in some circumstances, activities that would not be political intervention in the 501(c) context might be exempt function activity for purposes of section 527 when the activity is closely tied to election related activities. These were taxpayer favorable rulings sought by section 527 organizations. The IRS concluded that education, issue advocacy, and grassroots lobbying that is “inextricably linked to the political process” would be exempt function activity. See P.L.R. 1999-25-051 (June 25, 1999). See also G.C.M. 39,694 (Feb. 1, 1988) (a section 501(c)(3) organization could seek to influence the appointment of a federal judge because that is not an elective office, but seeking to influence the appointment of a federal judge is also a section 527 exempt function activity.)

have been very few cases analyzing the test, but the IRS has released several rulings and announcements describing it.⁶⁹ The IRS indicated that “political campaign intervention includes any and all activities that favor or oppose one or more candidates for public office.”⁷⁰ These activities can include more classic campaign activities that are regulated by the Federal Election Commission under the Federal Election Campaign Act, like engaging in express advocacy⁷¹ or electioneering communication,⁷² but may also include indirect methods such as influencing elections through the distribution of biased or partisan literature.⁷³ For example, political intervention in the section 501(c) context includes engaging in partisan voter registration drives, hosting candidates at forums and conventions without providing equal access to other candidates, or attending fundraisers for specific candidates.⁷⁴ Members of organizations may act politically in their individual capacity, but they may not do so on behalf of the organization.

Section 501(c)(3) organizations may engage in issue advocacy, either as part of the limited allowance for lobbying or as part of the educational mission of the organization. Determining whether advocacy is issue advocacy or intervention in a political campaign is one of the major instances where the IRS must investigate the political activity of organizations.

Revenue Ruling 2007-41 makes clear that section 501(c) organizations may take positions on public issues, including issues that divide candidates, but that intervention in a political campaign includes “. . . issue advocacy that functions as political campaign intervention. Even if a statement does not expressly tell an audience to vote for or against a specific candidate, an organization delivering the statement is at risk of violating the political campaign intervention prohibition if there is any message favoring or opposing a candidate.”⁷⁵

In determining whether a communication is issue advocacy or political intervention, key factors include:

- 1) whether the statement identifies one or more candidates for a given public office;
- 2) whether the statement expresses approval or disapproval for one or more candidates’

69. See, e.g., Rev. Rul. 2007-41; F.S. 2006-17.

70. F.S. 2006-17.

71. See *infra* notes 90–92.

72. Electioneering communication is defined as “broadcast, cable, or satellite communication which . . . refers to a clearly identified candidate for Federal office . . .” and is made within sixty days of a general election or thirty days before a primary. 2 U.S.C. § 434(f)(3)(A) (2007).

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

74. Rev. Rul. 2007-41, 2007-1 C.B. 1421.

75. *Id.*

positions and/or actions; 3) whether the statement is delivered close in time to the election; 4) whether the issue addressed in the communication has been raised as an issue distinguishing candidates for a given office; 5) whether the communication is part of an ongoing series of communications by the organization on the same issue that are made independent of the timing of any election; and 6) whether the timing of the communication and identification of the candidate are related to a non-electoral event such as a scheduled vote on specific legislation by an officeholder who also happens to be a candidate for public office.⁷⁶

The IRS explains “communication is particularly at risk of political campaign intervention when it makes reference to candidates or voting in a specific upcoming election.”⁷⁷

Facts and circumstances tests are common in tax enforcement. The political intervention test has the major advantage of not being a bright-line test. Bright-line tests in election law have allowed groups to use technical compliance to circumvent the intent of election rules.⁷⁸ The test requires the IRS to examine the totality of the circumstances to determine whether the communication is political campaign intervention or issue advocacy. The test, however, makes it difficult on the edges for organizations to know whether their communication is permissible issue advocacy or impermissible political campaign activity. Especially in the section 501(c)(3) context, uncertainty is problematic because even a limited amount of campaign activity may put an organization’s status in jeopardy.⁷⁹

The facts and circumstances test also necessarily requires the IRS to examine the activities of an organization to determine whether the activities

76. *Id.*

77. *Id.*

78. *See infra* note 94.

79. *See, e.g.*, I.R.C. § 501(c)(3); Reg. § 1.501(c)(3)-1(b)(3); I.R.S. PUBLICATION 1828, TAX GUIDE FOR CHURCHES AND RELIGIOUS ORGANIZATIONS: BENEFITS AND RESPONSIBILITIES UNDER THE FEDERAL TAX LAW 7 (2012) (“[A]ll IRC section 501(c)(3) organizations, including churches and religious organizations, are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office.”); STAFF OF THE JOINT COMM. ON TAX’N, DESCRIPTION OF PRESENT LAW RELATING TO SECTION 501(C)(3) ORGANIZATIONS AND SUMMARY OF SECTION 501(C)(3)-RELATED PROVISIONS OF THE PENSION PROTECTION ACT OF 2006 AND PROPOSED LEGISLATIVE PROPOSALS, (JCX-53-07), July 19, 2007, at 6. In addition to, or instead of, revocation, the Code provides for an excise tax on political expenditures, assessment of taxes due, and an injunction against further activity. *See* I.R.C. §§ 4955, 6852, 7409.

amount to intervention in a political campaign. This may require the IRS to examine an organization's publications, its communications, its website, and even sermons by religious leaders.⁸⁰

b. The IRS's New Proposed Regulation Creates A Bright-Line Test and Replaces the Facts and Circumstances Test for Determining Intervention in a Political Campaign

The Treasury has recently issued proposed regulations that suggest a bright-line test that will eliminate much of the uncertainty that currently exists with regard to what constitutes political activity. The proposed rule produced over 150,000 comments, and the IRS recently announced that it would propose a revised rule after considering the comments it received.⁸¹ The proposed rule, however, is very instructive and provides interesting insights into possible reforms in this area.⁸²

80. Each year in September, the Alliance Defense Fund (ADF) organizes "Pulpit Freedom Sunday" where it encourages religious leaders to endorse candidates to the pulpit. ADF hopes to create a test case with regard to a religious leader's right to endorse a candidate from the pulpit. To date, the author is not aware of any actions by the IRS with regard to religious leaders who participate in the pulpit initiative. See *The Pulpit Initiative Executive Summary*, ALLIANCEDEFENDINGFREEDOM.ORG, last accessed Dec. 23, 2009, http://adfwebadmin.com/userfiles/file/Pulpit_Initiative_executive_summary_candidates%203_11_10.pdf. Under current law, it is clear that a religious entity organized under section 501(c)(3) is not entitled to endorse a candidate. In order to enforce this prohibition and determine whether an organization has improperly endorsed a candidate, the IRS has examined the text of sermons given by religious leaders. See *infra* notes 86–88. See also Allan J. Samansky, *Deductibility of Contributions to Religious Institutions*, 24 VA. TAX REV. 65, 67 (2004).

81. The IRS noted on its website that it received over 150,000 written comments and that "[c]onsistent with what Commissioner Koskinen has previously stated, it is likely that we will make some changes to the proposed regulation in light of the comments we have received. Given the diversity of views expressed and the volume of substantive input, we have concluded that it would be more efficient and useful to hold a public hearing after we publish the revised proposed regulation." IRS.GOV, last visited June 22, 2014, [http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501\(c\)\(4\)-Organizations](http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations).

82. An analysis of the rule is outside the scope of this article. For a comment generally supporting the rule, see Brian D. Galle & Donald B. Tobin, *Comments on Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities* (Ohio State Pub. Law Working Paper No. 239, Bos. Coll. Law Sch. Legal Studies Research Paper No. 321), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2399315.

Under the proposed regulation, the facts and circumstances test remains for determining a group's primary purpose, but a new test, one relying on what the regulation refers to as "candidate-related political advocacy," is used for determining whether an activity is consistent with an organization's social welfare purpose.⁸³ If an activity is considered "candidate-related political advocacy," then it does not have a social welfare purpose. By clearly defining "candidate-related political advocacy," the Treasury has proposed a bright-line test that will significantly decrease the confusion and gamesmanship regarding the permissible activities of social welfare organizations.

The proposed regulation defines "candidate-related political advocacy" to include communications similar to express advocacy under election law, including communication expressing a view on a candidate and containing words like "vote," "support," or "reject," or is communication susceptible to no other interpretation.⁸⁴ The regulation also categorizes as "candidate-related political advocacy" communication similar to electioneering communication under election law, classifying all communication that refers to a clearly identified candidate within 30 days of a primary or 60 days of a general election as candidate related communication.⁸⁵

These first two components of the regulation would likely not have been that controversial. The regulation, however, also defines quasi-political activity, like get-out-the-vote operations and voter registration drives as "candidate-related political activity." The regulation also counts as campaign-related political activity the hosting or conducting an event within 30 days of a primary election or within 60 days of general election at which one or more candidates appear. Because the regulation was designed to create bright-line rules, there is no exception for nonpartisan candidate appearances, get-out-the-vote drives, or voter registration drives.

Although these activities are, at times, conducted in a nonpartisan manner, they are also often candidate-related. The proposed regulations thus create what at first looks like a conflict between the section 501(c)(3) and section 501(c)(4) rules. Under the proposed regulation, if these activities are conducted by a section 501(c)(3) organization in a nonpartisan manner, then they would be permitted because they would not be considered intervention in a political campaign, but if this same activity was engaged in by social welfare organizations, it would be considered "candidate-related political activity."

Although the IRS has indicated that it will propose a revised rule, the bright-line rule has the advantage of clearly identifying what activity is

83. Prop. Reg. § 1.501(c)(4)-1, 78 Fed. Reg. 71,535 (2013).

84. *Id.*

85. *Id.*

“candidate-related political activity” and thus not social welfare activity. Since social welfare organizations may engage in a certain amount of “candidate-related political activity,” the broad bright-line rule is workable. In addition, if groups engage in a significant amount of nonpartisan activity that is considered candidate-related in the social welfare context, then groups can simply create a tax-exempt charitable affiliate to engage in that activity. The fact that there is a better tax-exempt alternative for this type of communication indicates that SLBs are really not interested in engaging in nonpartisan get-out-the-vote drives and voter registration drives. If they wanted to engage in significant nonpartisan activity, then they could organize as section 501(c)(3) organization and receive tax deductible contributions.

D. Entity Manipulation and FEC Action Have Allowed Organizations to Circumvent Congressional Intent With Regard to Disclosure

Prior to 2000 when Congress added the requirements regarding donor and entity disclosure to section 527, the major tax regulatory difference between various tax-exempt organizations was whether the organizations were exempt under section 501(c)(3) or whether they were exempt under another provision of the Code. Organizations preferred section 501(c)(3) status because contributions were deductible by the donor, so organizations had an incentive to classify political campaign activity as a permissible section 501(c)(3) activity, such as education or lobbying. Since section 501(c)(3) organizations are completely prohibited from intervening in political campaigns, and are only allowed to engage in an insubstantial amount of lobbying, the IRS was charged with monitoring the political activity of organizations seeking exempt status. At times the IRS’s efforts to investigate the political activity of section 501(c)(3)’s caused organizations to complain that they were being targeted for political reasons.⁸⁶ In addition, members of Congress questioned whether the IRS was improperly investigating organizations because of an organization’s political beliefs.⁸⁷ When examining section 501(c)(3) organizations, however, the IRS only

86. See Michael Janofsky, *Citing July Speech, I.R.S. Decides to Review N.A.A.C.P.*, N.Y. TIMES, Oct. 29, 2004 (Julian Bond, Chairman of the NAACP, responding to the New York Times: “This is an attempt to silence the N.A.A.C.P. on the very eve of a presidential election . . . Clearly, someone in the I.R.S. doesn’t want that to happen.”); Rebecca Trounson, *IRS Ends Church Probe But Stirs New Questions*, L.A. TIMES, September 24, 2007 (quoting All Saints’ attorney Marcus Owens indicating his client was concerned that “the IRS allowed partisan political concerns to direct the course of the All Saints examination.”).

87. LETTER FROM SENATOR BAUCUS, THEN RANKING MEMBER OF SENATE FINANCE TO COMM’R EVERSON (Oct. 29, 2004), *reprinted in 2004 TAX NOTES TODAY* 211–12 (Dec. 2004) (expressing concern that the NAACP was being examined for political reasons).

needed to investigate a particular activity or a group of activities, and not the entire purpose of the organization.⁸⁸ Even with this more limited examination, some organizations and commentators complained that the standard was unworkable.⁸⁹

In addition, for constitutional and administrative reasons, the rules regarding what constitutes intervention in a political campaign developed differently from the rules governing permissible campaign-related activities in the election law context. In general, the definition of what constitutes campaign-related activity is broader under tax law than under election law.

1. Election Law Rules Governing Campaign-Related Activities

The Federal Election Campaign Act (FECA) regulates campaign contributions and expenditures and, as originally structured, imposed contribution limits and disclosure requirements on entities that attempted to influence elections.⁹⁰ FECA's contribution limits and disclosure requirements were severely curtailed by the Supreme Court in *Buckley v. Valeo*, where the Court limited the reach of FECA to PACs and to contributions and expenditures that expressly advocate the election or defeat of a candidate for public office.⁹¹ In *Buckley*, the Court set out examples of

88. See Rev. Dr. George F. Regas, Rector Emeritus, Sermon "If Jesus Debated Senator Kerry and President Bush" (Oct. 31, 2004), http://www.allsaints-pas.org/modules/toc/uploads/files/aid959_if_jesus_debated_sen_46b5669b_2eb3_a0f3_u1.pdf, for the complete transcript of the sermon. The NAACP controversy involved a speech at its annual convention. See Michael Janofsky, *Citing July Speech, I.R.S. Decides to Review N.A.A.C.P.*, N.Y. TIMES, Oct. 29, 2004.

89. See e.g., Mark Totten, *The Politics of Faith: Rethinking the Prohibition on Political Campaign Intervention*, 18 STAN. L. & POL'Y REV. 298, 309 (2007); Elizabeth Kingsley & John Pomeranz, *A Crash at the Crossroads: Tax and Campaign Finance Laws Collide in Regulation of Political Activities of Tax-Exempt Organizations*, 31 WM. MITCHELL L. REV. 55, 70 (2004); Kingsley, *Whose Time has Passed?*, *supra* note 68.

90. Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974) (codified as amended at 2 U.S.C. §§ 431-456 (2000)). FECA originally limited contributions to a candidate for federal office to \$1,000 with respect to any election, with the primary and general election each constituting a separate election. FECA, 2 U.S.C. § 441a(a) (2000) (amended 2002). The McCain-Feingold campaign reform bill recently increased this amount to \$2,000. Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, § 307(a), 116 Stat. 81, 102 (2002) (to be codified at 2 U.S.C. § 441(a)). Entities were also required to disclose contributions over \$200 that were for the purpose of influencing elections. 2 U.S.C. § 434(c)(1), (c)(2)(C) (2000).

91. *Buckley v. Valeo*, 424 U.S. 1 (1976). Section 431(8)(A)(i) of FECA defines contribution as "any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for

words that would constitute express advocacy, and these words have been referred to as “magic words.” Examples of magic words include “vote for,” “elect,” “support,” “defeat,” “reject,” “vote for Smith.”⁹²

Organizations could avoid the disclosure requirements in FECA by eschewing express advocacy and magic words, but still advocating for or against candidates in subtle or not so subtle ways. In the classic case, organizations sponsored commercials that were clearly designed to support or oppose candidates but avoided magic words, arguing that the speech was issue advocacy or grassroots lobbying.⁹³ This type of advocacy was referred to as “issue advocacy” or “sham issue advocacy.”⁹⁴

2. *Congressional Response to the Lack of Donor Disclosure—
Passage of Disclosure in Section 527 and the Requirement
of Donor Disclosure for “Electioneering Communication”*

The organizational structure of tax-exempt organizations and the interaction between election law and tax law changed dramatically in 2000 when Congress added disclosure provisions to section 527. Now, organizations had a major incentive to organize as social welfare

Federal office,” and section 431(9)(A)(i) defines expenditure as “any purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value, made by any person for the purpose of influencing any election for Federal office....” 2 U.S.C. § 431(8)(A)(i), (9)(A)(i) (2000).

92. *Buckley*, 424 U.S. at 44 n.52. Later cases recognize that express advocacy is broader than the magic words listed in *Buckley*, and includes express advocacy or its functional equivalent. *McConnell v. Fed. Election Comm’n*, 540 U.S. 93, 206 (2003), *overruled by Citizens United v. Fed. Election Comm’n*, 558 U.S. 310 (2010) (overruling on other grounds). In *Federal Election Commission v. Wisconsin Right to Life*, the Court determined that a court should find that an ad is the functional equivalent of express advocacy only “if the ad is susceptible of no reasonable interpretation other than as an appeal to vote for or against a specific candidate.” 551 U.S. 449, 469–70 (2007).

93. One of the classic commercials seeking to take advantage of this loophole was run by Republicans for Clean Air as part of the 2000 Republican presidential primary. It was later disclosed that the commercial was funded by the Wyllys who were strong supporters of George Bush. The advertisement stated: “Last year, John McCain voted against solar and renewable energy. . . . That means more use of coal-burning plants that pollute our air. New York Republicans care about clean air. So does Governor Bush. He led one of the first states in America to clamp down on old coal-burning electric power plants. . . . Governor Bush: Leading so each day dawns brighter.” John Mintz, “*Clean Air*” *Group Clouds the Airwaves*, WASH. POST, March 3, 2000, at A19.

94. Richard L. Hasen, *The Surprisingly Complex Case for Disclosure of Contributions and Expenditures Funding Sham Issue Advocacy*, 48 UCLA L. REV. 265 (2000).

organizations, labor unions, or business leagues because those organizations were not subject to the disclosure provisions in section 527 and were allowed to intervene in political campaigns as long as the primary purpose of the organization was consistent with its exempt purpose.⁹⁵

In addition to the disclosure provisions in section 527, Congress also amended FECA as part of the Bipartisan Campaign Reform Act of 2001 (BCRA), which among other things, created a new class of communication, “electioneering communication,” that would be subject to disclosure.⁹⁶ Electioneering communication is defined as “broadcast, cable, or satellite communication, which refers to a clearly identified candidate for Federal office [and] is made within 60 days before a general [election] . . . and 30 days before a primary . . . and . . . is targeted to the relevant electorate.”⁹⁷ Individuals or organizations that spend \$10,000 on electioneering communication must disclose both the expenditure and the names of donors who have contributed \$1,000 or more for the purpose of electioneering communication.⁹⁸

Congress therefore addressed the problem of inadequate disclosure with a two-pronged approach. It closed the loophole created by the restrictive definition of express advocacy by both engaging in entity-based regulation by requiring section 527 organizations to disclose, and by engaging in speech-based regulation by requiring the disclosure of electioneering communication.

Independent groups thus sought new ways to engage in political advocacy while avoiding the two new regulatory tools designed to require the disclosure of donors.⁹⁹ Independent groups accomplished this in two steps. First, organizations wishing to avoid disclosure organized as social

95. At the time of passage, some scholars were concerned that the disclosure provisions would encourage groups to reorganize as social welfare organizations. *See, e.g.*, Francis R. Hill, *Probing the Limits of Section 527 to Design a New Campaign Vehicle*, 86 TAX NOTES 400 (2000); Simmons, *Campaign Finance Reform*, *supra* note 51, at 81. *See also* Susan Schmidt, *Political Groups Change Status to Avoid Disclosure*, WASH POST, Sept. 15, 2000.

96. Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, 116 Stat. 81 (2002).

97. 52 U.S.C. § 30104(f).

98. *Id.*

99. Groups are generally not concerned with entity based disclosure because the group itself is generally created for campaign purposes. In addition, amounts spent on advertisements often have to be disclosed under FCC regulations. *See* Tobin, *Anonymous Speech*, *supra* note 67, at 634 n.108 (citing FCC regulations requiring disclosure for advertisements and cases upholding those regulations.). *See, e.g.*, 47 C.F.R. § 73.1212 (requiring licensed broadcast stations to identify the sponsors of paid advertisements).

welfare organizations, labor unions, or business leagues. In order to avoid section 527 status and the disclosure provisions in section 527, the organizations had to claim that intervention in a political campaign was not their primary function. The move by organizations to avoid section 527 status and take more aggressive positions regarding what constitutes political intervention is a foundational change that increased the need for more intrusive examination by the IRS. The IRS is now not only required to determine whether an organization engages in political campaign-related activity, but also whether the political intervention is significant enough that the organization can no longer claim its primary purpose is an exempt activity under section 501(c). This requires a far more extensive examination of the organization's activities than just examining whether a particular communication or activity violated an organization's exempt status.

The organizational status of the entity under the Code might be less important if campaign disclosure was achieved through alternative means. Although not exactly duplicative, the second prong in Congress's regulatory approach, amending FECA to provide for disclosure of electioneering communication, should have captured much of the campaign activity that was not captured by the disclosure provisions in section 527—either because the organization was properly organized under section 501(c) and engaged in some advocacy or because the organization was really a political organization masquerading as a section 501(c) organization. After all, much of the advocacy at issue met the definition of electioneering communication.

Congress's two-pronged approach, however, has failed to provide for further disclosure. The electioneering communications provisions have been unsuccessful in requiring disclosure of "sham issue advocacy" by SLBs. Although the electioneering communication provisions should have required disclosure of these advertisements, regulations by the FEC have produced huge loopholes that allow donors to SLBs that engage in significant campaign-related activity to remain anonymous.¹⁰⁰ The FEC

100. According to the Center for Responsive Politics, sixteen 501(c) organizations spent over \$1,000,000 during the 2010 election cycle. In most cases, these organizations did not disclose any of their donors. Eleven of the sixteen provided no information about donors, four provided some disclosure, and one provided significant disclosure. The one organization that provided more complete disclosure was a labor union. See *2010 Outside Spending by Group*, OPENSECRETS.ORG, last accessed Mar. 11, 2014, <http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=D&disp=O&type=I>. In 2012, there were 25 organizations listed as spending more than \$1,000,000. Of the 25 organizations, 23 provided no disclosure, one partially disclosed and one provided more complete disclosure. The one organization providing disclosure was a labor union. See *Susan B. Anthony List*, OPENSECRETS.ORG, last accessed Mar. 11, 2014, <http://www.opensecrets.org/outsidespending/detail.php?cmte=C90011313&cycle=2012>.

issued regulations interpreting BCRA's electioneering communication disclosure provisions providing 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).¹⁰¹ The premise is that, for independent groups that engage in non-campaign-related activities (as well as campaign-related activities), donations are made to the group to fund its activities generally. Absent a specific designation by the donor, there is no indication whether a specific donation was made to fund a particular communication by the group. Donors wishing to remain secret may do so simply by not affirmatively stating that the contribution is for electioneering communication.

The regulation completely eviscerates donor disclosure rules for independent groups because the default position is that a contribution is not "for the purpose of electioneering communication," and therefore is not subject to the disclosure rules. Donors have almost no incentive to designate their contribution as "for the purpose of electioneering communication."¹⁰²

With the failure of provisions dealing with electioneering communication to capture donations to independent groups, attention once again focused on the donor disclosure provisions in section 527. If organizations could avoid disclosure by claiming status as an SLB, then the donor disclosure provisions in section 527 would be ineffectual. Two existing tax provisions, the primary purpose requirement and the application of the gift tax to donations, had the potential to limit widespread movement away from section 527 political organizations to other tax-exempt organizations that were not subject to donor disclosure rules. These two provisions, however, have failed to achieve this end, largely because of lack of enforcement by the IRS.

a. The Primary Purpose Standard Has Failed to Limit Political Organizations From Organizing as SLBs

Although SLBs may intervene in a political campaign on behalf of or in opposition to a candidate for public office, the primary purpose of the

101. Electioneering Communication, 72 Fed. Reg. 72899, 72911 (Dec. 26, 2007) (codified at 11 C.F.R. pt. 104, 114) (emphasis added).

102. Ellen Aprill has explained that a donor's designation of a contribution as for the purpose of electioneering communication would strengthen the donor's argument that the contribution was not a gift and not subject to gift tax. In light of the IRS's announcement that it will not enforce the gift tax for donations to (c)(4)'s, there is no incentive for donors to designate contributions. Ellen P. Aprill, *Once and Future Gift Taxation of Transfers to Section 501(c)(4) Organizations: Current Law, Constitutional Issues, and Policy Considerations*, 15 N.Y.U. J. LEGIS. & PUB. POL'Y 289 (2012) [hereinafter Aprill, *Once and Future Gift*].

organization must still be consistent with its exempt purpose, and political campaign activity is not considered consistent with an SLB's exempt purpose. If the primary purpose standard is enforced, then SLBs are a less attractive means of subverting the requirements in section 527 because organizations must engage in a significant amount of non-campaign-related activity to ensure that the organization's primary purpose remains consistent with its exempt purpose.

Properly constituted organizations could still engage in their core function, like labor unions, business leagues, or legislative advocacy, and could engage in some political advocacy, because their core function would still be consistent with their exempt purpose. Enforcement of the primary purpose standard, however, would discourage independent groups engaged in political campaigns from emigrating from section 527 and thus avoiding campaign disclosure rules.

The primary purpose standard has been ineffectual in restraining groups from emigrating from section 527 political organizations towards other exempt organizations primarily because of lax enforcement by the IRS. Groups wishing to engage in political advocacy while maintaining section 501(c) status have argued that their activities are issue advocacy and not intervention in a political campaign. In some cases, groups have even argued that, as long as they do not engage in express advocacy or electioneering communication, they have not intervened in a political campaign.¹⁰³ Lax enforcement by the IRS has allowed groups to use an improper and very restrictive definition of campaign advocacy, claiming that most of their spending is issue advocacy and consistent with their exempt purpose.

As discussed in Part II.B.4, it is unclear how much activity that is inconsistent with a group's exempt status is allowed under the primary purpose standard. Commentators have suggested anywhere from 10 percent to 49.9 percent might be allowed under the standard. But even under the most generous definition of primary—that more than 50 percent of an organization's activities must be consistent with its exempt purpose—groups must still expend significant funds on activities consistent with their exempt purpose to satisfy the primary standard. Non-section 527 exempt organizations are an inefficient means of intervening in political campaigns if the organization must engage in non-electoral activity. Groups therefore try to characterize campaign-related activity as issue advocacy, education, or lobbying.

A 2012 study by ProPublica investigated the election disclosures and the tax filings of hundreds of exempt organizations.¹⁰⁴ ProPublica determined

103. *See infra* note 167 (discussing groups view of permissible activities).

104. Kim Barker, *How Nonprofits Spend Millions on Elections and Call it Public Welfare*, PROPUBLICA, Aug. 18, 2012, <http://www.propublica.org/article/how-nonprofits-spend-millions-on-elections-and-call-it-public-welfare> [hereinafter

that organizations were making inconsistent filings with the IRS and the FEC.¹⁰⁵ Organizations made filings with the IRS that indicated they would not intervene in an election, but then made filings with the FEC indicating election related activities. Other groups disclosed some political spending on their Form 990s with the IRS but disclosed even more political spending with the FEC.¹⁰⁶

It is possible that these groups are making false statements to the government, but it is more likely that the groups are choosing to use different definitions for purposes of election law and tax law. Apparently, at least some groups are arguing that communication is campaign related for purposes of election law, but not campaign related for purposes of tax law. This is particularly troubling because the tax definition of intervention in a political campaign is broader, not narrower, than the election law definition.

Since there has been very little enforcement by the IRS in this area, and limited cases defining primary purpose with regard to intervention in a political campaign, groups have been able to organize as SLBs and engage in almost unlimited political campaign intervention.

b. Provisions Subjecting Donors to SLBs to Gift Taxes Have Failed to Limit Political Organizations From Organizing as SLBs

Unlike section 501(c)(3) churches and charities, and section 527 political organizations, social welfare organizations, labor unions, and business leagues are not statutorily exempt from gift tax.¹⁰⁷ If the gift tax applied to donations to these organizations, then donors who contributed more than \$14,000 would be responsible for paying gift tax on the amount donated.¹⁰⁸ If donors were subject to gift tax, then tax-exempt organizations, other than political organizations, would be unattractive as campaign vehicles for large contributions.

Barker, *Public Welfare*]. See Kim Barker & Al Shaw, *How Some Nonprofit Groups Funnel Dark Money Into Campaigns*, PROPUBLICA, Oct. 4, 2012, <http://projects.propublica.org/dark-money/> for all of the data underlying the ProPublica study. See also Julie Patel, *Nonprofits' Failure to Report Political Activity to the IRS Raises Questions*, CENTER FOR PUBLIC INTEGRITY, Mar. 4, 2014.

105. See Barker, *Public Welfare*, *supra* note 104.

106. *Id.*

107. I.R.C. § 2501 (gift donor subject to tax if gift exceeds threshold amount and donor does not use gift tax exemption).

108. The gift tax would not apply to Corporations. Individuals could avoid paying tax by using part of the estate and gift tax exclusion amount, set at \$5,340,000 for 2014, but donors rarely want to use up their exemption on political contributions.

While some argue the gift tax does not apply to SLBs, there is significant authority for applying the gift tax to these organizations, and IRS rulings indicate that such donations would be subject to gift tax.¹⁰⁹ In addition, there is a specific statutory exemption for gift tax for section 501(c)(3) and section 527 organizations, which does not exist for SLBs.¹¹⁰ The fact that the exemption exists for section 501(c)(3) organizations and section 527 organizations, and that the exemption language was part of section 527 when it was enacted in 1975, indicates that Congress believed a statutory gift tax exemption was necessary.¹¹¹

After an estate and gift tax audit raised this issue with regard to a taxpayer's estate, members of the Senate Finance Committee complained to the IRS about the enforcement of the gift tax for donors to SLBs.¹¹² The IRS then issued a notice to its agents that they should not expend examination resources on whether the gift tax is applicable to contributions to section 501(c)(4) organizations.¹¹³ The IRS indicated it was going to examine this issue and determine whether further guidance was necessary. The IRS also explained that any future enforcement activity would be prospective and only after notice to the public.¹¹⁴

109. Aprill, *Once and Future Gift*, *supra* note 102.

110. I.R.C. § 2501 (exempts 527 organizations from gift tax); I.R.C. § 2522(a)(2) (exempts contributions to 501(c)(3) organizations by providing a credit against gift tax for charitable contributions). Section 2522 also provides for a credit for contributions to associations operating under a lodge system, but only if such gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes.

111. Act of Jan. 3, 1975, Pub. L. No. 93-625, § 10(a), 88 Stat. 2108, 2116–19.

112. Press 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 nine business days.), <http://finance.senate.gov/newsroom/ranking/release/?id=ec29441e-aefd-4192-a628-d96966cf4231>.

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

114. Miller, *Memo*, *supra* note 113.

Interestingly, the IRS's decision not to enforce the gift tax on donations to section 501(c)(4) had a positive impact on Republican organizations. At the time of the decision, the number of Republican-leaning section 501(c)(4) groups far outnumbered Democratic ones, and lax enforcement favored those organizations. By indicating there would be no enforcement actions regarding the gift tax and contributions to SLBs, the IRS, just several months before the 2012 election, provided SLBs with clarification that they could receive unlimited contributions without being concerned with the gift tax ramifications of the contributions. The IRS announcement removed the last hurdle for political organizations that wished to organize as SLBs to avoid disclosure.

To the extent there is concern regarding political decisions by the IRS, the announcement regarding the gift tax could also be seen as a political decision. It would just be a political decision favoring Republican-leaning organizations. Had the IRS determined that the gift tax applied to donations to (c)(4)'s, which would have discouraged contributions to SLBs, the IRS likely would have been accused of engaging in partisan politics in favor of democrats. The announcement is a clear case where either action or inaction favored a particular party and could be seen as a partisan act. Interestingly, the IRS employee who issued the memorandum that arguably favored Republican organizations was Steven Miller, the IRS official who was the acting Commissioner of the IRS at the time the controversy erupted in 2013 involving the IRS's examination of social welfare organizations.

III. THE ROOT CAUSES OF THE 2013 IRS CRISIS

In 2013, the Treasury Inspector General for Tax Administration released a report indicating that the IRS had used partisan criteria in evaluating whether to grant tax-exempt status to certain groups.¹¹⁵ This report unleashed a firestorm of criticism about the IRS and its examination practices. The events that followed, including management change at the IRS, congressional hearings, and further investigations, produced deeply divided narratives about the causes of the crisis and possible solutions. This section briefly discusses the crisis, including the facts surrounding the crisis and examines the underlying actions by tax-exempt groups that caused many academics and politicians to call for enforcement of the current rules regarding political campaign intervention and tax-exempt entities.

A. *Inspector General Report*

On May 14, 2013, the Treasury Inspector General for Tax Administration (TIGTA) issued a report concluding that the IRS used

115. TREASURY INSPECTOR, *supra* note 3.

inappropriate criteria to identify tax-exempt applications for review. The Inspector General conducted an audit to investigate allegations that the IRS was (1) targeting specific groups applying for tax-exempt status for further examination; (2) delaying processing of applications for targeted organizations; and (3) requesting unnecessary information from targeted groups.¹¹⁶ The TIGTA report created protest from Members of Congress, from conservative groups, and from commentators alleging that the IRS was targeting conservative groups in an attempt to suppress political expression by conservative groups.

TIGTA found that the IRS used inappropriate criteria in identifying potential cases for further review, including subjecting organizations to further examination based on phrases like “Tea Party,” “Patriots” or “9/12 Project.”¹¹⁷ These inappropriate criteria, such as organization names and policies, were used for over eighteen months as a result of insufficient management oversight.¹¹⁸ According to TIGTA, this resulted in lengthy delays, requests for unnecessary information, and a public perception of bias.¹¹⁹ TIGTA provided three recommendations for the IRS to cure these defects: (1) better oversight when modifying the criteria to be used; (2) documenting a brief explanation of why applications are chosen for review; and (3) holding training or workshops before each election cycle on the proper ways to identify applications for review.¹²⁰

Regarding the allegation of lengthy delays, the investigation found that some organizations waited two years or more, and in some cases, two election cycles, to find out the results of their application.¹²¹ More than 80 percent of the cases chosen for review were open for one year or longer.¹²² These delays were determined to also be a result of ineffective management oversight, and five recommendations were provided to limit delays, including development of better processes for monitoring cases and requesting assistance from other departments, increasing transparency, development of workshops to increase knowledge and training of employees, and ensuring better oversight.¹²³

During TIGTA’s investigation, he examined 170 organizations that received requests for additional information and determined 58 percent of them had been unnecessary.¹²⁴ This was found to be a result of lack of

116. TREASURY INSPECTOR, *supra* note 3, at 3.

117. TREASURY INSPECTOR, *supra* note 3, at 5–6.

118. TREASURY INSPECTOR, *supra* note 3, at 6–7.

119. TREASURY INSPECTOR, *supra* note 3, at 7.

120. TREASURY INSPECTOR, *supra* note 3, at 10–11.

121. TREASURY INSPECTOR, *supra* note 3, at 11, 14.

122. TREASURY INSPECTOR, *supra* note 3, at 15.

123. TREASURY INSPECTOR, *supra* note 3, at 12, 16–17.

124. TREASURY INSPECTOR, *supra* note 3, at 18.

managerial review and lack of knowledge regarding the applicable law.¹²⁵ To combat this, it was recommended that training or workshops be held before each election cycle, addressing which types of additional information are appropriate to request and how the questions should be worded.¹²⁶

Following the release of the report, there was backlash from liberal groups who argued that they had also been targeted, weakening the claim that the IRS only singled out conservative groups.¹²⁷ Since TIGTA's investigation revealed that around one-third of the applications identified for review contained "Tea Party," "9/12," or "Patriots" in their name, the Director of Rulings and Agreements argued that the remaining two-thirds was evidence that the IRS was not solely targeting conservative groups.¹²⁸ Lois Lerner, the then Director of the IRS Tax-Exempt Organizations Division, specifically stated during the TIGTA investigation that some of the organizations selected for scrutiny were specifically affiliated with either the Democratic or Republican party.¹²⁹ Additionally, in a May 15, 2013 release from the IRS, it was stated that, of the 300 cases TIGTA's investigation considered, only around 70 of those were cases involving the name "Tea Party."¹³⁰ The remaining applications selected for review were for organizations of "all political views."¹³¹ The top ranking Democrat on the House Oversight Committee argued that interviews with IRS employees held before the Committee demonstrated no intentional bias, and even criticized the Inspector General for omitting from his report information showing that liberal groups had also been targeted, particularly those that used the term "progressive."¹³² It was also pointed out that, even if Tea Party and other

125. TREASURY INSPECTOR, *supra* note 3, at 18.

126. TREASURY INSPECTOR, *supra* note 3, at 21.

127. Tom Cohen, *IRS Interviews Show No Political Bias, Democrats Say*, CNN, (July 16, 2013, 2:27 PM), <http://www.cnn.com/2013/07/16/politics/irs-scandal/> [hereinafter Cohen, *No Political Bias*]; Jonathan Weisman, *I.R.S. Scrutiny Went Beyond the Political*, N.Y. TIMES, July 4, 2013, http://www.nytimes.com/2013/07/05/us/politics/irs-scrutiny-went-beyond-the-political.html?pagewanted=all&_r=0.

128. TREASURY INSPECTOR, *supra* note 3, at 8; Martin A. Sullivan, *News Analysis: Substantial Minority of Scrutinized EOs Were Not Conservative*, 139 TAX NOTES 1103 (May 30, 2013) [hereinafter Sullivan, *Substantial Minority*].

129. Sullivan, *Substantial Minority*, *supra* note 128, at 1103.

130. Sullivan, *Substantial Minority*, *supra* note 128, at 1103.

131. Sullivan, *Substantial Minority*, *supra* note 128, at 1103 (also showing that according to Tax Analysts' research, of the 176 organizations approved by the IRS in May for tax-exempt status, 46 used "Tea Party," "Patriots," or "9/12 Project" in their name, 76 were other conservative organizations, 48 were not conservative organizations, and 6 were indeterminable).

132. See Cohen, *No Political Bias*, *supra* note 127; Deirdre Shesgreen, *IRS: Liberal Groups Got Less Scrutiny Than Tea Party*, USA TODAY (June 27, 2013, 9:54 PM), <http://www.usatoday.com/story/news/politics/2013/06/27/ways-and->

conservative groups had been singled out for scrutiny, the only group to have actually been denied tax-exempt status was in fact a progressive group.¹³³

B. Practices by Tax-Exempt Groups That Prompted Calls for Enforcement by the IRS

In general, contrary to the TIGRA report's conclusion, the IRS was likely under enforcing, not over enforcing, rules regulating tax-exempt social welfare organizations. While no one is condoning the use of partisan criteria in examining a group's tax-exempt status, groups have been very aggressive in seeking social welfare status as a means of avoiding the disclosure provisions in section 527. According to the Center for Responsive Politics, spending by organizations that do not disclose their donors increased from less than \$5.2 million in 2006 to well over \$300 million in 2012.¹³⁴

In addition, although it is difficult to determine what communication a social welfare group asserts is intervention in a political campaign and therefore not social welfare, and what communication groups claim is social welfare spending, groups appear to be taking a very aggressive approach in classifying their communication as social welfare spending.

First, groups have treated contributions from one social welfare group to another as social welfare spending.¹³⁵ By doing so, groups can increase the amount of spending that they claim is for social welfare spending. Groups can churn this money as one group gives to another, who then gives to another. Each group then claims that amount of money as social

means-irs-werfel-tea-party/2461573/; Richard Rubin, *Tea Party Groups More Likely to Get IRS Look Than Others*, BLOOMBERG (June 27, 2013, 12:23 PM), <http://www.bloomberg.com/news/2013-06-27/tea-party-groups-more-likely-to-get-irs-look-than-others.html>; Dan Roberts, *IRS Tax Scandal in US: New Evidence Undermines Political Bias Claims*, THE GUARDIAN (June 3, 2013, 8:01 PM), <http://www.theguardian.com/world/2013/jun/04/irs-tax-scandal-new-evidence>; Sam Stein & Michael McAuliff, *IRS Scandal Investigator 'Very Concerned' His Report Missed Progressive Targeting*, HUFFINGTON POST (July 18, 2013, 5:12 PM), http://www.huffingtonpost.com/2013/07/18/irs-scandal-report-russell-george_n_3619102.html.

133. Joan Walsh, *Meet the Group the IRS Actually Denied: Democrats!*, SALON (May 15, 2013, 8:40 PM) https://www.salon.com/2013/05/15/meet_the_group_the_irs_actually_revoked_democrats/.

134. *Political Nonprofits*, OPENSECRETS.ORG, last accessed Mar. 11, 2014, http://www.opensecrets.org/outsidespending/nonprof_summ.php.

135. See CrossroadsGPSChannel, *Can't Afford Patty*, YOUTUBE (Oct. 4, 2010) (commercial by Crossroads GPS attacking Senator Patty Murray), http://www.youtube.com/watch?v=nBJTiXvM3_4; Crossroads GPSChannel, *Hurting for Certain*, YOUTUBE (commercial by Crossroad GPS attacking Congressman Sestack), <http://www.youtube.com/watch?v=NCBIbj9nOMs> [hereinafter Crossroads GPS, *Hurting for Certain*].

welfare spending. As groups increase the claimed amount of social welfare spending, they create more room for organizations to engage in political activity while still claiming their primary purpose is social welfare. A 2013 study by the Center for Responsive Politics and National Public Radio traced the money flow of over \$17 million from one donor social welfare organization to over 15 organizations.¹³⁶ Another recent study by the Center for Responsive Politics and the Washington Post traced over \$400 million in a “maze of money” that involved the transfer of funds in a 17 entity network.¹³⁷

Second, groups have taken a very aggressive position with regard to what constitutes social welfare activity. For example, in 2010, Crossroads GPS announced that it was going to spend over \$2 million on advertisements in Pennsylvania, California, and Kentucky. Crossroads apparently argued that these advertisements were not political intervention for purposes of determining the group’s social welfare status.¹³⁸ 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.¹³⁹

These types of advertisements were exactly the type of political advertisements masquerading as “education” or “lobbying” that Congress

136. Viveca Novak, Robert Maguire & Peter Overby, *Wellspring’s Flow: Dark Money Outfit Helped Fuel Groups on Political Front Lines*, OPENSECRETS.ORG, Nov. 5, 2013, <http://www.opensecrets.org/news/2013/11/well-springs-flow/>.

137. Matea Gold, *Koch-backed Political Coalition, Designed to Shield Donors, Raised \$400 Million in 2012*, WASH. POST (Jan. 5, 2014), http://www.washingtonpost.com/politics/koch-backed-political-network-built-to-shield-donors-raised-400-million-in-2012-elections/2014/01/05/9e7cfd9a-719b-11e3-9389-09ef9944065e_story.html.

138. Dan Froomkin, *IRS to Take on Karl Rove? Tax Laws Could Take a Bite out of Secret Political Spending*, HUFFINGTON POST (May, 25, 2011, 5:12 AM), http://www.huffingtonpost.com/2011/05/25/irs-karl-rove-crossroads-tax-law-donor-disclosure_n_866428.html.

139. See Crossroads GPS, *Hurting for Certain*, *supra* note 135.

was trying to clamp down on when it required disclosure of section 527 political organizations.

Finally, there is evidence that groups, either purposefully or unknowingly, are claiming that they are engaged in social welfare activity when in fact they are engaged in candidate advocacy. For example, there is growing evidence that groups have reported political activity to the Federal Election Commission but have then claimed not to have intervened in a political campaign for purposes of disclosure to the IRS.¹⁴⁰ In addition, some groups that claimed they were improperly investigated by the IRS appear to have been engaged in candidate-related activities. For example, according to a press report, We the People Convention argues that it is an educational organization, but its conventions in Ohio included, among other things, a session on “unified grassroots effort supporting the Josh Mandel Candidacy.”¹⁴¹ At the time, Josh Mandel was the State Treasurer and a candidate for the United States Senate.

According to a report in the New York Times, the Wetumpka Tea Party trained participants in a get-out-the-vote drive designed to “defeat President Barack Obama,” and the Ohio Liberty Coalition organized members to distribute presidential campaign literature for Mitt Romney.¹⁴² CVFC 501(c)(4), which appears to be associated with Combat Veterans for Congress PAC, claimed it was going to be engaged in “social welfare programs to assist combat veterans to get involved in government” but then spent \$8,000 on radio ads in support of a candidate.¹⁴³ CVFC 501(c)(4) political spending is not on the group’s Form 990 filed with the IRS and the group checked “no” to the question of whether it engaged in political activities on behalf of a candidate.¹⁴⁴ Finally, the Ohio Liberty Coalition canvassed neighborhoods on behalf of Mitt Romney. The president of the organization told the New York Times that, after consulting with a lawyer, he believed “that other activities, like distributing literature for the Romney campaign, would not raise concerns” and noted that “[i]t’s not political activity.”¹⁴⁵

140. See Barker, *Public Welfare*, *supra* note 104.

141. Joe Hallett, *It’ll Be a Long Campaign for Ohio’s Fact-Checkers*, COLUMBUS DISPATCH (June 9, 2013, 6:01 AM), <http://www.dispatch.com/content/stories/editorials/2013/06/09/1-itll-be-a-long-campaign-for-ohios-fact-checkers.html>.

142. See Nicholas Confessore & Michael Luo, *Groups Targeted by I.R.S. Tested Rules on Politics*, N.Y. TIMES, May 26, 2013, at A1, http://www.nytimes.com/2013/05/27/us/politics/nonprofit-applicants-chafing-at-irs-tested-political-limits.html?pagewanted%253Dall&_r=0 [hereinafter Confessore & Luo, *Groups Targeted*].

143. *Id.*

144. *Id.*

145. *Id.*

IV. IMPROVEMENTS TO THE REGULATORY STRUCTURE REGARDING TAX-EXEMPT STATUS AND POLITICAL ACTIVITY

The current statutory framework fails to adequately and fairly regulate tax-exempt organizations involved in political campaigns. A fair and adequate statutory structure needs to respect and value the rights of tax-exempt organizations and political expression, while honoring congressional intent with regard to disclosure and the fact that tax deductible contributions should not support political campaign activity.¹⁴⁶

Absent the disclosure provisions in section 527, the tax benefits to political organizations and SLBs are nearly identical. Neither type of organization is entitled to tax subsidized contributions, and neither organization is required to pay tax on income related to its exempt function. Both types of organizations serve public goals that Congress has determined are entitled to tax-exempt status.¹⁴⁷ Because social welfare, labor, business leagues, and political activity is all worthy of tax-exemption, organizations that engage in a hybrid activity including some or all of the above should be entitled to tax-exempt status. Once it is recognized that political organizations, SLBs, and hybrid organizations should all be entitled to tax-exempt status, the difficult questions regarding primary purpose and political activity become less important. The primary purpose test sorts the groups into the correct tax category, but absent disclosure, all the groups are entitled to tax-exempt status and all the groups are treated similarly.

Prior to 2000 before disclosure provisions were added to section 527 but not to section 501(c), the statutory structure worked relatively well. Groups sought to organize based on their primary purpose, and there was little gamesmanship with regard to an organization's status.¹⁴⁸ The need still existed to police the boundary between section 501(c)(3) status and other

146. Although it is outside the scope of this article, allowing all tax-exempt organizations to engage in political campaigns, including charities and religious organizations, would allow campaign organizations to use charities and religious organizations as a means of providing tax subsidies contributions to political campaigns. Congress has had a consistent policy of supporting campaign advocacy but providing that it not be done with tax deductible contributions. *See, e.g.*, I.R.C. §§ 162(e), 501(c)(3), 527(f).

147. *See* S. REP. NO. 93-1357, at 26–27 (1974) (stating that political organizations were “the heart of the democratic process” and preferred status was justified).

148. In fact, prior to 2000, because a section 527 organization might be taxed on its non-political activity, groups sought private letters rulings from the IRS arguing that their activities were exempt function political activities under section 527. *See* P.L.R. 1998-08-037 (Feb. 20, 1998); P.L.R. 1999-25-051 (June 25, 1999).

exempt organizations, but there was very little dispute regarding entity status within the other exempt organization classifications.

A. *Create a Special Designation for Organizations That Wish to Intervene in Elections and Require Broad Based Disclosure of Donors to These Organizations*

Creating a similar disclosure regime for all organizations that wish to intervene in political campaigns will greatly simplify the regulatory structure and thereby reduce concerns regarding IRS enforcement. With the exception of section 501(c)(3) organizations, Congress should create two types of tax-exempt organizations for each exempt category—one that is allowed to intervene in political campaigns and one that agrees to eschew all campaign intervention activities. Those organizations that are not interested in engaging in campaign activity would not be subject to disclosure obligations but would be subject to the same political campaign restrictions applicable to section 501(c)(3) churches and charities. Tax-exempt organizations that wanted to engage in political campaign advocacy in addition to activities consistent with the group's exempt purpose would be designated with a "POL" designation. For example, a group could organize as a section 501(c)(4) organization or a section 501(c)(4)-POL organization. As discussed below, POL organizations would have disclosure obligations and would be subject to disclosure on donations above a threshold amount. Similar disclosure rules would apply to all tax-exempt organizations that chose to be organized as POL organizations.¹⁴⁹ Tax-exempt organizations would be subject to additional disclosure if the organization engaged in activities covered by election law.

By broadening disclosure but raising the disclosure limits, Congress would drastically reduce an organization's administrative burdens while also reducing enforcement costs. Since disclosure would be based on an organization's status and dollar value of the donations, there would be significantly less need for IRS examination of an organization's activities. Tracing rules would need to be developed to ensure that shell corporations or entities were not used as a means of subverting the disclosure requirements, but broad disclosure rules capturing large dollar donations will significantly simplify the process.

In addition, a more uniform regime would have the benefit of reframing the political intervention prohibition as a binary test. The question will be whether the organization engages in any campaign-related activity,

149. Section 527 organizations are currently required to disclose contributions in excess of \$200 and expenditures in excess of \$500. I.R.C. § 527(j)(3). My proposal would increase the section 527 amounts significantly and put them on par with the disclosure amounts for other tax-exempt organizations.

not the quantity of such activity. It will also allow rules to be put in place to define campaign activity in the context of this binary choice. In examining campaign activity in distinguishing between a non-disclosing tax-exempt organization and a “POL,” many of the difficult determinations that currently exist with the facts and circumstances test could be overcome by creating a definition of political campaign activity that is very broad. Once the distinction is between whether an organization is subject to disclosure or not, the consequences of a broad-based rule would be more disclosure, which would not have a drastic impact on free speech rights. Since the organization has an easy, not overly burdensome alternative if it wishes to engage in such activity, strict rules with strict application do not pose a heavy burden. Strict rules would still allow organizations that wish to avoid political campaign type activities also to avoid disclosure.

In 2013, a group of tax experts published what they termed the “bright line project.” The goal of the project was to create a test that would create more certainty with regard to the standard for determining whether an activity was impermissible political campaign activity. The “bright line project” is an extremely thoughtful and detailed response to the current problem, but the bright line project itself highlights the problems of creating bright lines. In order to deal with an extremely complicated subject, the recommendations from the bright line project are extremely complicated.¹⁵⁰ But if one limits the task to policing the non-disclosing tax-exempt organization/POL line, then the project may become a little easier.¹⁵¹ Activities like endorsing a candidate, using the organization’s resources to support a candidate, running commercials that promote or oppose a particular candidate, or engaging in more than an insubstantial amount of grassroots lobbying close in time to a political campaign would be prohibited, unless the organization registered as a “POL” organization and disclosed its donors. The 2013 proposed regulation on social welfare organizations provides a nice framework for creating a bright-line rule to police the tax-exempt organization/POL line.

More nuanced activity like prohibiting organizations from engaging in electioneering communication, which poses significant problems of over

150. Greg Colvin et. al., *The Bright Lines Project: Clarifying IRS Rules on Political Intervention*, THE BRIGHT LINES PROJECT (July 12, 2013), <http://www.citizen.org/documents/Bright%20Lines%20Project%20Explanation.pdf>.

151. The bright line project is also concerned with the permissible activities of section 501(c)(3) religious organizations and charities. This is also a binary question because section 501(c)(3) organizations are prohibited from engaging in any activities for or against candidates. In the section 501(c)(3) context, this prohibition is particularly daunting because an organization could lose its status for violating the provision. This paper is not seeking to set the standard for policing the (c)(3) and other tax-exempt line. *See also Comments of the Individual Members, supra* note 55, at 43 (proposing a bright-line standard).

inclusiveness with regard to section 501(c)(3) organizations, is less difficult in the tax-exempt/POL situation. Even though some electioneering communication might not be political campaign activity, a bright line could still be created indicating that only POL organizations could engage in electioneering communication.¹⁵² The fact that some electioneering communication might not be political campaign intervention activity, however, is less of a concern since organizations would still have a means of engaging in that communication.¹⁵³ They would simply have to organize as a POL and disclose donors over the threshold amount.

The distinction between non-political tax-exempt organizations and POL tax-exempt organizations would significantly decrease the enforcement burden on the IRS and would create a more transparent means of determining whether an organization was subject to the disclosure regime.

B. Provide for Transparency of Donor Contributions by Disclosing Large Contributions to Tax-Exempt Organizations

The new POL category will provide for disclosure of donors to organizations engaged in political activity. This broad-based disclosure should be accompanied by simplification rules to make it easier for groups to comply and to eliminate some over disclosure that may occur. Congress should set a high disclosure limit, around \$10,000-\$25,000, for disclosure of individual names and donations. Because an unlimited number of corporations can be created, Congress should require all contributions from corporations to be disclosed. Donor disclosure should be made within seven days of the contribution. Requiring donor disclosure will improve enforcement and decrease the attractiveness of using SLBs as a means of circumventing the disclosure provisions in section 527.¹⁵⁴ The threshold amount for donor disclosure in this proposal is purposefully set very high to ease administrative burdens while still capturing donations that have the potential to cause corruption or the appearance of corruption. Disclosure of large contributions also provides the type of information to voters that the Supreme Court has held justify disclosure provisions.

152. For example, an advertisement for a televised debate between two candidates might be electioneering communication, but it would not be intervention in a political campaign for tax purposes.

153. See *Reagan v. Taxation with Representation*, 461 U.S. 540 (1983).

154. In *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, 10 ELECTION L.J. 427, 448 (2011), I argue that the Treasury, by promulgating regulations, should require SLBs to disclose contributions of \$25,000 or more. While it is controversial whether Department of Treasury would have the power to implement such regulations, Congress has the authority to require disclosure. See *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

Donors that wished to contribute anonymously to an organization's non-political campaign primary purpose activity could still do so by donating to a connected non-POL organization.¹⁵⁵

Donor disclosure reduces both actual corruption and the appearance of corruption,¹⁵⁶ and it provides a signaling and information function to voters.¹⁵⁷ Donor disclosure by tax-exempt organizations will also restore some coherence to the regulatory structure by treating similar tax-exempt organizations similarly.

Because tax-exempt organizations are already required to disclose donors of \$5,000 or more on their Form 990s, and because disclosure here is aimed only at large donations, the disclosure requirement should not be very burdensome for tax-exempt organizations.¹⁵⁸

C. *Require SLBs to File for Recognition*

The 2013 IRS crisis involved the IRS using inappropriate partisan criteria to examine, and in some cases delay, the applications of groups seeking tax-exempt status. One of the bizarre aspects of this crisis is that many of the groups in the examination/delay category were not even required to apply for tax-exempt status. Although there is an application process for those seeking SLB status (Form 1024), groups are not required to apply and

155. Rules could also allow SLBs to set up segregated accounts for political activities and only require disclosure of contributions to the segregated accounts. Similarly, the proposal could allow donors to designate that their contributions can only be used for primary purpose activities, and that such donations would need not be disclosed. A blanket disclosure requirement for all large donations to SLBs engaged in political campaign activity is preferable, however, because segregated accounts and designated donations would recreate the problems in the current enforcement regime of line-drawing between campaign and non-campaign activity, questionable enforcement, and distrust of government action. A binary switch that requires disclosure for organizations that wish to engage in political campaign activity and those that do not greatly simplifies enforcement and reduces the chances of uneven or biased enforcement actions.

156. *Buckley v. Valeo*, 424 U.S. 1, 27 (1976); *Nixon v. Shrink Missouri Gov't PAC*, 528 U.S. 377, 390 (2000); *McConnell v. Fed. Election Comm'n*, 540 U.S. 93, 144 (2003), *overruled by* *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010); *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310, 366 (2010).

157. *Citizens United*, 558 U.S. at 366.

158. Some type of tracing rule would need to exist with regard to donor disclosure to avoid the problems that currently exist in the election law context with regard to electioneering communication. The tax-exempt organization would need to disclose its donors, but in the case of corporate donors, would also need to disclose major donors to the corporate donor. Otherwise, shell corporations could be used as a means of circumventing the disclosure requirements.

may “self-declare.”¹⁵⁹ Self-declaring organizations are still required to file a Form 990 but these organizations are not required to do so until several months after the close of their taxable year.

If an organization may self-declare, then there is no automatic time at which the IRS examines whether an organization meets the regulatory requirements of the statute. In addition, if transparency and disclosure requirements are put in place, then a required application process would be necessary to enforce the new regulatory requirements. A simplified application process, including an express review of applications, could be put in place for small organizations with anticipated contributions below a threshold amount.¹⁶⁰

D. Express Consideration of Applications for Exempt-Status

One of the main problems in the 2013 crisis involved delay in processing applications for exempt status. Under existing rules, inaction by the IRS may be even more harmful than action with a negative decision. Some believe that, in the 2013 crisis, the IRS used inaction and requests for information as a way of avoiding making decisions with regard to an organization’s exempt status. The IRS may have been avoiding political controversy by delaying decisions, and thereby avoiding the political controversy of having to deny or grant exempt-status to organizations. The groups subject to the delay, however, had no recourse to move the process forward (except for the ability in some circumstances to self-declare or petition members of Congress).

As part of the transparency reforms, Congress should also require the IRS to set up procedures to quickly review the Form 1024s that are filed. The IRS should be required to provide an initial determination with regard to an organization’s status within 30 days of receiving an organization’s application for SLB status. If the IRS failed to act within the 30-day period, then the group’s application for exemption would be deemed approved. This might result in extremely complicated groups receiving approval while the IRS was still investigating the organizations, but because these organizations would be subject to disclosure and because these organizations would still be required to file Form 990s at a later date, this initial application would not be the only chance for the IRS to investigate an organization. Congress should

159. See Reg. § 1.6033-1(e) (Social welfare organizations can be “nondeclaring” social welfare organizations. Even if an organization does not file for recognition, it is required to file a Form 990 information return.).

160. Currently, groups that anticipate contributions to be below \$25,000 are not subject to section 527s disclosure requirements. I.R.C. § 527(i)(5).

also establish a process for allowing groups denied SLB status to appeal that decision to a Federal court.¹⁶¹

E. Clarify Primary Purpose Standard

Congress should clarify the requirements for tax-exempt status. As previously discussed, under current law, an organization qualifies as an SLB if it is primarily engaged in activities consistent with the purposes of the exempt category.¹⁶² Outside of the section 501(c)(3) area, the IRS has not provided sufficient guidance regarding how an organization meets the primary purpose standards. Options range from an organization only being allowed to engage in an insubstantial amount of non-exempt activity to organizations being exempt as long as over half of its expenditures are for an exempt function.¹⁶³ Some of the reforms discussed earlier will reduce the need to apply the primary purpose test. Under current law, the primary purpose test serves as the sorting device for determining whether an organization qualifies for SLB status or whether the organization must organize as a section 527 organization and be subject to the disclosure regime in section 527. If the disclosure requirements are made more uniform, then the primary purpose standard becomes less essential, and it becomes easier to create a clear bright-line test.

If a standard disclosure rule is used for all non-section 501(c)(3) exempt organizations, then a bright line primary purpose standard may be more palatable. For example, under current law, a dividing line based on the expenditures of an organization is unsatisfactory. An organization might spend almost all of its expenditures on activity consistent with its exempt purpose, but also organize thousands of volunteers to engage in non-exempt activity. The magnitude of the volunteer hours might change the primary purpose of the organization, and the organization might be more appropriately designated as a section 527 political organization. If one recognizes that the organization is entitled to exempt status and the question is merely under what provision, then there is less concern regarding how to treat volunteer hours. The organization is clearly exempt.

In addition, if disclosure applies more broadly, then there will also be less concern about the content of particular communications. Under current law, groups are claiming that communication that is campaign related is instead issue advocacy. In order to determine whether the communication is in fact issue advocacy or intervention in a political campaign, the IRS applies a facts and circumstances test, discussed in Part II.C.2. This test

161. Section 501(c)(3) groups that are denied tax-exempt status may seek a declaratory judgment in district court. I.R.C. § 7428.

162. *Supra* Part II.B.1.

163. *Comments of the Individual Members, supra* note 55.

requires significant analysis by the IRS and requires the IRS to make politically sensitive judgments regarding what is and what is not political activity.

If broad disclosure is implemented, then Congress could then create clear safe harbor provisions regarding the primary purpose test. The organization's primary purpose would be determined based on exempt activity upon which the organization spent a majority of its funds. The IRS in its recent attempts to approve the backlog of tax-exempt applications has adopted a type of bright-line test applying a 40 percent standard, and members of the ABA tax section have recommended a 40 percent safe harbor with some additional restrictions. The 40 percent safe harbor being used or suggested is premised on the old disclosure paradigm.¹⁶⁴ If disclosure was more broadly required, then a 50 percent safe harbor would be appropriate.

In addition, as discussed in Part II.C.1., since the determination here would be sorting an organization to its proper category, the facts and circumstances test for political campaign intervention could be simplified.¹⁶⁵ If Congress does not broaden the disclosure requirements, then the primary purpose standard, along with the political campaign intervention test, will continue to play a major role in regulating the activities of SLBs and section 527 political organizations. Absent disclosure reforms, Congress should clarify what "primary" means with regard to section 501(c)(4) organizations and should clarify that an organization that fails the primary test because it engages in too much political intervention qualifies as a section 527 political organization. The political campaign intervention fact-based test would still do the heavy lifting with regard to determining what activities qualified in determining an organization's primary purpose. A clarified test, without more, would still create significant problems with regard to enforcement. If Congress is going to rely on the fact-based test for determining primary purpose, it is even more important that Congress create an enforcement mechanism, outside of the IRS, designed to create an independent and fair process for enforcing the primary purpose standard.

F. Redesign Form 990 to Clarify Rules Regarding Election-Related Activities

Redesigning Form 990 and clarifying a group's election-related activities will provide information to tax-exempt organizations and simplify the enforcement process. As the 2013 IRS crisis evolved, it became clear that

164. See *Comments of Individual Members*, *supra* note 55, at 8.

165. This simplified test would not work in the 501(c)(3) situation. Treatment of the political intervention test for religious organizations and charities is outside the scope of this article.

one of the problems in this area was that tax-exempt groups misunderstood, were misinformed, or purposefully violated the laws regarding political activities of tax-exempt groups. One study by ProPublica noted drastic discrepancies between what organizations claimed on their exemption applications, the groups' Form 990s, and the disclosures groups made to the FEC.¹⁶⁶ Some of these discrepancies may have been due to mistakes on the part of the organizations and some may be due to aggressive interpretations about the law by tax-exempt groups,¹⁶⁷ but clear questions on the Form 990 with regard to political activity will eliminate some of these inadvertent mistakes and will streamline enforcement.

The current Form 990 requires organizations to disclose if they “engage[d] in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office.”¹⁶⁸ Organizations, however, are making this representation based on their own interpretation of what qualifies as intervention in a political campaign. Specific questions on the Form 990 would focus the attention of tax-exempt groups to their activities and would provide information to the IRS to allow for appropriate enforcement.

For example, questions on the Form 990 could include: Does your organization, or members of your organization in association with organization activities, engage in or plan to engage in any of the following activities:

- Fund, support, provide expertise or advice with regard to any TV, radio, Internet, or print advertisement that mentions a name, likeness, or office of a candidate for public office?
- Engage in distribution of material through any means that mentions the name of a candidate?
- Participate in rallies, events, or meetings with political candidates?

Answering “yes” to any of these questions would not mean a group was in violation of its tax-exempt status, but it would provide clear guidance to groups about the type of activities that might be political campaign intervention. It will also provide a starting point for the IRS in its investigations whether groups are violating their tax-exempt status.

166. Barker, *Public Welfare*, *supra* note 104.

167. See Confessore & Luo, *Groups Targeted*, *supra* note 142 at A1 (finding some of the groups in the Inspector General's report claimed not to be engaged in campaign-related activity but spent funds on radio ads on behalf of a candidate, other groups claimed that a partisan get-out-the-vote effort was “educational,” and one group canvassed in favor of Mitt Romney but claimed that he thought the activity was okay as long as it wasn't radio or television advertising.).

168. I.R.S. Form 990 (2012), Part IV, Line 3.

V. CONCLUSION

As the 2013 IRS crisis makes clear, the IRS is poorly equipped to regulate the campaign activities of tax-exempt organizations. The Federal Election Campaign Act, the Bipartisan Campaign Reform Act, and the addition of disclosure provisions to section 527 of the Internal Revenue Code all evidence Congress's intent that "candidate-related political advocacy" be subject to a meaningful disclosure regime. Independent organizations have been manipulating campaign finance rules and tax rules to avoid campaign finance and tax disclosure provisions. The 2013 crisis highlights, however, that the IRS is the wrong entity to police disclosure provisions. If the IRS is going to be charged with enforcement, then the statutory regime must be structured as to avoid, as much as possible, broad agency discretion. In addition, the disclosure provisions should apply broadly so organizations will not have an incentive to manipulate organizational form to avoid disclosure. A statutory structure with bright-line rules and broad-based disclosure will increase compliance and decrease agency discretion, thus limiting the opportunity for perceived or actual political manipulation of the enforcement process.