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142 Tax Notes 1120 (2014).

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The 2013 IRS Crisis: Where Do We Go From Here?

By Donald B. Tobin

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This article argues that the IRS's new proposed regulation on candidate-related political activities is a good first step. It creates a bright-line standard that is easy to apply and will reduce concerns that the IRS is manipulating the enforcement process for political gain. The regulation addresses serious concerns that some independent groups are circumventing disclosure laws in the code. These groups are improperly arguing that they qualify as social welfare organizations when in fact they are political organizations subject to disclosure under section 527. A better solution would be for Congress to pass broad-based campaign disclosure laws that would apply regardless of the type of entity engaged in the activity. Absent broad-based disclosure, the IRS has the responsibility to enforce the restrictions contained in the code. Under the proposed regulation, organizations wishing to engage in candidate-related political activities may still do so. They simply must do so through a section 527 political organization and disclose their contributions and expenditures. However, absent broad-based disclosure, groups will seek out other entity structures to engage in non-disclosed candidate advocacy.

This article was presented on January 17 at a symposium in Malibu, Calif., sponsored by Pepperdine University School of Law and Tax Analysts. Twenty of the nation's leading tax academics, practitioners, and journalists gathered to discuss the prospects for tax reform as it is affected by two crises facing Washington: dangerously misaligned spending and tax policies, resulting in a crippling \$17.4 trillion national debt; and the IRS's alleged targeting of conservative political organizations. A video recording of the symposium is available at http://new.livestream.com/pepperdine_sol/taxreform.

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The biggest political campaign controversy in 2013 did not involve political candidates but instead centered on the IRS's enforcement of Internal Revenue Code provisions regulating the political activities of some tax-exempt organizations. Some tax-exempt groups and politicians argued that the IRS improperly targeted conservative, politically active tax-exempt organizations for scrutiny, while

others argued that the IRS had failed to enforce restrictions in the IRC regulating the political activity of tax-exempt organizations.¹ The IRS's attempt — and some say ineptitude — in enforcing the code's political campaign restrictions caused a political crisis that rocked America's trust in the nonpartisan enforcement of the tax laws. The Obama administration needs to move quickly to restore that trust while also restoring confidence that independent groups will not be able to circumvent congressional intent regarding the disclosure of donors to political organizations.

The underlying causes of the IRS crisis were both external and internal. First, external factors placed the IRS in the middle of regulating aspects of political campaigns — a chore for which it is not particularly well suited. The statutory regime vests the IRS with the responsibility of ensuring that tax-exempt organizations comply with restrictions on their political campaign activities. It also gives the IRS the responsibility of policing campaign-related disclosure provisions that require section 527 political organizations to disclose contributors and expenditures.

Second, internal factors within the IRS's control exacerbated the crisis. Despite a drastically changing regulatory landscape and significant changes to the ways tax-exempt organizations engage in political activity, the IRS failed to ramp up enforcement or provide adequate guidance to tax-exempt groups regarding permissible and impermissible activities. When the IRS finally sought to engage in some enforcement, it did so in a way that ignited the crisis. Because most tax-exempt section 527 political organizations must disclose the names of their donors and the amount of their contributions, as well as the organization's expenditures, independent groups have strong incentives to organize as tax-exempt entities that are not subject to the disclosure provisions, most notably social welfare organizations and business leagues. The regulatory structure is inadequate to deal with the growing number of organizations seeking to avoid political organization status and thereby avoid the code's disclosure provisions. As groups have become more aggressive in seeking alternative entity status to avoid disclosure provisions, the regulatory structure has not kept pace.

¹See, e.g., letter to then-IRS Commissioner Douglas Shulman from Sen. Carl Levin, D-Mich. (July 27, 2012) (calling attention to the IRS's inactivity in enforcing the statutory requirement that social welfare organizations not engage in political activity); Treasury Inspector General for Tax Administration, "Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review," 2013-10-053 (May 14, 2013).

The best step Congress and President Obama can take to restore confidence in the IRS and reduce damage from the crisis is to pass broad-based campaign disclosure laws that remove the IRS from the campaign finance landscape. The IRS is an organization designed to protect the fisc and enforce the internal revenue laws. It has no particular expertise in campaign finance, and placing the IRS in the middle of this fray can only lead to distrust in the agency and accusations that the IRS's decisions are based on a political agenda.²

Absent new legislation providing for broad-based disclosure, Treasury can engage in some self-help activities. In November 2013 the administration released a proposed regulation designed to clarify the rules for tax-exempt social welfare organizations involved in political activity.³ The regulation is a good first step. It creates a bright-line standard that is easy to apply and will eliminate much of the gray area regarding permissible political activity. Clearer lines will decrease the IRS's discretion and, in turn, reduce the opportunity for the IRS to be used as a political tool in an administration's toolbox.

In many instances, the proposed regulation does not go far enough to clarify the rules for tax-exempt organizations involved in political advocacy. Since groups have a strong incentive to avoid organizational forms that require disclosure, regulatory clarity will help prevent gaming by tax-exempt organizations. Further, the proposed regulation does not address a constant problem in this area: the fact that entity-based regulation will encourage the creation of new and different entities to get around the current rules. Any final regulation should be more broad-based and apply to all section 501(c) organizations except churches and charities.

Second, the regulation does not do enough to address the enforcement problems that surfaced as

part of the crisis. The administration should set out clear guidance regarding when and how it will enforce the current rules governing tax-exempt organizations. It appears the IRS failed to enforce those rules in the past because it feared entering the political fray, and there have been almost no court cases involving the enforcement of political restrictions on tax-exempt organizations. The regulation will have no effect if the IRS continues its practice of failing to enforce the requirements.⁴

A. History and Current Regulatory Structure

The history of the statutory structure regulating tax-exempt organizations indicates that Congress intended that tax-exempt organizations that wished to engage in significant political campaign advocacy organize as section 527 political organizations and disclose their donors and expenditures. The proposed regulation is not a new attempt by the administration to place further restrictions on tax-exempt organizations but is instead an effort to clarify the current rules and restore equilibrium to the statutory structure. The attempt by organizations to circumvent congressional intent and use other tax-exempt forms as a means of avoiding the disclosure provisions for section 527 political organization violates the statutory structure, and the administration is appropriately taking steps to stop that abuse. The proposed regulation also provides clearer standards, which give the IRS less discretion regarding enforcement and which provide tax-exempt groups more information about permissible activities.

1. Structure of exempt organizations. In general, almost all political campaign activity is conducted by tax-exempt organizations. Although section 501(c)(3) organizations are prohibited from intervening in a political campaign, social welfare groups organized under section 501(c)(4), labor unions organized under section 501(c)(5), and business leagues organized under section 501(c)(6) all may engage in campaign-related political activities. However, those organizations must be primarily engaged in activities consistent with their exempt function, and political campaign activities do not count as activities consistent with their exempt function.⁵

²In fact, even before this crisis, those assertions were made by Democrats during the George W. Bush administration and by Republicans during the Obama administration. See Michael Janofsky, "Citing July Speech, I.R.S. Decides to Review N.A.A.C.P.," *The New York Times*, Oct. 29, 2004 (quoting NAACP Chair Julian Bond: "This is an attempt to silence the N.A.A.C.P. on the very eve of a presidential election. We are best known for registering and turning out large numbers of African-American voters. Clearly, someone in the I.R.S. doesn't want that to happen."); Rebecca Trounson, "IRS Ends Church Probe but Stirs New Questions," *Los Angeles Times*, Sept. 24, 2007 (quoting All Saints Episcopal Church attorney Marcus S. Owens indicating his client was concerned that "the IRS allowed partisan political concerns to direct the course of the All Saints examination"); letter from Senate Finance Committee Republicans to Shulman (May 18, 2011) (six senators urged the IRS to stop enforcing gift tax on donations to groups active in politics).

³REG-134417-13.

⁴Although the crisis is the result of the IRS's delay in granting exempt status to organizations, there is little evidence of significant enforcement actions by the IRS in this area. There are almost no cases involving the revocation of exempt status for engaging in political activity, and I am unaware of any published cases involving the IRS reclassifying an organization as a section 527 political organization.

⁵Reg. section 1.501(c)(4)-1(a)(2)(ii).

Under the current regulatory structure, section 501(c)(3) churches and charities are entitled to receive contributions, which are deductible by the donors. Also, in most cases the income of section 501(c)(3) organizations is not subject to tax. However, section 501(c)(3) organizations are completely prohibited from engaging in campaign-related political activities.

Section 501(c)(4) social welfare organizations, the organizations that are the subject of the proposed regulation, must not be organized for profit and must be “operated exclusively for the promotion of social welfare.”⁶ Although Congress used the word “exclusively” in the statute, a current regulation provides that an organization qualifies if “it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.”⁷ Intervention in a political campaign is not a social welfare purpose.⁸ Thus, to the extent groups seek to engage in significant campaign-related activities, they do not qualify as social welfare organizations under current law. Further, unlike section 501(c)(3) organizations, social welfare organizations are not required to file a form with the IRS seeking recognition of their exempt status. They may seek recognition by filing a Form 1024, but they are not required to do so.⁹ A social welfare organization must file a Form 990 information return; however, that return may not be due (including extensions) for 22½ months from the group’s creation.¹⁰

If anything, the statutory definition providing that an organization must be exclusively engaged in social welfare indicates congressional intent that social welfare organizations not be political campaign advocacy organizations. It is the Treasury regulation, not the statute, that says a social welfare organization may engage in some level of political activity.

⁶These organizations are exempt from tax, but unlike section 501(c)(3) churches and charities, contributions to the organizations are not tax deductible.

⁷Reg. section 1.501(c)(4)-1(a)(2)(ii); see Rev. Rul. 2004-6, 2004-1 C.B. 328. Lobbying is considered a social welfare activity as long as the lobbying is related to the organization’s exempt purpose.

⁸Reg. section 1.501(c)(4)-1(a)(2)(ii).

⁹See reg. section 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.

¹⁰Form 990 must be filed by the 15th day of the fifth month of the end of the tax year. The organization can also seek a six-month extension. Thus, a social welfare organization may choose not to file an information return for 22½ months after its creation. See reg. section 1.6033-1(e).

The code also provides for myriad other tax-exempt organizations, including business leagues and labor unions. Similar to social welfare groups, these organizations may engage in political campaign-related activities, but they must be primarily engaged in an exempt activity — promoting business or labor.¹¹

In 1976 Congress recognized that there was no organizational category for groups that wanted to engage in political campaign advocacy. Before 1976, the IRS simply treated those organizations as tax-exempt, finding that the organizations had no income within the classic meaning of income. This informal tax exemption became unworkable, and Congress enacted section 527. Under section 527, a political organization is “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.”¹² Just like social welfare organizations, labor unions, and business leagues, section 527 political organizations are tax exempt, and contributions to the organizations are not deductible by donors.

Thus, after 1976 the statutory structure was clear. Organizations that eschewed campaign activity organized as either section 501(c)(3) churches or charities or under another code provision. Organizations that wished to engage in a small amount of political campaign activity that was not their primary purpose organized as social welfare organizations, labor unions, or business leagues. Organizations that wished to engage in significant campaign-related advocacy did so through section 527 political organizations. The tax treatment of each organization was fairly similar, and the intended activity, not the tax consequences, generally drove entity choice.

2. Intervention in a political campaign. Current rules governing tax-exempt section 501(c) organizations (thus excluding section 527 political organizations) regulate permissible political campaign activities by setting out whether and how much an organization can intervene in a political campaign. Section 501(c)(3) churches and charities are prohibited from intervening in a political campaign. Other section 501(c) organizations may engage in a limited amount of activities intervening in a political campaign, but intervention activities are inconsistent with the groups’ exempt status.¹³ Section 527

¹¹See GCM 34233 (Dec. 3, 1969).

¹²Reg. section 1.527-2(a).

¹³See section 501(c)(3) (prohibiting intervention in a political campaign for or against a candidate); reg. section 1.501(c)(4)-1(a)(ii) (determining that the promotion of social welfare does not include intervention in a political campaign for or against a candidate); section 527 (“does not include direct or indirect

(Footnote continued on next page.)

uses slightly different language and addresses an organization “influencing or attempting to influence” an election of an individual for public office. With limited exceptions, the IRS has determined that if an activity is prohibited as political intervention under section 501(c)(3), it is political intervention for purposes of determining the primary purpose for other section 501(c) organizations. Also, with few exceptions, the IRS has determined that if an action is political intervention for purposes of the section 501(c)(3) prohibition, it is election activity for purposes of determining whether an organization is a section 527 political organization.¹⁴ Thus, if an activity is considered intervention in a political campaign, a section 501(c)(3) church or charity may not engage in that activity; a social welfare organization and other section 501(c) organizations may engage in a limited amount of the activity; and a section 527 political organization may rely on that activity in proving satisfaction of its primary purpose.

There is no bright-line definition of what constitutes intervention in a political campaign, and the IRS has explained that the determination is based on all the facts and circumstances. The IRS has indicated that key factors include whether the statement (1) identifies candidates for public office; (2) expresses approval or disapproval for a candidate’s positions or actions; (3) is delivered close to the election; (4) addresses an issue that has been raised as an issue distinguishing candidates; (5) is part of a series of communications on the same issue that are independent of the timing of any election; and (6) is made when the identification of a candidate is related to a non-electoral event.¹⁵

Rev. Rul. 2007-41 says “a communication is particularly at risk of political campaign intervention when it makes reference to candidates or voting in a specific upcoming election.”

participation or intervention in a political campaign on behalf of or in opposition to any candidate for public office”).

¹⁴See LTR 9808037 (“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. Exempt.* 5, at notes 7-9 (Mar./Apr. 2010). The IRS has indicated that in some circumstances activities that would not be political intervention in the section 501(c) context might be exempt function activity for purposes of section 527 when the activity is closely tied to election-related activities.

¹⁵See Rev. Rul. 2007-41, 2007-1 C.B. 1421. See also Rev. Rul. 2004-06 (listing other factors and examples).

B. Current Problems

Before 2000, the regulatory structure worked reasonably well. There were some questions regarding the definition of intervention in a political campaign, but organizations could determine their proper entity choice fairly easily. Organizations wishing to be tax-exempt churches or charities organized as section 501(c)(3) organizations and avoided intervening in political campaigns. Organizations that wished to intervene in political campaigns in some circumstances but that still had another major tax-exempt mission organized as section 501(c)(4) social welfare organizations or as another organization under section 501(c). And organizations that wished to primarily engage in campaign-related activities organized as section 527 political organizations. Because donations to section 501(c)(3) organizations are tax deductible, organizations chose to organize as section 501(c)(3) organizations whenever possible. If an organization could not meet the requirements as a church or charity, however, the tax treatment of the other tax-exempt options was very similar. Because the tax treatment among the different tax-exempt groups was similar, there was little incentive to game the system. Organizations engaged in entity choice based on their purpose, and there was significantly less manipulation and gamesmanship regarding a tax-exempt organization’s underlying purpose.

This all changed in 2000 when Congress added disclosure provisions to section 527 and required most section 527 political organizations to disclose their donors and expenditures.¹⁶ Independent advocacy organizations that wanted to avoid the disclosure provisions in section 527 then sought to organize under other code provisions, principally as social welfare organizations or business leagues. The main hurdle for political groups was that to qualify for exempt status as a social welfare organization or a business league, their primary purpose needed to be consistent with their exempt purpose. It is this attempt to circumvent congressional intent regarding political organizations’ disclosure of contributions and expenditures that created most of the current regulatory mess.

Groups wishing to organize as social welfare organizations instead of as political organizations embraced several techniques to supposedly meet

¹⁶Section 527(j)(1), (j)(3)(A), (j)(3)(B) (requiring disclosure of donors who contribute more than \$200, and expenditures by the organization exceeding \$500).

the social welfare purpose requirement.¹⁷ First, to justify their exempt status, these new social welfare organizations needed to engage in social welfare activity. Political campaign activity would be insufficient. Some groups met this requirement by engaging in genuine social welfare activities, like lobbying or promoting issues. Others, however, sought to meet this requirement by classifying campaign-related activities as social welfare activities. Many of these groups appeared to take the position that as long as the activity was not election-related under Federal Election Commission rules, it was a social welfare activity. That position is clearly contrary to IRS rules and guidance.¹⁸ In fact, some groups maintained that even communication reported to the FEC was not campaign intervention activity for purposes of determining social welfare status.¹⁹

One particularly interesting method groups used to “increase” social welfare spending was to make donations to other social welfare groups. Groups determined that those contributions were social welfare because they were made to other social welfare groups, often with the requirement that they be spent on social welfare. The recipient group then transferred the donation to another group, which transferred it to yet another group. By transferring these funds and calling the transfers “social welfare,” each group was able to claim that amount as a social welfare expenditure. This churning of money had a multiplier effect and improperly increased the amount that each organization could claim as social welfare.²⁰ Once the groups could claim a large amount of social welfare spending, they had room to engage in significant political campaign activity.

The second impediment facing groups seeking to organize as social welfare organizations instead of as section 527 political organizations was that it was unclear how much social welfare activity was necessary to satisfy the “primary” requirement in the regulations. The IRS had never clarified what constituted an organization’s primary purpose. Instead, it used a facts-and-circumstances analysis to

reach its conclusion. In many ways, the facts-and-circumstances approach is preferable to a test that uses a specific amount of social welfare activity. For example, a rule that required that a majority of an organization’s expenditures be for social welfare would be problematic because an organization could spend only a small amount of money but have a huge volunteer contingent that engaged in a tremendous amount of campaign advocacy. Further, groups could use donations to other groups to inflate their expenditures. A facts-and-circumstances approach allows for an examination of what is actually happening, not just what organizations assert is happening.

Bright-line tests have the advantage of being easy to enforce, but in the campaign finance arena, where game playing is extreme, bright-line tests can often be problematic. Unfortunately, the facts-and-circumstances approach has failed, and social welfare groups have simply assumed they were complying with the law as long as their expenditures on social welfare exceeded 50 percent of their overall expenditures. Groups therefore succeeded in organizing as social welfare organizations, instead of as political organizations, by characterizing political campaign activity as social welfare education and lobbying and by taking a broad view about how much social welfare spending was required to meet the primary purpose standard.

The proposed regulation is an attempt to crack down on abuse in this area. Some claim that the regulation is a restriction on the First Amendment, but restrictions on massive political campaign activity by social welfare organizations, labor unions, and business leagues are not new.²¹ Groups have been prohibited from engaging in significant political campaign activity for over 50 years. The restrictions on political activity by exempt groups merely define the scope of an organization’s activities. Organizations can still engage in political campaign activity. They just must do so in a way that provides for disclosure of contributors, consistent with Congress’s intent in enacting section 527. The IRS should not allow groups to avoid disclosure by masquerading as social welfare organizations. The new proposed regulation is an attempt to address this problem.

C. Proposed Regulation

The proposed regulation tackles some of the existing problems by clearly indicating what types of political activities will not count as social welfare

¹⁷Because the proposed regulation deals with social welfare organizations, I have limited my analysis to those organizations. The comments here would also apply to business leagues organized under section 501(c)(6).

¹⁸See Rev. Rul. 2007-41; Rev. Rul. 2004-6 (“when an advocacy communication . . . does not explicitly advocate the election or defeat of a candidate, all the facts and circumstances need to be considered to determine whether the expenditure is for an exempt function”).

¹⁹Kim Barker, “How Nonprofits Spend Millions on Elections and Call It Public Welfare,” *ProPublica* (Aug. 18, 2012).

²⁰Robert Maguire and Viveca Novak, “Shadow Money Magic,” *Center for Responsive Politics* (Apr. 2013).

²¹Ellen P. Aprill, “Regulating the Political Speech of Non-charitable Exempt Organizations After *Citizens United*,” *10 Elect. Law J.* 363 (2011) (concluding the restriction on political intervention is constitutional).

activity and by limiting groups' ability to use donor social welfare organizations to inflate their social welfare spending.²² The preamble invites comment on whether the IRS should propose further regulations defining the term "primarily," what level of activity should satisfy the primary purpose standard, and how to measure the activity. Comment is also invited on whether the proposed regulation should be applied to other tax-exempt entities.

1. Create new definition of candidate-related political activity. The proposed regulation takes a new and creative approach to regulating intervention in a political campaign. Because the definition of intervention in a political campaign is inextricably linked to various tax-exempt organizations, it is difficult to create a bright-line standard that can be applied to all of them. To address this in the past, the IRS used a facts-and-circumstances test, which allowed it to examine the underlying activity to determine whether it was really intervention in a political activity. Because tax-exempt churches and charities are completely prohibited from intervening in a political campaign, a broad bright-line test might make it difficult for them to engage in some activities that, while often partisan, can be conducted in a nonpartisan manner.²³ If the bright-line test was going to apply to all tax-exempt organizations, the IRS might have to propose a more limited test, which would allow further circumvention of the current disclosure rules.

Instead, the proposed regulation creates a new term, "candidate-related political activity," which is used for determining whether a particular activity is consistent with the exempt organization's primary purpose.²⁴ If a social welfare organization engages in candidate-related political activity, that advocacy is not considered part of the organization's social welfare activity. By creating the concept of candidate-related political activity, the proposed regulation can implement a broader, bright-line definition that would not have worked if it needed to be applied to churches and charities.

Under the proposed regulation, a social welfare organization must still be organized primarily for a

social welfare purpose, and candidate-related political activity is not considered a social welfare purpose.

The regulation defines campaign-related political advocacy to include:

- 1) Communication expressing a view on a candidate that "contains words that expressly advocate, such as 'vote,' 'oppose,' 'support,' 'elect,' 'defeat,' or 'reject'"; or is susceptible to no other reasonable interpretation; or
- 2) Public communication "within 30 days of the primary or 60 days of the general election" that "refers to one or more clearly identified candidates" or political parties in an election.

These two definitions are very similar to the definitions for express advocacy and for electioneering communication currently used to regulate campaign activity under election laws. Both these types of communications are generally subject to disclosure and regulation by the Federal Election Commission (FEC).

As a catchall, prop. reg. section 1.501(c)(4)-1 also includes as campaign-related advocacy communications that are reported to the FEC. This catchall addresses an ongoing problem whereby organizations claim that expenditures are campaign related when filing with the FEC but, when filing with the IRS, argue they are not intervening in a political campaign.

Had the regulation stopped there, it would have closely tracked election law rules and likely been less controversial. It would also have been a significant expansion of the existing rules regulating the types of activities that social welfare organizations can engage in and would have allowed for significant gamesmanship regarding their activities. That regulation would also have been completely inconsistent with the congressional purpose of requiring section 527 political organizations to disclose contributions and expenditures.

The proposed regulation includes two other provisions that are designed to allow a bright-line rule to police the divide between political activity and social welfare activity. First, the regulation addresses quasi-campaign-related activity. These are activities that often have a significant political purpose but could arguably be non-campaign related. The proposed regulation could have simply created a bright-line rule allowing all those activities, but since they are largely done by organizations wishing to influence elections, a bright-line rule classifying these activities as campaign-related is appropriate.

For example, the proposed regulation classifies as campaign-related: voter registration drives, get-out-the-vote drives, distribution of material prepared on behalf of the candidate, preparation or

²²Donor social welfare organizations are social welfare organizations that donate to other social welfare organizations.

²³For example, voter registration and get-out-the-vote drives are often partisan activities done to support a candidate. A nonpartisan voter registration drive designed to encourage voter registration, or nonpartisan activity to help get people to the polls to vote, are not considered intervention in a political campaign and may be conducted by tax-exempt churches and charities.

²⁴Prop. reg. section 501(c)(4)-1(a)(2)(iii).

distribution of voter guides, and 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.

These activities can easily be conducted in a nonpartisan manner and not be an attempt to intervene in a political campaign, but they are often used by political campaign-related organizations claiming a nonpartisan purpose when their actual purpose is to influence an election. Under the proposed regulation, if these activities are conducted by a section 501(c)(3) organization in a nonpartisan manner, they would be permitted because they would not be considered intervention in a political campaign, but if a section 501(c)(4) social welfare organization engaged in the same activities, they would be considered candidate-related political activities.

The bright-line determination including all this activity as campaign-related troubles some commentators. But that treatment makes sense in the social welfare organization context. A church or charity is completely prohibited from intervening in a political campaign. This restrictive definition would put the charitable status of those organizations at risk even if they were not engaging in partisan campaign activity.

In the social welfare setting, however, the organization is allowed to engage in some amount of campaign-related advocacy. The proposed regulation would not prohibit a social welfare organization from engaging in those activities; it would just assert that they are not part of the group's social welfare purpose. If an organization engages in a large amount of quasi-political activity, it can either do so through a connected section 501(c)(3) organization if the activity is nonpartisan, or through a section 527 political organization if the activity is partisan.

Including this quasi-political activity as candidate-related political activity, however, is important if we seek a regulation that recognizes political realities. Over and over, the types of activities referenced by the proposed regulation have been used by groups as integral parts of a strategy to influence elections, while at the same time those groups have argued their activity was not political. In fact, social welfare organizations rarely engage in these activities in a nonpartisan manner. If the social welfare organization was engaged in a substantial amount of nonpartisan activities listed in the regulation, the group would organize as a section 501(c)(3) organization and receive the more favorable tax treatment. The proposed regulation tackles the problem of quasi-political activity by recognizing political reality and classifying this activity as campaign-related political activity.

For example, social welfare groups have held political events designed to motivate "base" supporters and have invited political candidates to rallies and claimed that those activities were social welfare educational activities.²⁵ Groups have also engaged in get-out-the-vote activities designed to defeat a particular candidate and distributed literature on behalf of a candidate while claiming that the activity was not political.²⁶ These quasi-campaign-related activities are difficult to police and are often political activities masquerading as social welfare or educational activities. The bright-line test in the proposed regulation makes clear that these quasi-campaign activities are treated as candidate-related political activity for purposes of determining whether an organization's primary purpose is social welfare.

Because social welfare organizations may engage in some level of political campaign-related activity, it is less troublesome that some of the advocacy would traditionally not be considered intervention in a political campaign. Those activities are simply part of the allowed activities of social welfare organizations that are not part of the organizations' primary purpose. Because a social welfare organization is still allowed to engage in some of this activity, the fact that it is not considered intervention in a political campaign in the section 501(c)(3) context is not problematic. In enacting section 501(c)(4), Congress used the term "exclusively" in the statute. The current regulations expand on that term, so a restrictive definition of campaign-related activity is still consistent with congressional intent. In fact, even this definition is broader than the statutory language because it still allows some amount of activities that are not social welfare activities. If organizations want to engage in significant nonpartisan activities that are classified as campaign-related activities under the proposed regulation, they can conduct those activities through a connected section 501(c)(3) or section 527 organization.

The second major provision in the proposed regulation that clarifies the rules for social welfare organizations engaged in political advocacy deals with donor section 501(c)(4) organizations. These are social welfare organizations that make large contributions to other social welfare organizations, and in some instances, have no other purpose.

²⁵Nicholas Confessore and Michael Luo, "Groups Targeted by I.R.S. Tested Rules on Politics," *The New York Times*, May 26, 2013, at A1.

²⁶*Id.* (reporting that the Wetumpka Tea Party get-out-the-vote drive was designed to defeat President Obama and that the Ohio Liberty Coalition claimed the distribution of door hangers for Romney was not political).

These groups claim that those expenditures count as social welfare spending in determining their primary purpose. By transferring funds from one social welfare organization to another, a group can multiply its alleged social welfare spending without engaging in social welfare. Moreover, by transferring from one organization to another, the donor is able to put more layers between the original donation and the final expenditure. This potentially allows donors even further opportunity to avoid campaign finance disclosure. A recent study by the Center for Responsive Politics and National Public Radio traced the money flow of more than \$17 million from one donor social welfare organization to more than 15 organizations.²⁷ Another recent study by the Center for Responsive Politics and *The Washington Post* traced more than \$400 million in a “maze of money” that involved the transfer of funds in a 17-entity network.²⁸

The proposed regulation addresses this issue by determining that a donation from one social welfare organization to another is a campaign-related donation unless the recipient organization provides a statement that it engages in no campaign-related activity. Nothing in this provision would stop a donor from giving to a social welfare organization. It would just stop an intermediate social welfare organization from acting as a smoke screen for the original donor or as a manipulator of money flows to make it look like a social welfare organization is engaged in a greater percentage of social welfare activity.

The bright-line rule that the entire contribution will be considered candidate-related political activity unless the recipient certifies that it spends no money on campaign-related activity is strict, but it has the significant benefit of seriously limiting major abuse. A social welfare organization that legitimately wants to contribute to another social welfare organization that engages in some campaign-related activity could still make the donation. The only consequence under the proposed regulation is that the spending would not count as social welfare spending in determining the donor organization’s primary purpose.

2. Primary purpose standard. Although the proposed regulation does not address the primary purpose standard, it does invite comment regarding whether that standard should be revised, what amount of activity should constitute primary pur-

pose, and how that amount should be calculated. If the final regulation is going to usefully curtail abusive activity, it must clarify the primary purpose standard. Under the current vague standard, groups (and, it appears, the IRS) have no clear guidelines regarding what constitutes the primary purpose of an organization.²⁹ The vague standard, especially in light of the IRS’s lack of enforcement, allows groups to self-determine the amount of social welfare activity that is sufficient to justify exempt status. If the IRS cannot articulate a standard for organizations to follow, there is a significant risk that the agency will once again find itself accused of biased enforcement.

The IRS needs to clarify the amount of nonexempt activity that is allowed under the primary purpose standard. In the church and charity context, the IRS has provided guidance regarding the primary purpose standard and through regulations has indicated that to satisfy that standard an organization may engage in only an insubstantial amount of nonexempt activity. Members of an American Bar Association Section of Taxation task force recommended that social welfare organizations be allowed to engage in nonexempt activity as long as the nonexempt activity does not exceed 40 percent of their activity.³⁰ At least at one point, the IRS appeared to have been applying a 50 percent standard for determining a group’s primary purpose.³¹

The problem with a specific amount of activity versus a facts-and-circumstances approach is that money is not the only measure of an organization’s primary purpose. For example, an organization with thousands of volunteers handing out campaign literature may have few campaign-related expenditures, but its primary purpose will still likely be campaign activity and not social welfare activity.

At some point, clarity here is more important than perfection. The IRS should set a clear guideline

²⁹Commentators have suggested standards for primary purpose that include everything from allowing a social welfare organization to engage only in an insubstantial amount of nonexempt activity to allowing an organization to engage in 49.9 percent of its activities for a nonexempt purpose.

³⁰See ABA tax section, “Comments of the Individual Members of the Exempt Organizations Committee’s Task Force on Section 501(c)(4) and Politics,” at 9 (May 25, 2004).

³¹In a presentation on this issue, Marcus Owens, then-director of the IRS’s Tax-Exempt and Government Entities Division, said, “When 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.” Owens, “Practicing Law Institute Program on Corporate Political Activities,” *Exempt Organization Tax Review*, June 1990, at 471.

²⁷Novak et al., “Wellspring’s Flow: Dark Money Outfit Helped Fuel Groups on Political Front Lines,” Center for Responsive Politics (Nov. 5, 2013).

²⁸Mattea Gold, “Koch-Backed Political Coalition, Designed to Shield Donors, Raised \$400 Million in 2012,” *The Washington Post*, Jan. 5, 2014.

of what constitutes the amount of nonexempt activity an organization may engage in and still qualify for exempt status. One reason the IRS can justify an expansive definition of campaign-related activity in the proposed regulation is that organizations involved in nonpartisan activity classified as campaign-related activity still can maintain their exempt status because they are allowed to engage in a significant amount of campaign-related activity. The proposed regulation is therefore hard to justify if the threshold amount of nonexempt activity is too low or if there is not another outlet for the activity. The IRS should therefore either create a more limited definition of campaign-related activity or establish a level of permissible nonexempt activity that allows social welfare organizations enough space to operate in a reasonable way. The exact percent of the ideal amount of allowable nonexempt activity is debatable, but a number somewhere between 10 and 30 percent would avoid having organizations unwillingly violate their exempt status by engaging in quasi-political activity now classified as campaign-related activity.

In addressing how to measure the amount of the activity, the final regulation should adopt a bright-line rule that is based on the expenditures of an organization. Although this is a crude measure of an organization's activity and purpose, it is fairly easy to measure and quantify. As long as the amount of expenditures does not include passthrough money used to increase the amount of an organization's social welfare spending, an expenditure test will capture most of a group's activities.

3. Organizations that fall through the cracks. One problem with the new regulation and the new standard for campaign-related activity for social welfare organizations is that organizations engaged in tax-exempt activities may find that there is no tax exemption home in which they can organize. In most cases, these organizations should be entitled to exempt status. Absent some modification in the regulation, hybrid groups would be engaged in tax-exempt activity but would not qualify for exempt status.

a. Hybrid organizations. For example, what happens to a group involved in education, lobbying, and candidate-related advocacy? Suppose under the proposed regulation the organization does not engage in sufficient social welfare activity to be characterized as a social welfare organization and that it also does not engage in enough "influencing an election" activity to qualify as a section 527 organization. All the hypothetical organization's activity is a type that would be tax-exempt, but the organization would fail to qualify for exempt status under any code provision. The IRS could treat the

organization as a taxable entity, but that conclusion makes no sense and would require significant IRS determinations regarding how to tax the organization.

Because the main thrust here is to ensure that groups are not circumventing congressional intent regarding the disclosure provisions in section 527, the proposed regulation should allow any organization engaged in candidate-related advocacy that does not qualify as a social welfare organization to organize as a section 527 organization and treat all the candidate-related contributions to the organization as tax-exempt contributions.³² Alternatively, the IRS could propose that organizations be able to create a segregated account for candidate-related advocacy and traditional section 527 advocacy that would not count as activity conducted by the social welfare organization. The amounts in the segregated account would be subject to the disclosure provisions in section 527.³³

b. Other tax-exempt organizations. The proposed regulation invites comment regarding whether it should apply to other tax-exempt organizations. The history in this area is clear. If the final regulations do not apply similar requirements to all section 501(c) organizations other than charities, groups will simply reorganize under another code provision. Groups are already contemplating using section 501(c)(6) business leagues and section 501(c)(19) veterans organizations as a way to engage in campaign-related activity, and section 501(c) contains many opportunities for organizations that could be used as an end run around the regulation.

4. Don't fight the last battle. Groups have consistently sought organizational forms that allow them to engage in anonymous campaign advocacy. Clarification of the rules surrounding tax-exempt organizations and campaign advocacy may encourage groups to seek out alternative entity classifications as a means of avoiding restrictions created by the new regulation. Absent further clarification of the tax treatment of taxable entities involved in campaigns, there is significant risk that groups will forgo exempt status and instead organize as taxable organizations. At the moment, it is unclear what the tax ramifications would be to a taxable organization involved in campaign advocacy. Without further

³²Under current law, some of the contributions would not be considered as for the purpose of influencing an election and would be subject to tax under section 527.

³³Social welfare organizations can already create a segregated account to engage in section 527 exempt activity. The regulations would need to create a broader account to include campaign-related expenditures as well as expenditures designed to influence an election.

IRS clarification, taxable organizations may be the next vehicle of choice to avoid campaign finance disclosure, which may once again embroil the IRS in unnecessary political decisions.³⁴

Although any taxable campaign organization would be subject to tax, the amount of taxable income for a group might be small. Section 162(e) prohibits an organization from deducting political expenditures as an ordinary and necessary business expense, so presumably a taxable organization would have some tax liability if its primary purpose was candidate-related political activity because it could not deduct campaign-related expenditures. However, if the group had little to no income, there would be nothing to tax. Thus, if contributions to the taxable organization were not considered income, there would be few tax consequences to using a taxable form as a campaign vehicle.

The IRS rulings in this area are old and are ambiguous regarding whether contributions to a taxable campaign organization are income. The IRS should clarify that contributions to taxable organizations for campaign advocacy are income to the taxable entity and subject to tax. Alternatively, the IRS should conclude that contributions are gifts and thus subject to gift tax. It should also clarify that taxable entities cannot circumvent this treatment by claiming that payments to the taxable entity are nontaxable contributions to capital.

Further, the IRS should clarify that the provisions in section 527 apply to all organizations that have as their primary purpose influencing elections, and that section 527 status is not voluntary. The statute is written in a way that makes section 527 status mandatory for all entities that are primarily engaged in influencing elections.³⁵ If section 527 treatment is mandatory, an organization could not

escape its disclosure requirements merely by claiming to be a taxable organization.

D. Conclusion

The administration has taken a strong step forward in proposing a regulation that will clarify the permissible political campaign activities of tax-exempt social welfare organizations. The regulation is helpful in that it creates a bright-line rule that would provide clear guidance to exempt organizations and also reduce the amount of discretion the IRS would need to exercise in determining whether a group is acting consistently with its exempt status. By providing clearer rules, the proposed regulation will also likely reduce the significant gamesmanship and violations of exempt status that have occurred because Congress required disclosure by section 527 groups.

Correctly implemented, broad-based bright-line rules will not violate the First Amendment. As long as there is a reasonable outlet for the communication in question, the proposed regulation would not be a significant burden on speech. Organizations can engage in unlimited political speech. If the organization's primary purpose is to engage in election-related activity, it can organize as a section 527 political organization and disclose its donors and expenditures. The proposed regulation is all about basketing an organization into its correct regulatory home — be that as a charity, social welfare organization, business league, or political organization.

Unfortunately, the proposed regulation is a fifth- or sixth-best choice for dealing with the current crisis. A better solution would be for Congress to pass broad-based legislation requiring disclosure of campaign-related activity and remove the IRS as a campaign finance regulatory agency. The IRS serves best when it is collecting revenue and protecting the fisc, not when it is seen as a political tool of elected officials, be they the Congress that funds it or the administration that supervises it.³⁶

³⁴This article does not address all the difficult questions raised by the use of taxable entities for political campaign advocacy. For a more thorough discussion of this issue pre-*Citizens United*, see Tobin, "Political Advocacy and Taxable Entities: Are They the Next 'Loophole'?" 6 *First Amend. L. Rev.* 41 (2007). Post-*Citizens United*, taxable corporations are an even more attractive vehicle for campaign advocacy.

³⁵See, e.g., Gregg D. Polsky, "A Tax Lawyer's Perspective on Section 527 Organizations," 28 *Cardozo L. Rev.* 1773, 1784 (2007) ("Status as a political organization is not, as a technical matter, elective").

³⁶The second-best alternative would be for the FEC to modify its current regulations and require disclosure of contributions to social welfare organizations engaged in express advocacy or electioneering communication unless the donor specifically indicates that the contribution may not be used for those purposes.