

**A CRASH AT THE CROSSROADS: TAX AND CAMPAIGN  
FINANCE LAWS COLLIDE IN REGULATION OF  
POLITICAL ACTIVITIES OF TAX-EXEMPT  
ORGANIZATIONS**

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## I. INTRODUCTION

In this first presidential election year following the enactment of the most sweeping change in campaign finance reform laws in a generation—the Bipartisan Campaign Reform Act of 2002 (BCRA) (better known as the McCain-Feingold Law in honor of its chief Senate sponsors)<sup>1</sup>—tax-exempt organizations have received unprecedented attention. Political operatives, regulators, commentators, and advocates on both sides of the campaign finance debate have focused intensely on nonprofit organizations. Those organized under § 527 of the Internal Revenue Code have been subject to particular scrutiny, and this once obscure provision

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1. Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, 116 Stat. 81 (codified in scattered new and amended sections of 2 U.S.C. & 36 U.S.C. § 510 (West 2004)).

has now become a regular feature of newspaper headlines.

The country's deeply felt political divisions have driven political combatants on both sides to see victory in the 2004 elections as essential, yet BCRA prevents these eager advocates from pouring unlimited resources into traditional political party structures. With unlimited giving to political parties now curtailed,<sup>2</sup> those with political agendas have been experimenting with various types of tax-exempt structures to create entities that can promote issues or candidates within the scope of both federal tax and election law.<sup>3</sup> Thus, they have looked to the federal tax code to determine what other types of organizations may be available to run advertising and conduct activities on the ground to activate voters. While 527 organizations have received the most press to date, various types of 501(c) organizations are also able to carry out this type of advocacy agenda, and many are actively engaged in electoral campaigns.

Meanwhile, advocates intent on protecting or reforming the political system see the stratagems of the ideologues as attempts to exploit "loopholes" in the law and undermine its effectiveness.<sup>4</sup> Pro-reform advocates are emboldened by back-to-back wins: 1) the passage of BCRA after many long years of work and debate; and 2) the Supreme Court's broad endorsement of the law in *McConnell v.*

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2. 2 U.S.C. § 441i (West 2004).

3. Of course other activities are happening in the context of state and local elections and may be subject to various state and local election laws. Organizations exempt from federal income taxation must traverse the equally tricky intersections between federal tax law and state election laws, not to mention additional complexities that may be added by state tax laws or other state laws. Although the information in this article about election-related activities under federal tax law is equally applicable to these state and local efforts, a full exploration of the relationship between these laws and any state election law is beyond the scope of this article. See Rosemary E. Fei, Diane M. Fishburn, & Barbara K. Rhomberg, *The Public Charity's Guide to the California Initiative Process* (providing an example of a practical guide to compliance with federal tax and one state's election laws), at <http://www.ncg.org/assets/NCGpubliccharityguide.pdf> (last visited Oct. 3, 2004).

4. Whether use of tax-exempt organizations as vehicles for political advocacy constitutes a circumvention of campaign finance regulation depends in large part upon what one considers the purpose of BCRA to have been. Independent advocacy organizations do not undermine the goal of taking candidates and officeholders out of the business of raising unlimited amounts of soft money for political campaigns, a result that the authors consider BCRA has significantly achieved. If the goal is limiting the ability of citizens to spend money on political speech, the availability of independent nonprofit organizations to fund and engage in such speech certainly means that goal has not been attained.

*Federal Election Commission*,<sup>5</sup> a ruling notable for the Court's willingness to accede to Congressional restrictions on electoral activity that Congress deemed necessary to protect the political system from the potentially corruptive influence of money on politics. Campaign reform advocates are eager to defend these recent victories, and many seem eager to ride the momentum even further.

As the 2004 federal election season commenced, the tax-exempt organizations being created by the political operatives were the next likely target for scrutiny. Both reform advocates and actors with a more clearly self-interested, partisan agenda<sup>6</sup> sought to extend the reach of the Federal Election Commission's (FEC) authority to regulate organizations and activities beyond those that the FEC has historically been able or willing to regulate.

These two powerful forces—political advocates and campaign reformers—collided in the spring of 2004 in the hearing room of the FEC, a collision at the crossroads of tax and election law. The FEC was urged to adopt broad definitions of regulable political activity drawn from the tax law.<sup>7</sup> Other commentators<sup>8</sup> urged that the vagueness of those definitions, vagueness perhaps tolerable for tax-exempt organizations, was unacceptable as guidance for those engaged in essential political debate. Faced with a politically sensitive and enormously complex task, the FEC voted to put off its rulemaking for ninety days. As this article was headed for

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5. See *McCConnell v. Fed. Election Comm'n*, 124 S. Ct. 619 (2003).

6. The coalition of strange bedfellows included traditional reform groups such as the Center for Responsive Politics and partisans such as the Republican National Committee, both of which had previously been staunch foes of campaign finance regulation. See E-mail comments regarding NPRM 2004-6 from Democracy 21, the Campaign Legal Center, and the Center for Responsive Politics, to Ms. Mai T. Dinh, Acting Assistant General Counsel, Federal Election Commission, (April 5, 2004), at [http://www.fec.gov/pdf/nprm/political\\_comm\\_status/comments.html](http://www.fec.gov/pdf/nprm/political_comm_status/comments.html) (last visited Oct. 3, 2004). See also Comments regarding NPRM 2004-6 from Republican National Committee to Ms. Mai T. Dinh, Acting Assistant General Counsel, Federal Election Commission, (April 5, 2004), at [http://www.fec.gov/pdf/nprm/political\\_comm\\_status/comments.html](http://www.fec.gov/pdf/nprm/political_comm_status/comments.html) (last visited Oct. 3, 2004).

7. See NPRM 2004-6, *supra* note †, at 11756–57 (discussing I.R.C. § 100.5, Alternative 2-A and Alternative 2-B that defined some or all entities organized under I.R.C. § 527 as “political committees” for purposes of federal election law). Unless otherwise indicated, all references and citations in this article to the Internal Revenue Code refer to the Internal Revenue Code of 1986, as amended, currently located at 26 U.S.C.A. (West 2004).

8. The authors' law firm was one of those commenting. (Indeed, those comments form the basis for much of this article.)

publication, the FEC again took up proposals to regulate 527s, but the only proposal that found the necessary four votes from among the commissioners did not include sweeping regulation of 527s. Nonetheless, the regulatory engines may yet roar back to life. Reform groups have expressed anger at the FEC decision and may seek restrictions on 527 organizations through other means—perhaps litigation or congressional action.<sup>9</sup>

In light of this vastly increased interest in political advocacy by tax-exempt organizations, this article will look at the tax law's definitions of "political" activity by § 501(c)(3)s, other § 501(c)s, and § 527s, identifying the many points of congruence and the occasional important differences. We further attempt to explain why the FEC's detour onto the slippery pavement of tax law led to this crash, and why attempts to follow the tax law's definitions of political activity will inevitably lead regulatory efforts astray. The legal roads of tax and election law begin from different policy rationales, intersect in seemingly similar concepts, but then proceed to wildly different legal destinations. We conclude with a discussion of why, as a matter of constitutional law, laws that suffice for tax purposes are fatally flawed for election law uses. It is our hope that this analysis will at least steer proponents of campaign finance reform away from another foreseeable crash.<sup>10</sup>

## II. PRELIMINARY MATTERS: A PRIMER ON TAX-EXEMPT ORGANIZATIONS AND IRS GUIDANCE

We begin with a brief overview of the types of tax-exempt organizations discussed below, followed by a quick detour to provide an introduction to the various types of Internal Revenue Service (IRS) guidance documents upon which the article draws.

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9. See Statement by Campaign Legal Center and Democracy 21 on FEC Failure Yesterday to Stop 527 Groups from Illegally Spending Soft Money on Attack Ads (Aug. 20, 2004), at <http://www.campaignlegalcenter.org/press-1278.html>; Kenneth P. Doyle, *FEC Votes 4-2 to Adopt Limited New Rule Requiring 'Hard Money' for Some 527 Groups*, BNA MONEY & POL. REP., Aug. 20, 2004.

10. The authors do not oppose, in theory, regulatory attempts to define more clearly and, perhaps more broadly, the scope of FEC-regulated "political committees," the primary focus of the recent rulemaking. See *supra* Part I. Our primary concern is the appropriation of tax law concepts for other purposes. The forces driving the development of tax definitions are not compatible with other constitutionally permissible regulatory ends.

### A. *Tax-Exempt Organizations*

The universe of nonprofit organizations consists largely, but not entirely, of tax-exempt organizations. Nonprofit corporations or associations, like their for-profit counterparts, are creatures of state law. Federal tax law separately provides for exemption from federal income taxation of entities that fall into certain specifically enumerated categories. By way of introduction for those readers who do not spend their days immersed in the U.S. Tax Code, the different types of organizations discussed in this article are briefly outlined below.<sup>11</sup>

The most common type of tax-exempt organization is organized under Internal Revenue Code (I.R.C.) § 501(c)(3). In addition to being exempt from paying income tax themselves,<sup>12</sup> 501(c)(3)s enjoy the additional advantage of receiving tax-deductible charitable contributions.<sup>13</sup> The activities of these organizations must be almost entirely educational, charitable, religious, or scientific.<sup>14</sup> Thus, these organizations include nonprofit healthcare providers and other human service organizations, educational institutions, nonpartisan policy research organizations, churches and other religious institutions, and foundations and other grant-making organizations. Section 501(c)(3)s that qualify as “public charities” are permitted to lobby to a limited extent;<sup>15</sup> all 501(c)(3)s are strictly prohibited from intervening in campaigns for elected public office.<sup>16</sup>

A 501(c)(4) organization is a “social welfare organization” or “civic league” that may pursue educational, lobbying, and political

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11. This is by no means an exhaustive or authoritative description of these organizations or the rules that apply to their operations. Readers seeking more detail should review the IRS Publication, *Tax-Exempt Status for Your Organization*. See I.R.S. Pub. 557 (Rev. May 2003). Readers should also review any of several credible texts on the subject, the most prominent of which is Bruce Hopkins' *The Law of Tax-Exempt Organizations*. BRUCE HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* (8th ed. 2004) [hereinafter HOPKINS].

12. I.R.C. § 501(a).

13. *Id.* § 170(a)(1).

14. *Id.* § 501(c)(3). These organizations may also be engaged in literary activities, testing for public safety, fostering international amateur sports competition, or prevention of cruelty to children or animals. *Id.*

15. See *id.* (“[N]o substantial . . . activities . . . attempting to influence legislation”) (emphasis added). See also *id.* § 501(h) (permitting lobbying by certain public charities within certain expenditure limits).

16. *Id.* § 501(c)(3).

activities.<sup>17</sup> 501(c)(4)s are exempt from most federal taxes,<sup>18</sup> but contributions to a 501(c)(4) organization are not tax-deductible.<sup>19</sup> A 501(c)(4)'s "primary" activities must be those that benefit the public, including any activity in which a 501(c)(3) organization may legally engage.<sup>20</sup> Although not the focus of this article, 501(c)(5) labor organizations and 501(c)(6) business associations are subject to similar restrictions.<sup>21</sup>

Section 527 is the section of the Tax Code for many different types of political organizations. These political organizations may be independent organizations, incorporated or not, or they may be organized merely as a fund established by a 501(c) organization under § 527(f).<sup>22</sup> Section 527 organizations are generally exempt from federal income tax, but do pay tax on investment income.<sup>23</sup> Gifts to 527s are expressly exempted from the estate and gift tax.<sup>24</sup> Political parties and campaigns are classified for tax purposes under § 527, as are various types of non-candidate political committees such as federal and state Political Action Committees (PACs).<sup>25</sup> Section 527 organizations that are not registered with the FEC must register with the IRS.<sup>26</sup> Those that do not disclose their receipts and expenditures to the FEC or a similar state agency must file periodic reports with the IRS.<sup>27</sup> Both the registrations and regular reports are publicly available.<sup>28</sup> In recent years, "527" has

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17. See *id.* § 501(c)(4) (defining organization). See also discussion *infra* Part IV.B (discussing IRS precedential and nonprecedential guidance regarding advocacy by § 501(c)(4) organizations).

18. I.R.C. § 501(a).

19. Cf. *id.* § 170(c) (defining charitable contributions as implicitly excluding contributions to § 501(c)(4) organizations).

20. See *id.* § 501(c)(4). See also *infra* Part IV.A (discussing definition of "social welfare" activities).

21. I.R.C. § 501(c)(5)–(6); Gen. Couns. Mem. 34, 233 (Dec. 3, 1969) (reversing prior IRS position that political campaign intervention could be sole activity of a § 501(c)(6) organization if shown to be germane to its exempt purpose and concluding that candidate support transcends the narrower exempt purpose of a business association and cannot be its primary activity).

22. See *id.* § 527(f).

23. *Id.* § 527.

24. *Id.* § 2501(a)(5).

25. Throughout this article, we use "PAC" as a simple way of describing a political committee subject to the state or federal legal restrictions, such as federal election law restrictions on the size and source of contributions. Our use of this term is meant to convey a distinction from so-called "soft" 527s discussed *infra* Part V.

26. I.R.C. § 527(i).

27. *Id.*

28. See Internal Revenue Service, Tax Information for Political Organizations,

become shorthand for non-party, non-PAC political organizations. It is generally used to refer to those political organizations that are required to file publicly available reports of their contributions and expenditures with the IRS. Although the authors are frustrated with this somewhat misleading short-hand, we have not been able to come up with a better substitute, so generally this article uses "527 organizations" as a term referring to a subset of the entire universe of 527 political organizations.

*B. IRS Materials*

Because of a general lack of precedential guidance from either the IRS or the courts in the area of political activity by exempt organizations, nonprofit organizations and their advisors have become accustomed to looking to a variety of sources to glean information about the proper interpretation of the relevant law.<sup>29</sup> Readers who are not regular practitioners in this area may not be familiar with the range of materials cited below, so perhaps a brief orientation to the wonderful world of IRS guidance may prove useful.<sup>30</sup>

In addition to the statutes, regulations, and cases familiar to legal practitioners, signposts on the road through federal tax law include an array of administrative materials. These are roughly divided into those considered "precedential" and those that are not. All are generated by various offices within the IRS. Precedential guidance, for obvious reasons, requires approval by more senior level officials at the IRS. These precedential documents represent authoritative interpretations of the law, in the sense that the IRS considers itself bound by them and allows taxpayers to cite and rely on them in proceedings before the Service. Although they are official agency interpretations due some deference, they are not necessarily binding on a court. This

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at <http://www.irs.gov/charities/political/index.html> (last visited Oct. 3, 2004).

29. For a small, grassroots, nonprofit organization, the most important question is not what the law actually is, or what the courts would eventually rule the law to be, but what interpretation the IRS is likely to apply. Being right on the law is of little solace when the organization has gone out of operation due to spending all available resources on protracted litigation. Hence, knowing how tax administrators understand the rules takes on added importance, and any public statement that sheds light on this question is of use, even if it is not considered precedential.

30. Readers interested in a more extensive discussion of the sources of law governing tax-exempt organizations are referred to HOPKINS, *supra* note 11.

category includes Revenue Rulings and Revenue Procedures, as well as some Announcements and Notices.

Non-precedential rulings are intended only to resolve a problem with regard to a specific individual or entity; they do not enunciate rules of general applicability and other taxpayers are not entitled to cite them as authority or rely on them as precedent, even in identical factual circumstances.<sup>31</sup> However, politically active tax-exempt organizations travel a route where legal standards have been stated very broadly and precedential guidance is rare.<sup>32</sup> Consequently, any hint as to where lines have been drawn (be they dotted white or double yellow) is welcomed and scrutinized. Private, non-precedential rulings include Private Letter Rulings, Technical Advice Memoranda, General Counsel Memoranda, and Field Service Advice.<sup>33</sup>

Finally, the IRS produces an annual internal instruction manual for its Continuing Professional Education (CPE) program. Articles published in the CPE text are not binding rulings, even with regard to a single taxpayer. They do, however, provide a useful and accessible compilation of relevant law on topics of interest. On occasion, the text may also indicate the thinking of IRS experts on unresolved questions, and, at the least, they can indicate how agents in the field are being directed to understand and apply legal principles.

### III. POLITICAL ACTIVITIES BY 501(C)(3)S

Restrictions on political activities by 501(c)(3)s are found not only in the explicit language of the statute and its implementing regulations,<sup>34</sup> but also in an interpretation of another 501(c)(3)

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31. I.R.C. § 6110(k)(3).

32. *See infra* note 39.

33. One possible rationale for the multiplicity of types of non-precedential documents is the ongoing struggle with the IRS by those in the regulated community trying to gain some insight into the ways in which the IRS applies the law. The nonprofit publisher of tax-law materials Tax Analysts (and its founder Tom Fields) have been diligent in pursuing federal Freedom of Information Act (FOIA) requests and litigation forcing the IRS to disclose its interpretations of tax law. Paul Streckfus (another champion of greater IRS disclosure) has suggested in his EO Tax Journal that to prevent disclosure the IRS changes the name of its guidance documents every time Tax Analysts wins another FOIA lawsuit. *See* Paul Streckfus, *Editor's Notebook*, PAUL STRECKFUS' EO TAX J., Nov. 2000, at 4-5 (discussion of unfortunate IRS penchant for secrecy subtitled "Why is the IRS Going Underground?").

34. *See* Treas. Reg. § 1.501(c)(3)-1(b)(3)(iii) (as amended in 1990).

doctrine—the restriction on use of charitable resources for private benefit. We consider each restriction in turn.

A. *Campaign Intervention Prohibited*

501(c)(3) organizations are subject to an absolute prohibition against political campaigning; they may not “participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”<sup>35</sup> (For shorthand throughout, this prohibited 501(c)(3) activity will be termed “campaign intervention.”) The prohibition on 501(c)(3) campaign intervention has been interpreted broadly. Indeed, it has been interpreted more broadly than would be permissible for most government restrictions on speech because 501(c)(3)s receive what is considered a tax subsidy; not only are they exempt from paying tax on their own income, but 501(c)(3)s receive tax-deductible donations.<sup>36</sup> A broad reading of “campaign intervention” is needed to avoid giving a taxpayer subsidy to electioneering.<sup>37</sup>

In determining whether a 501(c)(3) activity constitutes impermissible campaign intervention, the IRS will examine an activity based on all the surrounding “facts and circumstances.”<sup>38</sup> The test has not been further articulated in statute or regulation, and the courts and the IRS have issued only a very few rulings, even fewer of them precedential. The rulings that have been issued do not offer clear road signs, but rather mere examples of 501(c)(3)

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35. I.R.C. § 501(c)(3).

36. In the same vein, the restrictions on election-related activities by 501(c)(3)s are greater than those on other tax-exempt organizations because the tax subsidy for 501(c)(3)s is more generous than that provided to other organizations, which generally do not have tax incentives to offer donors.

37. In truth, this is an after-the-fact justification. As a matter of policy, the need to avoid taxpayer-funded subsidies of partisan political activity is a reasonable explanation for the prohibition on 501(c)(3) campaign intervention. The actual legislative intent behind adoption of the prohibition is murky, to say the least. (For an extensive discussion of the available evidence to suggest Congressional motivation, see Judith E. Kindell & John Francis Reilly, *Election Year Issues*, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 2002 app. I, at 448–51 [hereinafter 2002 ELECTION YEAR ISSUES CPE], available at <http://www.irs.ustreas.gov/pub/irs-tege/topici02.pdf>.) Nonetheless, the rationalization has become accepted truth. See *infra* Part VII.A for a more complete discussion of the courts’ analysis of the tax subsidy as justification for restricting 501(c)(3) election-related speech.

38. 2002 ELECTION YEAR ISSUES CPE, *supra*, note 37 at 339.

behavior that is permissible or impermissible.<sup>39</sup>

At one extreme, *activities that clearly support or oppose candidates* for office have been found to be in violation of the ban on 501(c)(3) campaign intervention. In *Christian Echoes Ministries, Inc. v. United States*, the court upheld the IRS revocation of the exempt status of a 501(c)(3) that attacked liberal candidates and endorsed conservatives.<sup>40</sup> In *Branch Ministries v. Rossotti*, the court upheld the IRS revocation of the 501(c)(3) status of the Church at Pierce Creek because the church had run newspaper ads four days before the 1992 presidential election urging Christians not to vote for then-candidates Bill Clinton and Al Gore.<sup>41</sup> Most non-precedential guidance from the IRS similarly forbids apparent 501(c)(3) support for or opposition to candidates.<sup>42</sup>

Likewise, *rating candidates* is prohibited for 501(c)(3)s, even if done in an objective and non-partisan manner. In *Association of the Bar of the City of New York v. Commissioner of Internal Revenue*, the court upheld the IRS denial of the Bar's application for recognition as a 501(c)(3) organization because the Bar rated candidates for non-partisan judicial elections.<sup>43</sup>

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39. The result is that practitioners called upon to advise 501(c)(3) clients on their election-related activities are like drivers forced to intuit the rules of the road by observing which drivers the police pull over or what crashes are featured in *Blood on the Highway* (or similar horrific films legendary from decades of drivers' ed. classes). Many practitioners in this area have expressed their frustration with this state of affairs. See, e.g., *Commentary on IRS 1993 Exempt Organization Continuing Professional Education Technical Instruction Program Article on 'Election Year Issues'*, prepared by individual members of the Subcommittee on Political and Lobbying Activities and Organizations of the Committee on Exempt Organizations of the Section on Taxation, American Bar Association (Feb. 21, 1995), reprinted in 11 EXEMPT ORG. TAX REV. 854 (1995). At least one prominent jurist has criticized IRS reliance on a subjective "facts and circumstances" test in another context. Judge Posner, considering IRS use of the "facts and circumstances" standard to evaluate appropriate structure of payments for fundraising costs for 501(c)(3)s wrote that "facts and circumstances' . . . is no standard at all, and makes the tax status of charitable organizations and their donors a matter of the whim of the IRS." *United Cancer Council v. Comm'r*, 165 F.3d 1173, 1179 (7th Cir. 1999).

40. 470 F.2d 849 (10th Cir. 1972), cert. denied 414 U.S. 864 (1973). In addition to finding that it had intervened in campaigns, the court found that Christian Echoes had engaged in substantial lobbying activities in violation of its 501(c)(3) status. *Id.*

41. 211 F.3d 137 (D.C. Cir. 2000).

42. See, e.g., Tech. Adv. Mem. 96-09-007 (Mar. 1, 1996) (501(c)(3) intervened in election by sending fundraising mailings timed to coincide with an election that implied that contributions would help candidates sharing the organization's ideology).

43. 858 F.2d 876 (2d Cir. 1988), cert. denied, 490 U.S. 1030 (1989). See also

On the other hand, charities may engage in nonpartisan *voter registration* and *get-out-the-vote* (GOTV) activity. Statute and regulations place substantial limits on 501(c)(3) private foundation funding for voter registration efforts, but in stating those restrictions, the statute makes it implicitly clear that 501(c)(3) organizations may conduct voter registration efforts.<sup>44</sup> In an effort to qualify for foundation funding under these laws, a number of charities have sought and received IRS approval for their effort through non-precedential Private Letter Rulings. These rulings suggest that 501(c)(3)s conducting voter registration or GOTV must target their efforts based on nonpartisan criteria and must ensure that the issue-related messages used in these efforts discuss a broad range of issues and do not promote a particular view on issues dividing the candidates.<sup>45</sup>

Two Revenue Rulings examine the area of 501(c)(3) voter guides and legislative voting records.<sup>46</sup> In 1978, the IRS provided four hypothetical examples—one “good” and one “bad”—for each of these two types of educational materials related to candidates and incumbent legislators.<sup>47</sup> For *voter guides*, the IRS approved of a 501(c)(3) producing a voter guide based on a questionnaire that asked all the candidates running for a particular office to respond to questions about their positions on a “wide variety of issues” selected “solely on the basis of their importance and interest to the

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Rev. Rul. 67-71, 1967-1 C.B. 125 (501(c)(3) may not evaluate candidates for elective school board and support certain candidates); Tech. Adv. Mem. 96-35-003 (April 19, 1996) (501(c)(3) may not support program in which panels of citizens seek objective information about candidates and the issues and use the information to rate the candidates).

44. I.R.C. § 4945(f). See also Treas. Reg. § 53.4945-3 (1972) (listing those activities that may constitute “carrying on voter registration drives” for 501(c)(3) organizations).

45. See Priv. Ltr. Rul. 97-51-029 (Sept. 19, 1997) (approving 501(c)(3) voter registration and GOTV program targeting low-income, minority, and young women and using voter education materials on a “broad range of issues”); Priv. Ltr. Rul. 95-40-044 (July 6, 1995) (approving 501(c)(3) voter registration program targeting minority women); Priv. Ltr. Rul. 92-23-050 (Mar. 10, 1992) (approving 501(c)(3) voter registration program targeting homeless people and using messages related to “poverty, housing, health care and crime”); Priv. Ltr. Rul. 88-22-080 (Mar. 9, 1988) (approving 501(c)(3) voter registration and GOTV program targeting communities with low voter participation); Priv. Ltr. Rul. 88-22-056 (Mar. 4, 1988) (approving 501(c)(3) voter registration program targeting “minorities, low-income people, recent immigrants, under-educated people, and young people”).

46. Rev. Rul. 78-248, 1978-1 C.B. 154; Rev. Rul. 80-282, 1980-2 C.B. 178.

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

electorate as a whole.”<sup>48</sup> Neither the questions nor the resulting voter guide that the hypothetical 501(c)(3) distributed to the general public demonstrated any “bias or preference with respect to the views of any candidate.”<sup>49</sup> In contrast, a similar voter guide based on questions that did evince some bias on the issues was deemed impermissible.<sup>50</sup>

For *legislative voting records*, the IRS approved a record of the votes of all members of Congress on a “wide variety of subjects” that did not suggest the organization’s approval or disapproval of the positions taken in those votes.<sup>51</sup> A 501(c)(3) produced this record annually and made it available to the general public.<sup>52</sup> In contrast, the IRS rejected a voting record that was distributed during an election campaign and that focused only on a narrow range of issues that were of interest to the organizational members and others to whom the 501(c)(3) distributed the guide.<sup>53</sup> Although the guide did not expressly support or oppose any candidate, the IRS found that “concentrating on a narrow range of issues in the voter’s guide and widely distributing it among the electorate during an election campaign” made it impermissible 501(c)(3) participation in an election.<sup>54</sup>

The IRS amplified its position on voting records two years later, holding that an organization could distribute, to a small number of interested members and others, a voting record that focused on select issues of importance to the organization and that compared each vote to the organization’s position on the issue.<sup>55</sup> The Ruling emphasized that this members-only voting record was not timed to coincide with any election, that it included all incumbent legislators without indicating which were running for reelection, and that its distribution was not targeted to particular legislative districts.<sup>56</sup> Furthermore, the guide did not express support for or opposition to any candidate and included a disclaimer reminding readers not to judge the qualifications of a

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48. *Id.*, Situation 2.

49. *Id.*

50. *Id.*, Situation 3.

51. *Id.*, Situation 1.

52. *Id.*

53. *Id.*, Situation 4.

54. *Id.*

55. Rev. Rul. 80-282, 1980-2 C.B. 178.

56. *Id.*

candidate based only on a few votes.<sup>57</sup>

In contrast, the IRS has been unwilling to let 501(c)(3)s publish lists of candidates who have signed or refused to sign a *candidate pledge*. In 1976, the IRS formally approved a 501(c)(3)'s distribution to candidates of a code of fair campaign practices that the 501(c)(3) did *not* ask candidates to endorse.<sup>58</sup> Indeed, the 1976 ruling overturned a Revenue Ruling from 1966 that had permitted 501(c)(3)s to affirmatively seek just such a candidate pledge to support a code of fair campaign practices.<sup>59</sup> The IRS held that asking candidates to endorse the code "constitutes intervention in a political campaign and may result, through the publication or release of the names of candidates who sign or endorse or who refuse to sign or endorse the code, in influencing voter opinion."<sup>60</sup>

Candidate *debates or forums* sponsored by 501(c)(3) organizations have been the subject of multiple Revenue Rulings. The most complete exposition of the IRS position came in 1986, when the IRS held that the following described a forum conducted "in a neutral manner:"<sup>61</sup>

All legally qualified . . . candidates [for a particular elected office] will be invited to participate in the forum.<sup>62</sup>

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57. *Id.*

58. Rev. Rul. 76-456, 1976-2 C.B. 151 (modifying and superseding Rev. Rul. 66-258, 1966-2 C.B. 213 for taxable years beginning after 1976).

59. *See id.*

60. Gen. Couns. Mem. 36,557 (Jan. 19, 1976). The full story of these two Revenue Rulings, Rev. Rul. 76-456 and Rev. Rul. 66-258, as described in the non-precedential General Counsel Memorandum (GCM) 36,557, makes the reasons for this IRS reversal clear. *See id.* The activities of the same organization were the motivation for both the 1966 and the 1976 Revenue Rulings. When the 1966 ruling was issued, the organization had assured the IRS that although it would ask candidates to endorse its code of campaign practices it would not publicize the results. *Id.* When the organization nonetheless publicized the pledges, the IRS General Counsel's office recommended a new ruling to forbid even solicitation of candidate pledges because publication (which the Counsel saw as having the potential to influence an election) was "but a logical extension of the solicitation process." *Id.* The result was Revenue Ruling 76-456, which, in its final form, was modified from the more restrictive draft proposed in the GCM in that it affirmatively permitted at least the distribution of such a candidate pledge by a 501(c)(3). *See id.*; Rev. Rul. 76-456, 1976-2 C.B. 151. The authors, as well as other practitioners with whom we have discussed the matter, believe that the 1976 ruling was an over-reaction by the IRS, and that, in spite of the 1976 ruling, a 501(c)(3) would likely win any dispute with the IRS if the organization asked candidates to sign a pledge but did not publish the results.

61. Rev. Rul. 86-95, 1986-2 C.B. 73.

62. With regard to the necessity of inviting all candidates to participate, the

The questions will be prepared and presented by a nonpartisan, independent panel. The topics discussed will cover a broad range of issues of interest to the public, notwithstanding that the issues discussed may include issues of particular importance to the organization's members. Each candidate will receive an equal opportunity to present his or her views on each of the issues discussed. Finally, the moderator selected by the organization will not comment on the questions or otherwise make comments that imply approval or disapproval of any of the candidates.<sup>63</sup>

Several rulings also allow 501(c)(3)s to make certain *charitable resources* available to candidates if the resources are made available to all candidates on an equal basis. The IRS held that 501(c)(3) universities could support a campus newspaper that featured student-written editorials favoring particular candidates, and any political science classes that require students to participate in a political campaign (selected by the student).<sup>64</sup> The IRS has also held that 501(c)(3)s operating broadcast stations may provide candidates with free air time on an equal basis in compliance with then-current federal communications law.<sup>65</sup>

These rulings provide examples of how the IRS applies the "facts and circumstances" test and illuminate key "facts" or "circumstances," such as the content and timing of any message, the intended audience for any message, the organization's history of engaging in similar activities, and many other factors. A number of rulings emphasize the importance of including a "broad range of issues" in any 501(c)(3) voter education or other election-related activities and communications. The rationale seems to be that a selective focus on only one or a few issues creates a greater possibility that the allegedly non-partisan activity will be

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courts have allowed 501(c)(3)s to exclude certain candidates with little practical chance of winning the election if the charity sets objective qualifications for participation and applies them to all candidates. *See Fulani v. League of Women Voters*, 684 F. Supp. 1185 (S.D.N.Y. 1988), *aff'd*, 882 F.2d 621 (2d Cir. 1989) (permitting charity to exclude candidate who failed to meet such a threshold test).

63. Rev. Rul. 86-95, 1986-2 C.B. 73 (amplifying Rev. Rul. 66-256, 1966-2 C.B. 210, holding that a 501(c)(3) organization may conduct debates on political matters).

64. Rev. Rul. 72-513, 1972-2 C.B. 246 (regarding a student run newspaper); Rev. Rul. 72-512, 1972-2 C.B. 246 (regarding political science courses).

65. Rev. Rul. 74-574, 1974-2 C.B. 160.

manipulated to promote one candidate over another.

Although existing precedential guidance strictly limits the election-related activities of 501(c)(3)s, a couple of private rulings do appear to sanction behavior that most advisors in this field would counsel against. In a Technical Advice Memorandum (TAM), the IRS Chief Counsel's office reluctantly concluded that a charity had not intervened in the 1984 presidential election, even though it ran issue ads near the time of the October 1984 debates between candidates Ronald Reagan and Walter Mondale that would generally be understood "to support or oppose a candidate."<sup>66</sup> A more recent example is a TAM issued to the Progress and Freedom Foundation (PFF).<sup>67</sup> PFF's activities included sponsorship of a course taught by Congressman Newt Gingrich entitled "Renewing American Civilization." After a lengthy, careful analysis of extremely complex facts, the IRS concluded that the organization, a 501(c)(3), had not violated the campaign intervention prohibition.<sup>68</sup> It was clear that individuals involved intended to subsequently use themes and ideas developed in the course for partisan purposes, but it was difficult to impute that intent to the entire organization. In light of the approach we will see in the Empower America ruling, discussed in Part IV.D.2, it is interesting to note that the IRS conceded that "conservative" did not equate to "Republican" in the PFF ruling.<sup>69</sup>

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66. Tech. Adv. Mem. 89-36-002 (Sept. 8, 1989).

67. The TAM was unpublished, but its full text was made available by the organization. I.R.S., Tech. Adv. Mem. (Dec. 1, 1998), in 1999 TAX NOTES TODAY 24-25 (Feb. 5, 1999).

68. *Id.* The ruling also concluded that the organization did not operate to substantially further private partisan interests. The TAM distinguished *American Campaign Academy v. Comm'r*, 92 T.C. 1053 (1989), on several grounds: the PFF course was not a direct outgrowth of an official party organization's activities; its funding sources were not partisan; there was no evidence of political bias in admission of students because the course was offered through established colleges; and the material in the course was not explicitly biased towards a party.

69. Another 501(c)(3) organization involved in activities related to PFF, the Abraham Lincoln Opportunity Foundation (ALOF), lost its exemption prior to the PFF ruling. Announcement 99-45, 1999-1 C.B. 927. Because ALOF had already been dissolved by the time the IRS ruled for PFF, ALOF lacked standing to challenge its own revocation. *Abraham Lincoln Opportunity Found. v. Comm'r*, 2000 WL 1161109 (T.C. 2000). For a time the matter remained as another non-precedential application of the facts and circumstances test leading to revocation of an organization's 501(c)(3) status. However, in an unusual move, the IRS agreed to reopen the ALOF matter through its "independent review process"—a newly created and previously little-known process the IRS created to review difficult cases. See *Statement of Callaway Foundations on IRS's Reversal of Exemption*

Both of these cases represent situations where the IRS's failure to find campaign intervention and impose sanctions has drawn criticism from commentators. Given the Service's extreme reluctance to issue any precedential rulings that could be taken to encourage "indirect" or surreptitious campaign intervention, it seems likely that these two cases stand simply as illustrations of the difficulties of administering the ambiguous "facts and circumstances" test. A determined organization with sufficient time and resources to bring to the fight may be able to forestall negative IRS action after a protracted battle. However, this does not indicate that organizations that seek to follow the legal rules, or that lack the resources to engage in a lengthy legal battle, can engage in similar activities with impunity.

*B. 501(c)(3) Election-Related Activities as Private Benefit*

Campaign intervention seems to require one or more candidates involved in a specific election, but it is also problematic for a 501(c)(3) to promote partisan interests more generally.<sup>70</sup> The seminal case applying the private benefit doctrine to the advancement of partisan interests is *American Campaign Academy v. Commissioner*.<sup>71</sup> The American Campaign Academy was formed to train campaign workers, which was previously part of the function conducted by the National Republican Congressional Committee (NRCC).<sup>72</sup> Although the Academy had no explicit requirements regarding students' party affiliation, there was evidence suggesting a Republican slant on the admissions panel as a matter of

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*Revocation*, 2003 TAX NOTES TODAY 94-59 (May 15, 2003) (noting that Internal Revenue Manual § 1.54.1 regulations published Jan. 2002 rebut allegations that the process was secret). Upon review, the IRS retroactively restored ALOF's 501(c)(3) status. See I.R.S. Announcement 2003-30, 2003-1 C.B. 929. The ALOF review, and the process by which it was conducted, led to a great deal of controversy, and the IRS soon after ended its independent review process. See Fred Stokeld, *IRS Abandons Process that Restored Exemptions to Gingrich Groups*, 42 EXEMPT ORG. TAX REV. 339 (2003).

70. See generally I.R.C. § 501(c)(3). There is not, of course, any requirement that candidates be specifically identified. For example, urging voters to "vote pro-choice" would likely be considered to promote the election of candidates widely understood to be pro-choice, even if the organization's message did not identify particular candidates. Furthermore, it appears that attempts to provide benefits to political parties or PACs will also violate the campaign intervention prohibition as a form of indirect intervention for or against the candidates supported or opposed by the party or committee.

71. 92 T.C. 1053 (1989).

72. *Id.* at 1053.

practice.<sup>73</sup> Other evidence and inferences indicated that most if not all of the Academy's graduates went to work for Republican candidates.<sup>74</sup> The instructional program was conceded to be legitimately educational, but portions of the curriculum indicated an explicit bias towards Republican interests, with no corresponding examination of Democratic materials.<sup>75</sup> Finally, the organization's primary source of funding was the NRCC.<sup>76</sup>

Based on these facts, the court concluded that the IRS had correctly determined that the Academy did not qualify as a 501(c)(3) because it operated substantially to further the private interests of Republican entities and candidates.<sup>77</sup> The idea that a legitimate educational program could be conducted so as to impermissibly advance private interests was not novel.<sup>78</sup> *American Campaign Academy* established that the interests of partisan entities constitute private interests.<sup>79</sup>

#### IV. POLITICAL ACTIVITIES BY 501(C)(4)S

##### A. *Primary Social Welfare Purpose Excludes Political Activities*

Organizations operating under I.R.C. § 501(c)(4) may engage in certain election-related activities too partisan for 501(c)(3)s, but there are limits imposed by the 501(c)(4)'s tax-exempt status.<sup>80</sup>

I.R.C. § 501(c)(4) describes organizations "operated exclusively for the promotion of social welfare."<sup>81</sup> Somewhat counter to what one might expect, "operated exclusively" has been interpreted in the associated regulations to mean that the organization "is *primarily* engaged in promoting in some way the

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73. *Id.* at 1056.

74. *Id.* at 1060.

75. *Id.* at 1070–71.

76. *Id.* at 1070.

77. *Id.* at 1078–79.

78. This point was noted in an extended discussion of this case published in the 2002 Continuing Professional Education text. 2002 ELECTION YEAR ISSUES CPE, *supra* note 37 app. II, at 452.

79. *Am. Campaign Academy*, 92 T.C. at 1077–79. The court declined to consider whether Republican entities and candidates could constitute a charitable class that would be the appropriate recipient of 501(c)(3) benefits, despite the large size of the class. *Id.* The partisan affiliation indicated that the interests defining the class were private. *Id.*

80. *See* I.R.C. § 501(c)(3)–(4).

81. *Id.* § 501(c)(4).

common good and general welfare of the people of the community.”<sup>82</sup> The regulations further provide that “the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”<sup>83</sup> For the sake of convenience, this activity that may not be primary for a 501(c)(4) will be referred to as “political activity.”

Revenue Ruling 81-95 states affirmatively what is implied in the 501(c)(4) regulations: that 501(c)(4)s may engage in political activity so long as they primarily conduct social welfare activities.<sup>84</sup> The organization in question carried on what was characterized as “certain activities involving participation and intervention in political campaigns.” Apparently these activities were fairly direct: “financial assistance and in-kind services.” The ruling stated as a fact that the organization was primarily engaged in activities designed to promote social welfare. Thus, its legal conclusion was reached quickly: “[A]n organization may carry on lawful political activities and remain exempt under § 501(c)(4) as long as it is

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82. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (as amended in 1990) (emphasis added).

83. *Id.* § 1.501(c)(4)-1(a)(2)(ii). Unfortunately, no publicly available regulatory history sheds any light on the rationale underlying adoption of the IRS interpretation that social welfare activities do not include political activity. Such an explanation could be extraordinarily useful to organizations and their advisors attempting to understand and comply with the limitation on 501(c)(4) political activity. However, as noted in a recent IRS instructional article, a 1969 General Counsel’s Memorandum reached a similar conclusion with regard to 501(c)(5) and (c)(6) organizations, reasoning that while the content of legislation may be readily identified with the organization’s exempt labor or business purposes, “support of a candidate for public office necessarily involves the organization in the total political attitudes and positions of the candidate.” Gen. Couns. Mem. 34,233 (Dec. 3, 1969), *quoted in* 2002 ELECTION YEAR ISSUES CPE *supra* note 37, at 433. The CPE article suggests that, “This rationale would appear to apply to other types of exempt organizations.” *Id.* at 433. In other words, 501(c)(4), 501(c)(5) and 501(c)(6) organizations may lobby to an unlimited extent on issues germane to their exempt purposes, but because supporting a candidate furthers positions entirely unrelated to those purposes, such activities are not part of those in which the organization must primarily be engaged.

Note that if this is indeed the rationale for the restriction on 501(c)(4) political activity, it arguably does not support extending the definition as far as the reach of the prohibition on 501(c)(3) campaign intervention. For instance, voter education activities that focus on social welfare issues might reasonably be argued to be “germane” to a 501(c)(4)’s purpose of promoting a position on those issues, yet because the materials suggest a preference for candidates that share the organization’s view on the issues they would be impermissible for a 501(c)(3) to produce or distribute.

84. Rev. Rul. 81-95, 1981-1 C.B. 332.

primarily engaged in activities that promote social welfare.”<sup>85</sup>

What the regulations and rulings for 501(c)(4)s do not tell us is precisely what constitutes political activity. Existing authority is both scant and contradictory, and the IRS appears to have adopted a “facts and circumstances” approach similar to the analysis used to determine when an activity constitutes campaign intervention for a 501(c)(3).<sup>86</sup> In addition, the uncertainty for 501(c)(4)s is compounded by the lack of a clear standard to determine what activities an organization is “primarily engaged in.” Rather, the IRS has held that “[a]ll facts and circumstances are taken into account in determining an [501(c)(4)] organization’s primary activity.”<sup>87</sup> An only slightly more detailed description appeared in a 1995 CPE article:

Whether an organization is “primarily engaged” in promoting social welfare is a “facts and circumstances” determination. Relevant factors include the amount of funds received from and devoted to particular activities; other resources used in conducting such activities, such as buildings and equipment; the time devoted to activities (by volunteers as well as employees); the manner in which the organization’s activities are conducted; and the purposes furthered by various activities.<sup>88</sup>

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85. *Id.*

86. See Raymond Chick & Amy Henchey, *Political Organizations and IRC 501(c)(4)*, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1995, 192, 197-98 (1995) [hereinafter 1995 501(c)(4) POLITICAL CPE] available at <http://www.irs.ustreas.gov/pub/irs-tege/eotopicm95.pdf> (last visited Oct. 3, 2004) (“IRC 501(c)(4) does not define political campaign activities; instead, the definition and interpretation of terms used has occurred principally under IRC 501(c)(3). . . . [W]hether an organization has participated or intervened in a political campaign is a ‘facts and circumstances’ test.”).

87. Rev. Rul. 68-45, 1968-1 C.B. 259.

88. 1995 501(c)(4) POLITICAL CPE, *supra* note 86, at 192.

B. *501(c)(4) "Political Activity" as 501(c)(3) "Campaign Intervention"*

1. *Precedential Authority Suggesting Congruence of 501(c)(4) Political Activity and 501(c)(3) Campaign Intervention*

As discussed above, organizations operating under § 501(c)(3) may not "participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office,"<sup>89</sup> language clearly echoed in the 501(c)(4) regulations that set out activity that may not be primary for a 501(c)(4). It is highly likely that the intent in drafting the 501(c)(4) regulatory language was to mirror the set of activities that constitute campaign intervention under § 501(c)(3). This interpretation is consistent with principles of statutory interpretation—that absent evidence to the contrary, one should read similar language to mean similar things.

It is notable that implementing regulations under § 501(c)(3) expressly state the interpretation that the campaign intervention prohibition is limited to candidates for "elective public office."<sup>90</sup> No authority expressly limits the scope of 501(c)(4) political activity to campaigns for elective office. However, the 501(c)(3) regulations did not purport to be imposing an additional limitation that would narrow the statutory prohibition. Rather, they set forth a clarifying reading. The phrase "political campaign" is generally understood to refer to elections. It is reasonable to read the language of the 501(c)(4) regulations similarly, so that 501(c)(4) political activity would relate only to campaigns for elected public office.<sup>91</sup>

Only one precedential ruling addresses a specific activity that was found to be political, and therefore not permissible as the primary activity of a 501(c)(4). Revenue Ruling 67-368 says that rating candidates, even on a nonpartisan basis, is political activity that may not be primary for a 501(c)(4).<sup>92</sup> This is consistent with finding 501(c)(3) campaign intervention and 501(c)(4) political activity to be the same thing, given that, as noted above, other

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89. I.R.C. § 501(c)(3).

90. Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii) (as amended in 1990).

91. Other advocacy relating to non-elected public office (e.g. appointed judges), or elected non-public offices (e.g. corporate officers), would not be covered in the definition of 501(c)(4) political activity and presumably would be acceptable as promotion of social welfare, so long as it was linked to the organization's social welfare purposes.

92. Rev. Rul. 67-368, 1967-2 C.B. 194.

rulings have found that such activity would constitute impermissible campaign intervention if conducted by a 501(c)(3).<sup>93</sup> Thus, this Revenue Ruling suggests, but does not necessarily require, that 501(c)(4) political activity is described by the same set of activities as 501(c)(3) campaign intervention.

In reaching its conclusion that 501(c)(4)s may engage in political activities, Revenue Ruling 81-95 cites Revenue Ruling 67-368 and, in passing, existing 501(c)(3) rulings for other examples of what constitutes campaign intervention.<sup>94</sup> Thus, although it is not necessary to the conclusion of the ruling, Revenue Ruling 81-95 demonstrates an assumption that anything that constitutes prohibited 501(c)(3) campaign intervention will be 501(c)(4) political activity.

It has been widely assumed that, whatever the definition of 501(c)(4) "political activity" includes that is not the promotion of social welfare, it cannot logically include a broader set of activities than is covered by 501(c)(3) campaign intervention. There is no authority suggesting that something might constitute political activity for a 501(c)(4) and yet not be campaign intervention for a 501(c)(3), and there is no apparent policy reason to impose any such rule.<sup>95</sup> Charitable activities (i.e., permissible for a 501(c)(3)) certainly promote social welfare; although social welfare is likely a broader concept, covering activities and purposes other than the charitable as well.<sup>96</sup> Hence, political activity that may not be primary for a 501(c)(4) does not logically include any activities permissible for a charitable organization under 501(c)(3).

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93. See, e.g., *Ass'n of the Bar of New York v. Comm'r*, 858 F.2d 876 (2d Cir. 1988).

94. Rev. Rul. 81-95, 1981 C.B. 332.

95. This assumption is supported by the language of the regulations concerning "action" organizations. One thing that triggers "action organization" status is political campaign intervention. The regulations state that such an organization may not qualify under § 501(c)(3), but "may nevertheless qualify as a social welfare organization under 501(c)(4)." Treas. Reg. § 1.501(c)(3)-1(c)(3)(v) (as amended in 1990).

96. See *id.* § 1.501(c)(3)-1(d)(2) (including the promotion of social welfare in the definition of charitable purposes); John Francis Reilly et al., *IRC 501(c)(4) Organizations*, EXEMPT ORGANIZATIONS TECHNICAL INSTRUCTION PROGRAM FOR FY 2003, I-25 [hereinafter 2003 501(c)(4) CPE], at <http://www.irs.gov/pub/irs-tege/eotopic03.pdf> (last visited Oct. 3, 2004) ("[T]here is considerable overlap between IRC 501(c)(4) and 501(c)(3). Many organizations could qualify for exempt status under either Code section.")

## 2. *Non-precedential Support for 501(c)(3)-501(c)(4) Congruence*

Other published IRS interpretations are consistent with a conclusion that 501(c)(4) political activity under the primary purpose test is coterminous with prohibited 501(c)(3) campaign intervention. The 2002 CPE text discusses the primary test for 501(c)(4)s and cites these authorities.<sup>97</sup> The article does say that a 501(c) organization may make expenditures for political activities or other things that do not further its exempt purpose so long as they are not the primary activity.<sup>98</sup> Neither that discussion nor the article on political activity by 501(c) organizations in the 2003 CPE provides further insight into whether 501(c)(4) political activity is defined by the same standard that determines 501(c)(3) campaign intervention.<sup>99</sup>

A series of letter rulings in the late 1990s include express statements by the IRS that the set of activities which are prohibited campaign intervention for 501(c)(3)s are the same activities that constitute political activity, which must not be the primary activity of a 501(c)(4). The rulings arose in the context of taxpayers seeking a determination that certain activities *were* exempt function activity under § 527, and will be discussed in further detail below. However, because of the way the request was framed, it was easy to conclude that the proposed activities would be campaign intervention for a 501(c)(3). The first of these rulings looked at Revenue Ruling 81-95 and made explicit what was implicit in its reasoning: that prohibited 501(c)(3) campaign intervention is the same thing as activity that must be less than primary for a 501(c)(4).<sup>100</sup> Subsequent Private Letter Rulings (PLRs) repeated this reasoning in sketching out the scope of 527 exempt function activity. Thus, they provide strong evidence that the IRS interprets 501(c)(4) political activity as described above: the same activities that constitute prohibited campaign intervention under § 501(c)(3) are those that are considered political activity under § 501(c)(4) and may not be a 501(c)(4) organization's primary

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97. 2002 ELECTION YEAR ISSUES CPE, *supra* note 37, at 433.

98. *Id.*

99. John Francis Reilly & Barbara A. Braig Allen, *Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5), and (c)(6) Organizations*, EXEMPT ORGANIZATIONS TECHNICAL INSTRUCTION PROGRAM FOR FY 2003 [hereinafter 2003 POLITICAL CAMPAIGN ACTIVITIES CPE], at <http://www.irs.gov/pub/irs-tege/eotopicl03.pdf> (last visited Oct. 3, 2004).

100. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996).

activity.

501(c)(4)s seeking to engage in political activity are faced with a multitude of uncertainties. The lack of clear guidance about the precise scope of the 501(c)(3) campaign intervention prohibition, and the nebulous “facts and circumstances” test used to analyze a given activity is compounded by the application of another “facts and circumstances” analysis to determine whether an organization is “primarily” engaged in social welfare activities. 501(c)(4)s interested in participating in public debate around both elections and policy issues have little useful guidance to apply in deciding what to measure and how to weigh it in trying to ensure their primary activities promote social welfare.<sup>101</sup>

*D. Private Benefit and 501(c)(4)s*

No precedential authority has followed the *American Campaign Academy* case (discussed above) to restrict 501(c)(4) political activities.<sup>102</sup> However, several rulings make it clear that the primary social welfare purpose of a 501(c)(4) must be met by a community benefit rather than a private benefit, and these rulings directly connect this concept of private benefit to the private benefit forbidden as a substantial purpose of 501(c)(3)s. The difference is quantitative, not qualitative—less than “primary” for 501(c)(4)s versus “substantial” for 501(c)(3)s.<sup>103</sup>

*1. Primary Purpose Versus Private Benefit*

An organization will be considered “operated exclusively for the promotion of social welfare [under 501(c)(4)] if it is primarily engaged in promoting in some way the common good and general welfare of the . . . community.”<sup>104</sup> Numerous cases and rulings contrast the requirement that a 501(c)(4) operate primarily for the common good and provide community benefit with the provision of private benefit, which may not be the primary function of a 501(c)(4) social welfare organization.<sup>105</sup>

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101. See *Final Report of the Members of the Exempt Organizations Committee’s Task Force on Section 501(c)(4) and Politics*, reprinted in 45 EXEMPT ORG. TAX REV. 136 (2004) (noting lack of precedential guidance).

102. See *supra* note 71 and accompanying text.

103. See I.R.C. § 501(c).

104. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (as amended in 1990).

105. The following discussion touches on a few rulings in order to illustrate the parameters of the 501(c)(4) private benefit standard. A lengthier summary of

Otherwise exempt activities and purposes may be tainted if the organization's benefits are confined to or targeted towards a limited class of members. Thus, an organization formed to promote the common interests of tenants in an apartment complex does not operate primarily for the common good and general welfare of the community, but rather for the private benefit of the residents.<sup>106</sup> In contrast, an organization undertaking similar advocacy activities was found to qualify as a 501(c)(4) because it "promote[d] the legal rights of all tenants in a particular community."<sup>107</sup>

501(c)(4)s may provide greater private benefit than 501(c)(3)s and still retain exemption. A 501(c)(3) must not engage in any non-exempt activity unless it can be considered "insubstantial,"<sup>108</sup> but a 501(c)(4) need only ensure that activities not in furtherance of social welfare are less than primary. The distinction is illustrated by an organization whose membership was restricted to residents, property owners, and businesses located in a single city block.<sup>109</sup> It was formed to preserve and beautify the public areas of that block; activities included planting shrubbery, picking up litter, and paying the city to plant trees.<sup>110</sup> Although the private benefit to members was too great to allow exemption under § 501(c)(3), the community benefit was found to be sufficient for exemption under § 501(c)(4).<sup>111</sup>

## 2. *Private Benefit to Partisan Interests*

While it has never issued a precedential ruling applying the concept of 501(c)(4) private benefit in the political context, the IRS expressly raised the possibility in a proposed denial letter issued to Empower America, which had applied for recognition as a 501(c)(4): "The private benefit standard used in *American Campaign Academy* is similar under § 501(c)(4). The difference is in the

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precedents addressing community versus private benefit is found in 2003 501(c)(4) CPE, *supra* note 96.

106. Rev. Rul. 73-306, 1973-2 C.B. 179.

107. Rev. Rul. 80-206, 1980-2 C.B. 185.

108. *Better Bus. Bureau of Wash., D.C. v. United States*, 326 U.S. 279, 283 (1945).

109. Rev. Rul. 75-286, 1975-2 C.B. 210.

110. *Id.*

111. *Id.* Cf. Rev. Rul. 68-14, 1968-1 C.B. 243 (stating that an organization formed to beautify and plant trees in an entire city is operated for charitable purposes and qualifies for exemption under § 501(c)(3)).

weighing of the private benefits (i.e., the amount of private benefits), not the standard.”<sup>112</sup>

The Empower America application illustrates an attempt by the IRS to deny exemption based on a determination that the applicant was a “partisan issues organization” and hence primarily operated for private benefit.<sup>113</sup> The organization was founded by several prominent Republicans with the purpose of advancing a conservative reform agenda.<sup>114</sup> Its activities included publishing various materials on public policy issues, holding conferences and seminars, grass roots lobbying, and conducting “candidate schools.”<sup>115</sup>

In a proposed denial letter, the IRS asserted that Empower America did not primarily promote social welfare because it was “partisan.”<sup>116</sup> To support this conclusion, the IRS set out a long list of factors that it considered indicated partisan operations.<sup>117</sup> These included that the organization was controlled by individuals affiliated with the Republican party; repeated criticism of the Clinton Administration and its policies such that (it was alleged), “Clinton Administration” became a negative code word for the Democratic party; seminars covering topics similar to Republican policies; and public communications characterized as “partisan” because of their use of code words and ideas associated with the Republican party.<sup>118</sup> A similar, yet distinct, concern raised was that the organization operated to further the private benefit of its directors by maintaining their political prominence.<sup>119</sup>

Empower America responded forcefully, disputing the factual basis for the IRS’s conclusion that it was a “partisan issues organization.”<sup>120</sup> Its reply cited numerous instances of speaking out on non-political issues (concerns about the degradation of American popular culture), working together with Democratic affiliated organizations, criticizing Republicans and opposing

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112. Letter from Edward K. Karcher, Chief of Exempt Organizations Technical Branch 3, to Empower America (Feb. 21, 1997), *reprinted in* PAUL STRECKFUS'S EO TAX J., Dec. 22, 1997, at 28, 34.

113. *Id.*

114. *Id.* at 28.

115. *Id.* at 28–29.

116. *Id.* at 34.

117. *Id.* at 33.

118. *Id.*

119. *Id.* at 34.

120. Letter of Empower America to Edward K. Karcher, (April 21, 1997), *reprinted in id.* at 35.

positions forwarded by some Republican leaders, and working actively to promote a position of the Clinton Administration (passage of NAFTA).<sup>121</sup> In sum, Empower America effectively took issue with the suggestion that “conservative” was a code word for “Republican.”

The organization eventually received a favorable determination letter based on the adoption of several procedural safeguards to reassure the IRS that it would not operate for private benefit.<sup>122</sup> These safeguards included not soliciting or knowingly accepting funds from Republican entities, requiring any director who is seeking elective office to take a leave of absence, and continuing to have the issues it focused on be selected by the Board based on their importance to the nation and not in coordination with any other organization.<sup>123</sup>

The story of Empower America highlights the possibility of applying the partisan benefit theory to deny exemption, but also illustrates the difficulty involved. In all but the most extreme cases, an organization that is not merely an arm or outgrowth of a political party will be able to point to differences with partisan entities sufficient to undermine a partisan private benefit argument. While conservative interests may have significant overlap with policies and priorities of the Republican Party, that alone is not sufficient to find that promoting a conservative agenda confers impermissible private benefit on partisan Republican interests.

## V. POLITICAL ACTIVITY BY 527S

To read the mainstream press, one would think that political organizations operating under § 527 of the Internal Revenue Code were a new creation invented by nefarious political operatives intent on undermining the campaign finance system. In fact, Congress passed § 527 in 1975.<sup>124</sup> What is “new” about 527s is that,

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121. *Id.* at 36–44.

122. 1997 TAX NOTES TODAY 231-15 (Dec. 2, 1997).

123. *Id.*

124. Congress passed I.R.C. § 527 to address a concern raised by the IRS. Until that time, no section of the I.R.C. explicitly exempted political parties, candidate campaign organizations, and political committees from taxation on the funds they received. 2002 ELECTION YEAR ISSUES CPE, *supra* note 37, at 387. In light of this legislative silence, the IRS proposed a solution in 1973 to exempt contributions to political organizations from taxation but to subject their investment income to taxation. Announcement 73-84, 1973-33 I.R.B. 18, restated

beginning in the late 1990s, there was increased recognition that 527s could be created to engage in activities that met the requirements of § 527 but that were not sufficiently political to be regulated by federal, state, or local election authorities. These new “soft” 527s (so-named because their fundraising for political purposes was not limited to the “hard money” restrictions of election law) offered certain strategic advantages under tax and election law, but the growth of the “soft” 527s almost immediately resulted in increased regulation.<sup>125</sup>

A. “*Exempt Function*” Under § 527

I.R.C. § 527 governs taxation of “political” organizations, defined as organizations “organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.”<sup>126</sup> “Exempt function,” in turn

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

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in Rev. Rul. 74-21, 1974-1 C.B. 14 (modified and clarified in Rev. Rul. 74-475, 1974-2 C.B. 22). However, the IRS indicated that it would not enforce this policy until Congress had time to consider this issue. Congress acted by passing § 527.

125. Rosemary E. Fei, *The Uses of Section 527 Political Organizations*, in 1 STRUCTURING THE INQUIRY INTO ADVOCACY 23 (Elizabeth J. Reid ed., 2000) at <http://www.urban.org/advocacyresearch/structuring.html> (last visited Oct. 3, 2004).

126. I.R.C. § 527(e)(1). Although technically organizations must merely be “primarily” engaged in exempt function activities to be tax-exempt under § 527, the practical standard may be higher. Many, perhaps most, 527 organizations are actually segregated funds of other organizations. Thus, a 501(c)(4) might establish a fund for political activities, which the IRS will treat as a 527 organization. See Treas. Reg. § 1.527-2(b)(1) (as amended in 1985). However, if a segregated fund spends more than an “insubstantial” amount in a year for non-exempt activities, the IRS will not recognize the fund as a separate 527 organization. *Id.* Substantial expenditures for non-exempt activities over multiple years may result in the IRS treating the fund as if it had never been exempt from tax under § 527. *Id.* Thus, the would-be 527 might find itself in tax-exempt limbo—unable to qualify as tax-exempt under § 527 because it engaged in “substantial” non-exempt activities, yet unable to qualify as tax-exempt under any section of 501(c) because its “primary” purpose is still political activities. The tax status of such in-between organizations is far from clear.

nominated, elected, or appointed.<sup>127</sup>

By referring to these activities as “exempt functions,” § 527 creates a great deal of confusion because, as is clear from the discussion of 501(c)(3) and 501(c)(4) political activities above, 527’s “exempt function” describes as “exempt” political activities that are prohibited or limited for most types of tax-exempt organizations. Organizations primarily engaged in these political “exempt functions,” including not only political committees, but also political parties and candidate campaigns, pay federal income tax on any investment income but not on contributions they receive. Furthermore, contributions to 527 organizations are exempt from the federal gift tax usually imposed on donors that make gifts in excess of an indexed annual threshold (currently \$11,000).<sup>128</sup>

Not only does the I.R.C. definition of political “exempt function” determine which organizations qualify for this tax treatment under § 527, but it also determines which activities of other organizations are subject to tax on political activities under § 527(f). Section 527(f) subjects 501(c) organizations to federal income tax on an amount equal to the lesser of expenditures they make for “exempt functions” defined under § 527(e)(2) and the amount of investment income the 501(c) organization has received in that year.

Various IRS rulings indicate a broad interpretation of this standard to apply to most expenditures related to the campaign process. For instance, expenditures for an election night party were ruled to be exempt function expenditures as “an inherent part of . . . the selection process” even though such expenditures clearly would not be able to influence the actual outcome of the election and as such could also be permissible for a 501(c)(3) organization.<sup>129</sup> “Testing the waters” or exploratory costs have been ruled to qualify as exempt function expenditures even when the individual ultimately did not run for the office contemplated.<sup>130</sup>

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127. I.R.C. § 527(e)(2).

128. *Id.* § 2501(a)(5).

129. Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 1.

130. *See, e.g.*, Tech. Adv. Mem. 93-20-002 (May 21, 1993).

1. *Similarities in the Tests*

No explicit precedential authority addresses the connection between “exempt function,” “campaign intervention,” and “political activity,” but a series of Private Letter Rulings in the late 1990s contained reasoning based on the idea that the standards are largely, if not entirely, equivalent.

The first of the rulings examining the outer limits of 527 exempt function activity appeared in 1996.<sup>131</sup> It concerned a 501(c)(4) organization that had set up a separate segregated fund (SSF) to conduct certain activities and sought a ruling that those activities would constitute a 527 exempt function and that the SSF would be treated as a 527 organization under § 527(f)(3).<sup>132</sup> The proposed purpose of the fund was to conduct a voter education program to raise awareness of the importance of certain issues and the position of candidates on those issues without engaging in express advocacy for or against any identified candidates.<sup>133</sup> Although few specific facts remain in the heavily redacted ruling, it appears that the program would *not* follow the guidelines set out in existing guidance on permissible 501(c)(3) voter education. Issues, for instance, were to be selected not because of “their importance and interest to the electorate as a whole,”<sup>134</sup> but “based on their importance to [the organization]’s agenda and their expected resonance with the public.”<sup>135</sup> Selected issues and themes would be “linked to the . . . records and positions of incumbents and candidates in order to reinforce the significance of those connections in the minds of the voters.”<sup>136</sup> Voter guides would report candidates’ positions on issues as well as major campaign contributors. Distribution would be targeted geographically based on the organization’s political interests and timed to coincide with political campaigns.<sup>137</sup> Both voter guides and incumbent voting

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131. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996).

132. *Id.*

133. Engaging in express advocacy would bring the program within the ambit of the campaign finance laws whose contribution limits and disclosure obligations the organization was attempting to avoid. *See* I.R.C. § 527(f)(3).

134. Rev. Rul. 78-248, 1978-1 C.B. 154, at Situation 2.

135. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996).

136. *Id.*

137. This last factor is frequently cited as an important consideration in determining that an activity constitutes 501(c)(3) campaign intervention. It is obviously relevant in analyzing materials that are purportedly not related to elections, such as lobbying messages. The significance of timing is less apparent

records would be designed to indicate the organization's stance on the issues covered and to implicitly compare that position to the views of the candidates and legislators covered.

Other than the statute and regulations, there was no precedential authority on which to base an analysis of whether these activities constituted a 527 exempt function. The IRS agreed with the taxpayer that this program did not come within the areas of permitted voter education set out in existing 501(c)(3) rulings.<sup>138</sup> It clearly fell on the political side of the campaign intervention line. It was therefore reasonable to conclude it was exempt function activity, that is, "influencing or attempting to influence the . . . election . . . of any individual to any . . . public office."<sup>139</sup>

The ruling then looked at Revenue Ruling 81-95 and concluded explicitly what was strongly implied in that prior ruling: that prohibited 501(c)(3) campaign intervention is the same thing as 501(c)(4) political activity. The ruling went on to say that those same activities "are, in turn, activities that are exempt functions for a section 527 organization."<sup>140</sup> Certainly, regulations under § 527 do state that whether an activity constitutes an exempt function depends on all the facts and circumstances.<sup>141</sup> It is only in this last logical step of the ruling, for which no other authority was cited, that the IRS indicated that the same "facts and circumstances" that determine 501(c)(3) campaign intervention also define the extent of the 527 exempt function.

Subsequent rulings have taken this analysis further in finding that specific activities constituted a 527 exempt function. Letters issued in 1997 and 1998 addressed what was termed "dual-character activities."<sup>142</sup> These were grass roots lobbying messages that served both legislative and political purposes. The rulings stated that this activity, although not exclusively directed towards influencing elections, was nonetheless permissible for a 527 fund because it served an exempt function.<sup>143</sup>

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with regard to voter education materials, which are obviously only of use to the public when made available during an election campaign.

138. *See, e.g.*, Rev. Rul. 78-248, 1978-1 C.B. 154, at Situation 2; Rev. Rul. 80-282, 1980-2 C.B. 178.

139. I.R.C. § 527(e)(2).

140. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996).

141. Treas. Reg. § 1.527-2(c)(1) (as amended in 1985).

142. Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997); Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997).

143. *See id.* It is uncertain how this analysis would apply to a 501(c)(4) conducting such activity. It might be considered exempt function activity and

Finally, in 1999, another letter ruling pushed the 527 envelope even further.<sup>144</sup> The ruling concluded that a whole host of activities that, at least generically, could be legally conducted by a 501(c)(3), would be treated as 527 exempt functions based largely on the intent of the organization, as evidenced by factors such as targeting, polling, and expert advice about the likely electoral effect of various messages and activities.<sup>145</sup> The covered activities included ballot measure advocacy and other lobbying activity, which had traditionally been presumed permissible for a 501(c)(3) (and which, therefore, would constitute the promotion of social welfare for a 501(c)(4)).<sup>146</sup> This ruling opened up the possibility that this advocacy would be considered campaign intervention if the organization's primary purpose in engaging in the ballot measure work was to increase turnout of voters likely to vote for identified candidates. Viewed externally, this activity would seem wholly appropriate for a 501(c)(3), but it could be treated as an exempt function, apparently, solely because of the taxpayer's intent. Because the ruling was issued to a taxpayer seeking to establish its political motivation, the ruling gives little insight into how this test might be applied to advocacy by a 501(c)(4) (or 501(c)(3)) that would prefer not to have its ballot measure activities characterized as political.

In 2000, an IRS ruling determined that an organization applying for 501(c)(4) status did not qualify because its primary activities were campaign intervention.<sup>147</sup> Factors supporting that conclusion also led to a finding that the organization was primarily operated to conduct 527 exempt functions. There are not enough facts in the ruling to let us know whether this is based on a belief that 501(c)(4) political activity and 527 exempt function describe

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therefore not part of the 501(c)(4)'s social welfare function. Alternatively, a 501(c)(4) could argue that its activity is primarily directed towards lobbying and therefore should not be treated as a 527 expenditure.

144. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999).

145. *Id.*

146. In fact, earlier rulings had also concluded that under certain circumstances ballot measure activity would be an exempt function. Communications regarding a ballot measure that prominently featured an individual's name and picture were found to be for an exempt purpose although they did not mention the person's candidacy. Tech. Adv. Mem. 91-30-008 (Apr. 16, 1991). Even if the message did not identify a candidate it could be an exempt function if the advocacy was carried to encourage turnout of voters favorable to candidates supporting the issue. Tech. Adv. Mem. 92-49-002 (June 30, 1992).

147. Field Serv. Adv. 2000-37-040 (June 19, 2000).

the same activities, so that 501(c)(4) and 527 are indeed mirror images of each other, or whether the activities were so clearly “political” under either section that the distinction did not matter to the conclusion reached.<sup>148</sup>

The problem with using these rulings to understand the parameters defining 501(c)(4) political activity is that they responded to requests from taxpayers affirmatively seeking to characterize their activities as 527 exempt functions. Thus, they presented their activities as avowedly intended and designed to influence elections. In light of that approach, it would have been difficult to conclude that the activities were anything other than appropriate exempt function activities for a 527 political organization. However, for 501(c)(4) taxpayers who have not so carefully mustered evidence of the intent and expected effects of their actions, the rulings shed little light on the question of how activities will be judged.

There is also a significant degree of uncertainty about the treatment of “dual purpose” activities conducted by a 501(c)(4). For instance, suppose an organization engages in lobbying activities for the primary purpose of influencing legislation, but talks about a legislator’s position on the issue using rhetoric that it knows is likely to influence some voters in an upcoming election. Will this electoral element cause the activity to be considered political? Or is the entire activity classified based on the organization’s primary motivation for conducting it?

Before publication of these rulings, many advisors to nonprofits had believed that there was a “gray area” open to 501(c)(4)s between the line of 501(c)(3) campaign intervention and 527 exempt function. Advocacy outside of the 501(c)(3) safe harbors could be conducted by a 501(c)(4) without risk. By pushing the lines delimiting 527 and 501(c)(3) activities together in the sphere of candidate elections, those rulings seem to have eliminated any margin of safety available to 501(c)(4)s. Given the indefinite “facts and circumstances” test that is used to determine prohibited campaign intervention, exempt organizations previously thought they could safely protect the exempt status of a 501(c)(3) organization by conducting any questionable activities with a 501(c)(4). Now they must be concerned about whether this would cause the 501(c)(4) to be primarily engaged in political activities

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148. *Id.*

which, because of its close relationship to the 501(c)(3), could also jeopardize the 501(c)(3)'s status. Under the reasoning of these rulings, it is necessary to know the characterization of every activity carried out so there can be less tolerance for uncertainty. Yet the rulings use the same nebulous "facts and circumstances" analysis used in the 501(c)(3) context to identify 527 exempt function activity, a situation that provides no clear guidance to 501(c)(4)s seeking to preserve their status.

## 2. *Distinctions Among the Tests*

Section 527 organizations' exempt functions include activities not covered by the 501(c)(3) prohibition and presumably also not political activity for a 501(c)(4). The definition of 527 "exempt function" in the statute explicitly extends to areas that are not within the 501(c)(3) campaign intervention prohibition.<sup>149</sup> As discussed above, 501(c)(3) campaign intervention is explicitly limited by regulation to "elective public office," and 501(c)(4) political activity is implicitly so limited as well. In contrast, the exempt function of a 527 political organization includes influencing the "selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization. . . ."<sup>150</sup> Thus, unlike the 501(c)(3) prohibition, the statutory definition of exempt function applies to non-elected public offices, and to office in a political organization.<sup>151</sup>

The regulations do not further delineate the scope of offices with which the 527 exempt function is concerned. Most of the examples provided assume an elected office, or do not state whether the office is elected or appointed.<sup>152</sup> However, one provision states that expenditures are not for an exempt function when incurred by a 501(c) organization associated with providing testimony in support of the confirmation of an individual to a

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149. I.R.C. § 527(e)(2).

150. *Id.*

151. The statute also includes special treatment for newsletter funds maintained by a candidate or officeholder as a 527 political organization. I.R.C. § 527(g). Newsletter funds, however, may not be used for campaign expenses. Treas. Reg. § 1.527-7(d) (1980). In addition, paying for expenses associated with a political office that would be deductible as business expenses if paid by an individual office holder are treated as an exempt function under the statute. I.R.C. § 527(e)(2).

152. *See* Treas. Reg. § 1.527-2(c)(5) (1980).

cabinet position in response to a written request from a Congressional committee.<sup>153</sup> From the context, it is not completely clear whether this is intended to set out a narrow exception for a 501(c) organization, or to state more broadly that these expenditures would not be for an exempt function if conducted by a 527 organization. It is certainly possible to read this example as defining a narrow region (invited Congressional testimony on cabinet appointments, and possibly other positions subject to Senate confirmation) where activity by a 527 will be treated as exempt function but the same activity by a 501(c)(4) is not considered an exempt function.<sup>154</sup>

Beyond the language of the statute and regulations there is no precedential authority to illuminate the extent to which 527 exempt function covers activity outside the area defined as 501(c)(3) campaign intervention, but some non-precedential guidance supports distinctions between the tests. A 1988 General Counsel Memorandum (GCM) confirmed that 527 exempt function and 501(c)(3) campaign intervention are not coterminous.<sup>155</sup> It concluded that 501(c)(3)s may seek to influence appointment of federal judges because judges do not hold elective public offices.<sup>156</sup> The ruling further concludes that influencing judicial appointments is a 527 exempt function activity that triggers the 527(f) tax (discussed in Part II above) if conducted by a 501(c) organization.<sup>157</sup> Announcement 88-114 publicized the IRS's belief that this is the correct conclusion and solicited public comment.<sup>158</sup> Comment was also sought on whether the proposed application of the 527(f) tax to 501(c) organizations that seek to influence judicial appointments should be only prospective, as many such organizations, particularly 501(c)(3)s, had not been aware that this activity might be considered an exempt function.<sup>159</sup> No further guidance has been forthcoming and the most recent IRS Continuing Professional Education text on Election-Year Activities

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153. *Id.* § 1.527-6(b)(4).

154. Similarly, illegal expenditures are not for an exempt function, Treas. Reg. § 1.527-2(c)(4) (1980), but presumably would be treated as campaign intervention for a 501(c)(3) if made to influence an election.

155. Gen. Couns. Mem. 39,694 (Jan. 21, 1988).

156. *Id.*

157. *Id.*

158. Announcement 88-114, 1988-37, I.R.B. 26 (Aug. 30, 1988).

159. *Id.*

states that no final determination of the issue has been made.<sup>160</sup> Nonetheless, the GCM remains as a non-precedential indication that 501(c)(3)s may legally engage in some activities that constitute a 527 exempt function.

As discussed above, an activity or purpose that comes within the ambit of “charitable” and is therefore permissible for a 501(c)(3) should per se qualify as the promotion of social welfare for a 501(c)(4).<sup>161</sup> Thus, the logic of this GCM indicates that a 501(c)(4) could be organized to primarily attempt to influence federal judicial or executive branch appointments and qualify under 501(c)(4).<sup>162</sup> On the other hand, if this is exempt function activity for a 527, this same organization could equally well qualify as a 527 political organization.

Of course, the conclusions of GCM 39,694 and Announcement 88-114 caused substantial controversy and have never been adopted in precedential guidance. But based on the statutory language there are less controversial examples of activity that could be primary for either a 501(c)(4) or a 527 organization, such as attempting to influence elections or appointments of individuals to office in political parties. For instance, if an organization’s purpose is to promote social welfare by increasing the number of African-Americans in important leadership positions, it might choose to further this purpose by advocating for the selection of a specific African-American as chair of a national party committee. Were the organization to engage in this activity exclusively (or primarily), it would appear to be equally able to qualify as exempt under either § 501(c)(4) or § 527.

There may be a fairly narrow set of activities that constitute a 527 exempt function but not campaign intervention for a 501(c) organization, and few organizations are engaged primarily in carrying out these activities. Nonetheless, it is possible under (relatively) undisputed provisions of current law that an organization’s primary activities could simultaneously be the promotion of social welfare *and* 527 exempt function. At least to this extent, the exempt function of a 527 organization does not define 501(c)(4) political activity. If it is correct, as stated in the PLRs discussed above, that “any activities constituting prohibited political intervention by a 501(c)(3) organization are activities that

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160. 2002 ELECTION YEAR ISSUES CPE, *supra* note 37, at 397 n. 27.

161. *See* discussion, *supra* notes 95–96 and accompanying text.

162. Gen. Couns. Mem. 39,694 (Jan. 21, 1988).

must be less than the primary activities of a 501(c)(4) organization, which are, in turn, activities that are exempt functions for a 527 organization,”<sup>163</sup> then this can be true only with regard to campaigns for elected office. In other words, despite the broad wording adopted, the rulings at most indicate that seeking to influence an election and intervening in a campaign represent the same thing. Because the taxpayers seeking those PLRs were not seeking to influence the selection of individuals for other office, their reasoning did not address the overlap between exempt functions and 501(c) activity in those cases.

## VI. STRATEGIC ISSUES DRIVING CHOICE OF ORGANIZATIONAL FORM

Having defined (insofar as possible) the law governing election-related activities by 501(c)(3)s, 501(c)(4)s, and 527s, we turn now to the strategic issues driving political operatives to choose one form over another. As discussed below, choices are often not made to thwart the policy goals of campaign finance regulation, but are rather made as rational efforts to preserve resources and reduce administrative burdens.

### A. *Tax on 501(c) Political Activities Under § 527(f)*

The most commonly discussed factor pushing political activities into 527 organizations is the potential tax imposed under § 527(f) on 501(c) organizations engaged in political activity.

Section 527(f) subjects 501(c) organizations to tax on the lesser of their investment income or their exempt function expenditures.<sup>164</sup> Regulations set out the application of this tax, and in doing so create some exceptions that presumably would be exempt function activities otherwise, but will not trigger the 527(f) tax, despite statutory language stating that all expenditures by a 501(c) organization for an exempt function trigger the 527(f) tax.<sup>165</sup> In addition, a recent Revenue Ruling discussed the factors to be considered in determining whether a 501(c)'s activity is a 527

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163. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996); Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997); Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997).

164. I.R.C. § 527(f)(1). The policy rationale frequently put forward to explain this tax is that it levels the playing field between 527 organizations, which must always pay this investment income tax, and 501(c)s, which are subjected to it only if they venture into the area of activity occupied by the 527s.

165. *Id.*

exempt function, and set out a number of very useful examples.<sup>166</sup>

1. *Explicit Exceptions from Definition of “Exempt Function”*

Regulations provide two explicit areas where activity by a 501(c) organization will not trigger application of tax under § 527(f)—that is, activities that are excluded from the definition of exempt function when conducted by a 501(c) organization.<sup>167</sup> These exceptions apply specifically to the imposition of 527(f) tax on 501(c)s, rather than as part of the general definition of exempt functions, and thus presumably describe things that would otherwise be 527 exempt function activities.

The first of these explicit exceptions applies to organizations that appear “before any legislative body in response to a written request by such body for the purpose of influencing the appointment or confirmation of an individual to a public office, any expenditure directly related to such appearance is not treated as an expenditure for an exempt function.”<sup>168</sup> Because of the narrow wording of this provision, it sounds particularly like an exception, implying that other advocacy on appointments or confirmations to a covered office would be taxable activity. If that is correct, it is probable that invited testimony on a legislative confirmation by a 527 organization would count as an exempt function, but not be considered an exempt function for purposes of the 527(f) tax when conducted by a 501(c)(4).<sup>169</sup> Of course, this conclusion is difficult to reconcile with the clear statutory language

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166. Rev. Rul. 2004-6, 2004-4 I.R.B. 328. It may be worth noting that Rev. Rul. 81-95 mentioned the 527(f) tax as potentially applying to a 501(c)(4)'s political activities, but *did not* assume that all activities that constitute campaign intervention are 527 exempt function activities that trigger the tax. It was carefully worded only to say that those expenditures that are for a 527 exempt function would subject the 501(c)(4) to tax under 527(f). It is unclear whether this implicitly suggests that 501(c)(4) political activity was not considered to be identical to 527 exempt function, or if the question was simply not addressed. Rev. Rul. 81-95, 1981-1 C.B. 332.

167. Treas. Reg. §§ 1.527-6(b)(4), (5) (1980). *See also supra* notes 154–55.

168. Treas. Reg. § 1.527-6(b)(4) (1980).

169. *Id.* This exception is also set out in an example which is part of the regulations defining a 527 exempt function. Treas. Reg. § 1.527-2(c)(5)(vi) (as amended in 1985). However, the example is limited to the activities of a 501(c) organization. It is unclear whether its inclusion in that section indicates that invited testimony is universally excluded from the definition of exempt function or, as appears more likely, it is simply included there along with other examples. *Id.*

about application of the tax.<sup>170</sup>

The second explicit exception provides that “nonpartisan” voter registration and get-out-the-vote (GOTV) campaigns are also not treated as exempt function activity when conducted by a 501(c) organization.<sup>171</sup> To qualify as “nonpartisan,” the campaign may not be explicitly identified with a party or candidate.<sup>172</sup> The regulations do not impose any additional limitation on these voter involvement activities. It is likely that the intent in drafting this provision was to limit the exception to 501(c)(3)-permissible activity, but the regulations explicitly state only the one requirement. Narrowly focused, issue-based voter involvement messages might be considered prohibited for a 501(c)(3), and indeed may be intended to influence an election. Nonetheless, there is a viable reading of this exception that would exclude such communications from the definition of exempt function for 527(f) purposes. By expressly stating this as an exception, the regulations certainly suggest that voter involvement campaigns not identified with a candidate or party could also potentially be carried out by a 527 organization and be considered an exempt function. Statements made at the time of publication of the final regulations<sup>173</sup> suggest that this provision was intended to cover GOTV and voter registration activities permitted by federal and state election laws. Because those laws allow 501(c)(4)s to engage in voter motivation campaigns that focus more narrowly on divisive issues than would be permitted to a 501(c)(3), it is at least arguable that this exception exempts from 527(f) tax some activities that would constitute 501(c)(3) campaign intervention.

The 1999 PLR also concluded that voter registration, voter motivation, and GOTV communications would be treated as exempt functions when conducted by the 527 organization, even if they were not always identified with a specific party or candidate.<sup>174</sup> It is not clear whether this was intended as a narrowing reading of § 1.527-6(b)(5), interpreting it to apply only to 501(c)(3)-permissible activities. It could also be confirmation that there is a set of voter-activation messages that will be treated as exempt function when

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170. The statutory language states that all expenditures by a 501(c) organization for an exempt function trigger the 527(f) tax. I.R.C. § 527.

171. Treas. Reg. § 1.527-6(b)(5) (1980).

172. *Id.*

173. T.D. 7744, 1981-1 C.B. 360.

174. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999).

conducted by a 527, yet not trigger the tax when conducted by a 501(c)(4) due to the exception.

The explicit exceptions from 527(f) tax set out in the regulations for confirmation hearings, invited testimony, and voter activation work set out activities that are not taxable when engaged in by a 501(c)(4), but that apparently (and logically) could also be conducted by a 527 and treated as exempt function.

## 2. *Reserved Regulations*

When regulations under § 527 were first proposed, a number of comments pointed out that there are sound reasons that a 527 tax on 501(c) organizations should be applied consistent with provisions of the Federal Election Campaign Act (FECA) that permit 501(c) organizations to engage in certain activities without establishing a separate segregated fund.<sup>175</sup> Lack of consistency between FECA and tax law would create a significant burden on these organizations. In order to maximize their use of non-PAC<sup>176</sup> money as permitted by campaign finance laws, and yet avoid paying the 527(f) tax, they would be required to create two SSFs (a traditional PAC and an SSF for 527 exempt function expenditures that fall outside the regulatory scope of FECA). This would double the organization's bookkeeping and administrative burden, contrary to at least one expression of Congressional intent.<sup>177</sup>

A Congressional desire to maintain consistency between the two sets of laws was also expressed:

In prescribing such rules, regulations, and forms under this section, the [Federal Election] Commission and the Internal Revenue Service shall consult and work together to promulgate rules, regulations, and forms which are mutually consistent. The Commission shall report to the

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175. Those comments are discussed in 2002 ELECTION YEAR ISSUES CPE, *supra* note 37, at 437.

176. As noted earlier in this article, we use "PAC" as a simpler and more easily understood term than the more technically accurate language describing a political committee subject to the state or federal legal restrictions, such as FECA's restrictions on the size and source of contributions. In the context of this discussion, such a "PAC" refers to a separate segregated fund maintained in compliance with the restrictions of applicable campaign finance laws.

177. "It was our intention, in order to promote uniformity and simplicity of regulation, that the tax law match the then existing [Federal Election] Campaign Act restrictions." 122 CONG. REC. 12,200 (1976) (statement of Rep. Ullman).

Congress annually<sup>178</sup> on the steps it has taken to comply with this subsection.

On the other hand, Congress had clearly spoken elsewhere to say that a 501(c)(4) organization would be subject to tax under 527(f) if it “expends any amount during the taxable year directly (or through another organization) for an exempt function (within the meaning of subsection 527(e)). . . .”<sup>179</sup> The statute includes no exceptions. The legislative history indicates an intent that 501(c) organizations and 527s should be treated on an equal basis for tax purposes to the extent they engage in the same activities.<sup>180</sup>

Unable to satisfactorily resolve this tension, the IRS adopted final regulations that put off making a final decision on the tax treatment of electoral activity permitted by campaign finance law.<sup>181</sup> Two types of expenditures by 501(c) organizations will be taxable exempt function expenditures only to the extent provided in sections of regulations which both state only, “Reserved.”<sup>182</sup> Upon publication of the final § 527 regulations, the IRS indicated that any tax imposed on a 501(c) based on activities falling within the ambit of the reserved regulations would be applied only prospectively.<sup>183</sup>

One class of expenditures clearly covered by the reserved regulations is indirect costs—expenditures for establishing, maintaining, and fundraising for an SSF.<sup>184</sup> The other category is expenditures “which are otherwise allowable under the Federal Election Campaign Act or similar State statute.”<sup>185</sup> There is no precedential authority further explaining the scope of this provision. Based solely on the published regulations, one could read them to exempt from taxation all those expenditures legal under federal campaign finance law, that is, those short of express advocacy, coordination with a candidate, or electioneering communications.<sup>186</sup> This approach would be consistent with the

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178. 2 U.S.C. § 438(f) (2000).

179. I.R.C. § 527(f)(1). The tax is imposed on the lesser of the organization’s exempt function expenditures or its net investment income. *Id.*

180. S. REP. NO. 93-1357 at 7505 (1974).

181. T.D. 7744, 1981-1 C.B. 360.

182. *Id.*

183. *Id.*

184. Treas. Reg. § 1.527-6(b)(2) (1980).

185. *Id.* § 1.527-6(b)(3).

186. Recent amendments to FECA added restrictions on “electioneering communications” and further modified the law. *See* 2 U.S.C. § 441(b) (West

reasoning behind the decision to reserve the regulations, which was to maintain consistency between tax and election law.

Some IRS texts suggest a more limited reading. The IRS discussion of the final 527 regulations cites some specific activities expressly permitted by the statutory language of FECA.<sup>187</sup> Subsequent CPE texts have reiterated that member communications and SSF administrative and fundraising costs determine the coverage of this reserved section.<sup>188</sup> The drafters of the regulations clearly had these categories in mind, but they may not have focused more specifically on the entire range of activities legally permitted under FECA. It is uncertain how to apply the reserved regulations to other activities that are clearly permissible under FECA, at least as constitutional limits on FECA's scope have been developed in the case law. In other words, it is uncertain whether the exception applies to activities expressly permitted by the statutory language of FECA, or more broadly, to those activities legal for a 501(c)(4) under the campaign finance law as interpreted by regulatory and judicial decisions.<sup>189</sup>

In addition, there is no further authority as to what a "similar state statute" is. Is it one that regulates campaign finance, or one that allows a corporation to create an SSF? Particularly in light of the extraordinarily broad scope of different state campaign finance laws, this creates further uncertainty for 501(c)(4)s engaged in advocacy related to state office, officeholders, and policies. A logically consistent resolution is that the reserved sections would not protect legal state activities that would not be legal for the organization under FECA. But the devil is in the details. If a state law differs only slightly from FECA in what it permits, will activities falling into that small area of discrepancy trigger the 527(f) tax?<sup>190</sup>

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2004).

187. T.D. 7744, 1981-1 C.B. 360.

188. See, e.g., 2003 POLITICAL CAMPAIGN ACTIVITIES CPE, *supra* note 99, at L-10.

189. Further complexity is added by the fact that unlike most corporations certain 501(c)(4) organizations, termed Qualified Nonprofit Corporations, are permitted by FEC regulations (implementing the holding in *Fed. Election Comm'n v. Mass. Citizens for Life, Inc.*, 479 U.S. 238 (1986)) to engage in express advocacy for or against federal candidates. Presumably this expressly political advocacy would be treated as a 527 exempt function regardless of the correct interpretation of the reserved regulations.

190. For instance, FEC regulations permit "occasional, isolated or incidental" use of corporate resources by employees who are volunteering for political campaigns. Occasional use is defined to be no more than four hours per month. 11 C.F.R. § 114.9 (1980). If a state law allows a corporation to permit volunteers to

A 1984 Technical Advice Memorandum concluded that a union's contributions to state candidates, permitted by applicable campaign finance law, would trigger the 527 tax.<sup>191</sup> It did not clarify the underlying reasoning by deciding, for instance, that the state law was not "similar." Rather, the ruling cited what its author(s) perceived as clear congressional intent to impose the 527 tax on all direct political expenditures by a 501(c) organization. It states that "we can see no reason to conclude that anything other than indirect political expenditures would be covered" by the reserved sections of the regulations.<sup>192</sup> This is obviously too broadly stated. Even the IRS texts that read the scope of "permitted by FECA" narrowly would permit some activities beyond indirect expenditures, for example, express advocacy communications to members.

When the 527 regulations were promulgated, the IRS indicated that these sections were reserved pending resolution of the relationship between tax law and FECA.<sup>193</sup> This resolution may prove difficult to achieve administratively. Certainly it would be difficult to craft a regulation explicitly defining an activity simultaneously as an exempt function for a 527 and not an exempt function (that is, not taxable) for a 501(c), yet avoid a conflict with the plain language of I.R.C. § 527(f). The desire for consistency between FEC and IRS regulation may be irreconcilable with the statutory language of 527 imposing a tax on any exempt function expenditure by a 501(c)(4). Hence, "resolution" of the relationship between campaign finance and tax laws may require legislative action. There is a persistent tension between the two goals of leveling the playing field (by imposing 527(f) tax on 501(c)(4) exempt function activities) and consistent administration of tax and campaign finance laws (so organizations have only one set of administrative rules to apply).

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use its offices up to eight hours per month, would the value of the additional four hours' use constitute a taxable exempt function expenditure?

191. Tech. Adv. Mem. 85-02-003 (Sept. 27, 1984).

192. *Id.*

193. 181 T.D. 7744, 1981-1 C.B. 360.

### 3. *Revenue Ruling 2004-6*<sup>194</sup>

In December 2003, the IRS did something both rare and surprising: it released a precedential ruling in the exempt organization area.<sup>195</sup> The ruling expressly addresses only the application of § 527(f) investment income tax to 501(c)(4), 501(c)(5), and 501(c)(6) organizations.<sup>196</sup> Specifically, it discusses whether expenditures for certain public communications should be characterized as 527 exempt functions and thus trigger the tax. Despite the fact that the discussion and examples are limited to the context of campaigns for elected public office, exempt organizations of all stripes are looking to this new ruling with great interest.

After restating the familiar refrain that “all the facts and circumstances must be considered,” the ruling goes on to provide representative lists of factors that will be taken into account.<sup>197</sup> Summarizing the relevant factors illustrated in the ruling, a public communication is more likely to be deemed a 527 exempt function if it: identifies a candidate for office; is timed to coincide with an electoral campaign; targets voters in a particular election;<sup>198</sup>

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194. Rev. Rul. 2004-6, 2004-4 I.R.B. 328. The authors are not generally inclined to believe in either conspiracy theories or numerology, and hence ascribe no significance whatsoever to the fact that this major new IRS ruling on political campaign activities by nonprofits bears the same number, 2004-6, as the FEC’s notice of proposed rulemaking on political campaign activities by nonprofits.

195. *Id.* This ruling is discussed in this section because on its terms it directly addresses only the application of the § 527(f) investment income tax to 501(c) organizations. Nevertheless, it certainly would provide valuable guidance to § 527 organizations interested in determining whether their activities constitute exempt functions. In light of the substantial overlap between the 527 exempt function and 501(c)(3) campaign intervention, the ruling is also of great interest in determining whether election-year advocacy activities would jeopardize a 501(c)(3)’s exempt status. IRS officials have acknowledged this relevance in public remarks. See Judith Kindell, *Remarks*, in 43 EXEMPT ORG. TAX REV. 244, 245 (2004) (statements of Judith Kindell of the IRS regarding Rev. Rul. 2004-6).

196. Rev. Rul. 2004-6, 2004-4 I.R.B. 328.

197. *Id.*

198. *Id.* The meaning of “targets” as used here is not further elaborated. *Id.* In all the examples, communications are directed at an elected official’s constituents, who are naturally the logical audience for both electoral and bona fide lobbying communications. *Id.* In the opinion of the authors, this factor alone, without further elaboration, is not particularly helpful in distinguishing 527 exempt function communications from other advocacy messages. See Judith Kindell, *Remarks*, in 43 EXEMPT ORG. TAX REV. 244, 245 (2004) (“[a]ll we intended when we said the communication targets the voters is that it was directed at the same voters.”).

identifies the candidate's position on a public policy issue; focuses on an issue that has been raised as distinguishing candidates in the campaign; and is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.<sup>199</sup> A public communication is less likely to be considered an exempt function if it: identifies legislation or another specific event outside the organization's control that the organization hopes to influence; is timed to coincide with an event outside the organization's control that the organization hopes to influence; identifies the candidate solely as an official in a position to act on the issue; or identifies the candidate solely as a key sponsor of legislation.<sup>200</sup>

These factors are then applied in a series of specific examples.<sup>201</sup> Some are unsurprising in their conclusions, but a few take on more challenging situations. For instance, an advertisement that encourages citizens to "Tell Governor E what you think about our under-funded schools" constitutes a 527-exempt function, even though the text contains no references to the Governor as a candidate or the pending election.<sup>202</sup> Key to this outcome seem to be the facts that the opposing candidate has raised funding for public education as a campaign issue, the advertisement is not part of a series of substantially similar advocacy communications by the organization on the same issue, it is aired on radio shortly before the election, and there is no pending legislative vote or other activity the organization may be hoping to influence.<sup>203</sup> Thus, while the message on its face appears to be solely about a public policy issue, an inquiry into external circumstances compels a conclusion that it will be treated as political campaign activity.

The final example also concludes that a television advertisement with no reference to voting, elections, or candidacy nonetheless constitutes an exempt function.<sup>204</sup> The critical factors here appear to be timing, identifying a public official's position as opposed to that of the organizations, and probably most critically that the ad is not tied to an event outside the organization's

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199. *Id.*

200. *Id.*

201. *Id.*

202. *Id.*, Situation 4.

203. *Id.*

204. *Id.*, Situation 6.

control, but rather calls for moratorium on imposition of the death penalty, a call that the IRS presumably believes could have been made at another time if the true intent was not to influence a pending election.

This ruling is the first precedential guidance issued that helps clarify the ambiguity discussed above regarding the meaning of the reserved sections of the regulations under § 527.<sup>205</sup> The communications described in the specific examples are carefully drafted to be clearly “allowable under the Federal Election Campaign Act.”<sup>206</sup> That is, the examples that refer to federal candidates are crafted to describe communications that any corporation, including 501(c) nonprofit corporations, may legally pay for with general treasury funds consistent with federal campaign finance laws. The ruling unambiguously holds that expenditures for these communications trigger application of the 527(f) tax.<sup>207</sup> Questions still remain about “similar state statutes,” but there is now precedential authority to indicate that “allowable under FECA” cannot be read to include *any* expenditure permissible under federal election law.

Revenue Ruling 2004-6 is a laudable attempt to provide meaningful guidance to politically active exempt organizations and their advisors. By taking on examples that mix “good” and “bad” facts, it demonstrates how real-world situations might be resolved. However, it also demonstrates the breadth of the IRS’s interpretation of the 527 exempt function. Together with the remaining uncertainties of the “facts and circumstances” approach, this broad sweep makes this standard ill-suited for importation into the campaign finance world, an area of law that is designed to address different governmental interests.<sup>208</sup>

### B. *Gift Tax*

Recent popularity in the use of 527 organizations has also been driven by the fact that contributions to most 501(c) organizations (other than 501(c)(3)s) are subject to the gift tax<sup>209</sup> but

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205. See *supra* note 181 and accompanying text.

206. Treas. Reg. § 1.527-6(b)(3) (1980).

207. Rev. Rul. 2004-6, 2004-4 I.R.B. 328.

208. See *infra* Part VII (discussing different constitutional analyses of speech regulation under tax and election law).

209. I.R.C. § 2522.

contributions to 527s are not.<sup>210</sup> Individual donors are generally subject to a tax on gratuitous transfers of funds in excess of an annual exclusion.<sup>211</sup> (This annual exclusion is indexed and was recently raised from \$10,000 per year to \$11,000.)<sup>212</sup> Gifts in excess of that amount will either be taxed or consume a portion of the individual's lifetime exclusion from gift and estate tax.<sup>213</sup>

Gifts to certain organizations are exempt from the gift tax. Gifts to 527 organizations are exempt from the tax, as are gifts to 501(c)(3)s.<sup>214</sup> Revenue Ruling 82-216 states that "gratuitous transfers to persons other than organizations described in § 527(e) of the Code are subject to the gift tax absent any specific statute to the contrary, even though the transfers may be motivated by a desire to advance the donor's own social, political, or charitable goals."<sup>215</sup> There is no such exemption for 501(c)s other than 501(c)(3)s.

The incentive created seems to have been inadvertent. It is not at all clear *why* Congress chose to exempt 527s and 501(c)(3)s but not other 501(c) organizations. Indeed, such an outcome is particularly absurd when applied to 501(c)(4) organizations, many of which engage solely in activities that, if separated out, could be conducted independently by 501(c)(3)s and 527s. There is no apparent rationale for taxing gifts to the 501(c)(4) but exempting from tax contributions to other organizations carrying out the same functions. Nonetheless, large donors are understandably reluctant to subject themselves to possible tax liability by making a contribution to a 501(c) when an alternative exists in the form of a contribution to a 527 (for political activities) or a 501(c)(3) (for non-political activities)—with the added bonus, in the case of a 501(c)(3) contribution, of a charitable tax deduction.<sup>216</sup>

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210. See I.R.C. § 2501(a)(5) (noting exemption from gift tax for § 527 organizations).

211. I.R.C. §§ 2501–05.

212. *Id.* § 2503(b)(2).

213. This lifetime exclusion is currently \$1,500,000. I.R.C. § 2010(c). Absent any additional action from Congress, the repeal of the estate tax (to which the gift tax is linked) in 2010 will briefly change this exclusion, but the \$1,000,000 gift and estate tax exclusion will return in 2011 when the estate tax repeal expires. I.R.C. § 2210. (A full discussion of the ups and downs of the estate tax and the political wrangling it has engendered is, mercifully, beyond the scope of this article.)

214. I.R.C. §§ 2501(a)(5), 2522.

215. Rev. Rul. 82-216, 1982-2 C.B. 220.

216. For a comprehensive and thoughtful discussion of the applicability of the gift tax to 501(c) organizations, including an ingenious argument against

### C. Primary Purpose Test

The discussion above makes it unnecessary to belabor the point here, but it is also important to remember that the primary purpose tests discussed above in the context of 501(c)(4) and 527 organizations also drive the choice of organization used for political advocacy.

As noted above, 501(c)(4)s and other organizations exempt from federal tax under § 501(c) of the I.R.C. (except for 501(c)(3)s) may engage in efforts to influence elections as long as such activities do not become the “primary purpose” of the organization.<sup>217</sup> 501(c) organizations (or their donors) that wish to engage in additional partisan election-related activity without a concomitant expansion of the non-partisan aspects of the organization’s program often look to create 527 organizations, typically separate segregated funds of the parent organization.

### D. Legitimacy of These Strategic Choices

It is worth noting in discussing the strategic reasons pushing political activities into the much-maligned 527 organizations that none of the three key reasons discussed above for the growth of 527s as a political tool are anything other than a rational choice to achieve legitimate goals without wasted resources. Donors wishing to engage in political activity need not fritter away their funds on 527(f) tax, gift tax, or funds spent inflating the non-political work of 501(c) organizations. Indeed, since the year 2000, they have been willing to subject themselves to increased disclosure requirements to make those contributions.<sup>218</sup>

Furthermore, the use of 527s for political activities was foreseen and acceded to by Congress. Congress passed the disclosure law just cited in the wake of the presidential primaries of 2000 and several highly publicized cases of 527 intervention in campaigns.<sup>219</sup> Yet Congress chose to require disclosure rather than

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application of the gift tax to 501(c)s, see Barbara K. Rhomberg, *The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions*, 15 TAXATION OF EXEMPTS 62 (2003).

217. See *supra* notes 81–83 and accompanying text.

218. See I.R.C. § 527(j) (requiring disclosure of all donors to 527 organizations not already required to report donors to federal or state election authorities). No equivalent disclosure requirements exist for donors to 501(c) organizations engaged in political activities.

219. See *e.g.*, Richard W. Stevenson, *The 2000 Campaign: The Tactics; Wealthy*

attempt to rein in 527s.<sup>220</sup>

In short, despite much of the recent discourse portraying the use of 527 organizations as an attempt to circumvent legal restrictions, these organizations are anticipated and even encouraged by provisions of the tax code; they are not “loopholes” or abuses of the system.

## VII. CONSTITUTIONAL CONSIDERATIONS

In light of the foregoing, can the standards of federal tax law constitutionally be applied in attempting to restrict or regulate the political activities of tax-exempt organizations? We suggest that the answer is no. The vague definitions and tests that restrict the political activities of tax-exempt organizations are problematic even in the context of the government recognition of tax-exempt status. They are fatally flawed when viewed under the strict constitutional scrutiny that applies to federal election law.

### A. *Standards of Review*

Government restrictions on speech, particularly core political speech, face a far more stringent constitutional standard than the standard that applies to restrictions on political activities of tax-exempt organizations.

The courts often have been reluctant to approve restrictions on core political speech under federal election law. In general, any such government restrictions must survive strict scrutiny by the courts, i.e. they must be necessary to achieve a compelling governmental interest. In *Federal Election Commission v. Massachusetts Citizens for Life, Inc.* the Supreme Court held that a tax-exempt organization was exempt from the FECA restrictions on express advocacy communications because “government must curtail speech only to the degree necessary to meet the particular problem at hand, and must avoid infringing on speech that does not pose the danger that has prompted regulation.”<sup>221</sup> The Court

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*Texan Says He Bought Anti-McCain Ads*, N.Y. TIMES, March 4, 2000, at A1 (describing the funding provided by Texas businessman Sam Wyly to the 527 organization Republicans for Clean Air that was used to fund independent ads bought to support the presidential campaign of George W. Bush).

220. Indeed, Congress had another opportunity when it amended the disclosure law in 2002 following the passage of BCRA. *See supra* note 1. Again Congress chose the route of disclosure, not regulation.

221. 479 U.S. 238, 265 (1986).

has been similarly protective of political speech on numerous occasions. In *Buckley v. Valeo*, the Court reminded us that “[d]iscussion of public issues and debate on the qualifications of candidates are integral to the operation of the system of government established by our Constitution. The First Amendment affords the broadest protection to such political expression in order ‘to assure [the] unfettered interchange of ideas for the bringing about of political and social changes desired by the people.’”<sup>222</sup> The *Buckley* Court went on to cite other cases in which the Supreme Court viewed restrictions on political speech with a skeptical eye.<sup>223</sup>

*Buckley* was the Supreme Court case from 1976 that struck down much of the original FECA as an unconstitutional regulation of protected political speech. The *Buckley* Court upheld the portion of the law restricting the use of corporate or union funds for certain activities only by narrowly interpreting the law to restrict what became known as “express advocacy” communications—communications that expressly advocate the election or defeat of a clearly identified federal candidate.<sup>224</sup> Over the years of post-*Buckley* litigation, many courts have limited the scope of “express advocacy” to communications that clearly identify a federal candidate and use the so-called “magic words” in reference to that candidate—“vote for,” “vote against,” “support,” “oppose,” “elect,” “defeat,” “re-elect,” etc.<sup>225</sup> Because Congress failed to set any other standard that the Court might have approved, the express advocacy “magic words”

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222. 424 U.S. 1, 14 (1976) (citing *Roth v. United States*, 354 U.S. 476, 484 (1957)).

223. *Id.* at 14–15. “[T]here is practically universal agreement that a major purpose of that Amendment was to protect the free discussion of governmental affairs . . . of course includ[ing] discussions of candidates . . . .” *Mills v. Alabama*, 384 U.S. 214, 218 (1966). “[D]ebate on public issues should be uninhibited, robust, and wide-open.” *New York Times Co. v. Sullivan*, 376 U.S. 254, 270 (1964). “[I]t can hardly be doubted that the constitutional guarantee has its fullest and most urgent application precisely to the conduct of campaigns for political office.” *Monitor Patriot Co. v. Roy*, 401 U.S. 265, 272 (1971).

224. *Buckley*, 424 U.S. at 44.

225. *Id.* See also, e.g., *Maine Right to Life Comm., Inc. v. Fed. Election Comm’n*, 98 F.3d 1 (1st Cir. 1996), *cert. denied*, 522 U.S. 810 (1997); *Fed. Election Comm’n v. Christian Action Network, Inc.*, 110 F.3d 1049, 1055 (4th Cir. 1997); *Iowa Right to Life Comm., Inc. v. Williams*, 187 F.3d 963, 969 (8th Cir. 1999); *Citizens for Responsible Gov’t State Political Action Comm. v. Davidson*, 236 F.3d 1174, 1187 (10th Cir. 2000) (holding for narrow definition of ‘express advocacy’); *but see Fed. Election Comm’n v. Furgatch*, 807 F.2d 857 (9th Cir. 1987), *cert. denied*, 484 U.S. 850 (1987) (upholding broader interpretation of “express advocacy”).

test became the gauge against which all corporate or union political communications were measured.

In contrast, tax-exempt organizations voluntarily assume restrictions far more onerous than those that the government may generally impose because the organizations accept these restrictions in exchange for the grant of certain tax benefits. As a key case upholding the restriction on political activities by 501(c)(3)s explains:

In light of the fact that tax exemption is a privilege, a matter of grace rather than right, we hold that the limitations contained in section 501(c)(3) withholding exemption from nonprofit corporations do not deprive [the organization] of its constitutionally guaranteed right of free speech. The taxpayer may engage in all such activities without restraint, subject, however, to withholding of the exemption or, in the alternative, the taxpayer may refrain from such activities and obtain the privilege of exemption.<sup>226</sup>

Even in the context of tax exemption, there are limits on the ability of the government to impose restrictions on constitutionally protected activities as a condition of a grant of tax benefits.<sup>227</sup> In particular, organizations that do not receive the much-favored 501(c)(3) status, with the accompanying ability to accept tax-deductible contributions, do not enjoy the same level of tax subsidy (if any). It seems reasonable that courts would be willing to countenance fewer restrictions imposed in return for this less favorable treatment. Nonetheless, the courts generally have been willing to allow at least some substantial limits on the otherwise protected activities of tax-exempt organizations.<sup>228</sup>

#### *B. Restrictions on Political Speech Under Tax Law*

As the discussion above makes clear, there is a great deal of uncertainty in existing law about definition of political activity for

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226. *Christian Echoes Nat'l Ministry, Inc. v. U.S.*, 470 F.2d 849, 857 (10th Cir. 1972).

227. *See, e.g., Speiser v. Randall*, 357 U.S. 513 (1958) (overturning a law requiring anyone seeking a property tax exemption to declare that he or she did not advocate the forcible overthrow of the Government of the United States).

228. *See, e.g., Regan v. Taxation With Representation of Washington*, 461 U.S. 540 (1983) (upholding restrictions on lobbying by 501(c)(3) organizations).

tax-exempt organizations. Even if one theoretically determines that there is, in fact, a single line defining 501(c)(3) campaign intervention, 501(c)(4) political activity, and 527 exempt function, it must be acknowledged that this line has not been drawn with any precision. The “facts and circumstances” approach may have the benefit of allowing a decision-maker to reach what he or she perceives as the “right” outcome in every case. However, a test that puts this much discretion in the hands of the tax administrator could suffer from constitutional weaknesses. It certainly provides no assurance to an organization that it will not be subject to tax, or even loss of its tax-exempt status, on the basis of activities that are plainly legal under applicable election law and in fact constitute protected political speech under the First Amendment.

This vagueness is manifest in the definition of 527 exempt function as explored in the letter rulings in the late 1990s.<sup>229</sup> How an activity will be treated for tax purposes depends on evidence of the organization’s subjective intent. It appears possible that the exact same activity might be characterized as permissible 501(c)(3) activity or 527 exempt function based solely on evidence of the organization’s intent.<sup>230</sup>

Congress need not subsidize protected political speech.<sup>231</sup> However, constitutional principles require that citizens be given reasonable notice of proscribed conduct. A law will be struck if “men of common intelligence must necessarily guess at its meaning.”<sup>232</sup> Laws are also invalidated if they are “wholly lacking in ‘terms susceptible of objective measurement.’”<sup>233</sup> The void-for-vagueness doctrine further requires explicit standards for government officials, who might otherwise engage in arbitrary and discriminatory enforcement.<sup>234</sup>

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229. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999); Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997).

230. This is contrary to repeated IRS statements that subjective intent is irrelevant to identifying campaign intervention. For a more nuanced discussion of the appropriate consideration of intent or state of mind in examining 501(c)(3) activities, see 2002 ELECTION YEAR ISSUES CPE, *supra* note 37, at 350–52.

231. See *Regan*, 461 U.S. 540.

232. *Hynes v. Mayor of Oradell*, 425 U.S. 610, 620 (1976) (quoting *Connally v. Gen. Constr. Co.*, 269 U.S. 385, 391 (1926)). See also *Buckley v. Valeo*, 424 U.S. 1, 77 (1976).

233. *Keyishian v. Bd. of Regents*, 385 U.S. 589, 604 (1967) (quoting *Cramp v. Bd. of Pub. Instruction*, 368 U.S. 278, 286 (1961)).

234. See *Grayned v. City of Rockford*, 408 U.S. 104, 108–09 nn.3–4 (1972). This appears to be the position taken by the plaintiff in litigation currently pending in

The standard the IRS has set for 501(c)(4)s fails these tests. The regulations define social welfare activities as excluding “direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”<sup>235</sup> On its face this standard appears to lack terminology that is susceptible of objective assessment. Given the dearth of precedential guidance on the subject, it is arguably so vague as to what speech is encompassed within its ambit that ordinary people cannot know whether their organization is exempt under § 501(c)(4) and hence what requirements the tax law imposes on it. Further, the imprecision of the “facts and circumstances” approach, together with the vagueness of the campaign intervention standard, enable arbitrary administration of these laws.

This constitutional difficulty cannot be addressed by suggesting an organization could avoid legal difficulties by avoiding all political activity. Even for tax-exempt organizations, this is core political speech protected under the First Amendment. Adopting taxable status may also not be an option, because an organization whose primary activities are political may be forced into 527 status. Field Service Advice 2000-37-040 indicates that an organization that fails to be a 501(c)(4) because it primarily engages in political activity will be treated as a 527, and that 527 is not an elective provision.<sup>236</sup> There is no safe area of operations for an organization uncertain how its activities will be classed by the IRS. It must apparently be either a 501(c)(4) or a 527, but lacks sufficient guidance to determine in close cases which is the correct

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District Court. *See* Complaint at ¶¶ 46–54, *The Christian Coalition Int’l v. U.S.*, No. 2:01CV377 (E.D. Va.), *available in* 2001 TAX NOTES TODAY 165-27. The case appears to have stalled, but the authors have hopes that it will at some point proceed and shed further light on the questions discussed herein. *See also* ABA *Members Comment on Exempt Organizations and Politics*, 45 EXEMPT ORG. TAX REV. 136, 161 n.73 (2004).

235. Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (as amended in 1990).

236. A recent circuit court decision appears to be to the contrary, upholding the registration and disclosure provisions of § 527 based in part on the idea that exemption under § 527 is optional. *Nat’l Fed’n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300 (S.D. Ala. 2002) *vacated by* *Mobile Republican Assembly v. U.S.*, 353 F.3d 1357 (11th Cir. 2003). However IRS officials have stated that the Service reads this case to hold that registration is optional but 527 status is not. *Edited Transcript of the January 30, 2004 ABA Tax Section EO Committee Meeting*, 44 EXEMPT ORG. TAX REV. 23, 29 (2004) (“Whether or not you choose to register and therefore avail yourself of the tax-exempt status that 527 makes available is voluntary. . . . But we do not understand the statute to say that whether or not you’re a political organization is a voluntary matter.”).

conclusion. The organization that guesses wrong stands not only to lose its 501(c)(4) status but also to face severe penalties for failure to comply with the registration and disclosure requirements of § 527. Unlike the case of 501(c)(3)s, political activity does not just delimit the end of a tax subsidy. Which side of the 501(c)(4)/527 line an organization falls on determines significant legal obligations.<sup>237</sup> For nonprofits to have a reasonable chance of complying, they must have clear rules.

Thus, there is a plausible argument that the Constitution demands that an objectively determinable line be drawn defining the scope of political activity that will cause a 501(c)(4) to lose its exemption if it is the organization's primary activity. (Similar arguments apply to activity that will trigger the 527(f) tax, but that is not the topic of discussion here.) If the question is not resolved legislatively or administratively it may be that the courts will be left to decide.

### *C. Restrictions on Political Speech Under Election Law*

If these rules are problematic when applied as a condition to recognition of tax exemption, the recent attempts by certain campaign reform proponents and members of the FEC to import them into federal election law is of even greater concern. The vague standards of the tax code are fundamentally unsuitable for use as a general standard for regulating electoral speech.

#### *1. The Political Committee Rulemaking*

As the country faced its first post-BCRA election, many interests were attempting to take the new landscape of federal election law into account. The stakes were—and, as we write this, still are—high. The 2000 presidential election was the closest in this country's history. The deep partisan divisions left by decades of often vicious inter-party warfare were worsened by the aftermath of the November 2000 elections and fundamental policy disagreements between the parties about critically important issues. Political ideologues scrambled to find any advantage they could in the new, untested federal election laws. Those who had succeeded

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237. These legal obligations include the requirement that § 527 organizations register within twenty-four hours of establishment and file monthly or quarterly reports with the IRS that include donor and expenditure information. See I.R.C. §§ 527(i),(j),(k).

in passing BCRA were committed to making sure that they would keep their hard-won victory, and perhaps even extend it.

Certain political operatives, primarily, but not exclusively, on the left, believed that it was necessary to create new, independent entities to support the soft-money operations—particularly base-mobilizing voter registration and GOTV efforts, but also issue advertising—that the parties were less able to fund in the wake of BCRA's soft-money ban. Often (but not always) these new entities were established as non-party 527 organizations<sup>238</sup> to permit large donors to make unlimited contributions free from fear of the gift tax. The creation of these new 527 organizations, and the gifts made to them by several large donors, were prominently reported in the media, often with the assistance of the organizations and donors themselves.<sup>239</sup>

While not intended as such, these new organizations were a finger in the eye of those in the campaign reform community who believed that the intent of BCRA was to eliminate the use of unlimited funds to influence elections.<sup>240</sup> Several of these reform organizations sought theoretical constructs to regulate the newly emerged 527s.

These reform groups found allies in the Republican National Committee and right-leaning advocacy organizations. Republicans had been slower to embrace the post-BCRA 527 strategy. The reason for this may have been a belief that Republicans' long-standing advantage over the Democrats in attracting 'hard' political contributions to candidates and parties would be multiplied by the increases in hard money limits under BCRA, making Republican-leaning 527s unnecessary. Republican control of the White House and both houses of Congress likely gave the party further reason to believe that its hard money fundraising would be successful. It may have been that Republicans expected to instead rely on support from Republican-leaning 501(c)(6) trade associations. Whatever the reasons for the apparent Republican reluctance to embrace the use of 527 organizations, the party was certainly eager to see

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238. As discussed, *supra* Part II.A, the authors are using the popular, and inaccurate, term '527 organization' to refer to independent entities organized under § 527 of the Internal Revenue Code that are not currently required to register as political committees under FECA.

239. See, e.g., Thomas B. Edsall, *Liberals Form Fund To Defeat President; Aim Is to Spend \$75 Million for 2004*, WASH. POST, Aug. 8, 2003, at A3; Glen Justice, *George Soros Gives, and Republicans React with Fury*, N.Y. TIMES, Nov. 16, 2003, at A2.

240. See discussion of BCRA's purposes, *supra* note 4.

Democrats, as the primary proponents of campaign finance reform, feel a bit of pain related to the new law. Thus, the high-profile early success of Democratic-leaning 527s helped to forge a new alliance of convenience between the anti-527 campaign reform groups, the Republican National Committee, and other Republican or right-leaning groups.

These strange bedfellows, the reform community and the Republicans, looked to BCRA and the ruling upholding it in *McConnell v. FEC* to find a broader alternative to *Buckley's* narrow “express advocacy” test. In *McConnell*, the Court had reminded us that “express advocacy” was only one possible way to define the scope of political speech that could be regulated by government without violating the First Amendment.<sup>241</sup> The Court upheld another when it approved BCRA’s provisions related to electioneering communications.<sup>242</sup> In addition, the Court upheld BCRA’s ban on the raising and use of soft-money by state parties to fund “federal election activities,” defined as including “any public communication” that “refers to a clearly identified [federal] candidate” and “promotes, supports, attacks, or opposes” such a candidate.<sup>243</sup> The anti-527 coalition believed that if the Supreme Court had upheld this broad test as constitutional in the context of soft-money restrictions on parties, then it would also pass constitutional muster in the context of a restriction on independent groups.

The reform coalition’s hopes for a broader standard with

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241. See *McConnell v. Fed. Election Comm’n*, 124 S.Ct. 619 (2003). This ruling breaks no new ground in this regard. *Buckley* already made it clear that the express advocacy standard was merely the Supreme Court’s best line-drawing effort when presented with the vague and overbroad language of the original FECA. *Buckley v. Valeo*, 424 U.S. 1, 40-44 (1976). The real issue—in 1976, in 2003, and still today—is who may engage in that line-drawing—only Congress and the Supreme Court, or the FEC as well?

242. See *McConnell*, 124 S.Ct. 619 (ruling that definition of electioneering communications in BCRA lacked the problems of vagueness and overbreadth that led the Court to apply the express advocacy standard in *Buckley*).

243. *Id.* at 675 (upholding restrictions on party communications within 120 days of an election that promote, support, attack, or oppose a candidate as “closely drawn to the anticorruption interest it is intended to address”). The Court suggested that the “promote, support, attack, or oppose” standard was easy to apply and gave it only limited discussion when approving it in the context of communications by political parties, which might be presumed to be engaged in activities designed to get their candidates elected. *Id.* at 675 n.64. We suggest that the standard is far more difficult to apply and would be subject to a more extensive and probing Supreme Court review if it were applied, instead, in the context of independent organizations.

which to regulate 527s relied on language from *Buckley* that suggests that, while an “express advocacy” or other bright-line standard was generally necessary to preserve the constitutionality of attempts to restrict independent election-related speech, groups that primarily existed to support or oppose federal candidates could be more broadly regulated.<sup>244</sup> The would-be reformers reasoned that because under federal tax law a 527 organization was operated primarily for the purpose of engaging in “political” exempt functions under 527(e), then these organizations were among those that the Supreme Court had suggested could be more broadly regulated.

Effective advocacy from this coalition and, more to the point, its supporters on the FEC, led to an attempt in the spring of 2004 to put this theory into regulation. The FEC’s notice of proposed rulemaking on Political Committee Status (NPRM 2004-6) proposed that an organization that in any year spends certain threshold amounts on so-called “federal election activities” would be a federal political committee and thus be subject to strict fundraising limitations under FECA.<sup>245</sup> These “federal election activities” included nonpartisan voter registration and GOTV efforts, and any activity that “promotes, supports, attacks, or opposes” a candidate for federal office.<sup>246</sup> In these situations, 527

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244. *Buckley*, 424 U.S. at 79–82 (upholding against vagueness challenge restrictions on “organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate”). However the Court explicitly references in this discussion its early holding overturning similar restrictions on independent organizations, and the Court only applied this definition in the context of express advocacy communications by those committees. *Id.* It seems unlikely that the Court intended this language to be the basis of broader restrictions of groups not controlled by candidates and not engaged in express advocacy.

245. See 69 Fed. Reg. 11,736 (Mar. 11, 2004) (proposing definitions of “political committee”); 2 U.S.C. §§ 441a(a)(1)(C), 441b, 441c (West 2004) (limiting individual contributions to a maximum of \$5,000 per year and forbidding contributions to political committees by corporations, union, foreign nationals, and government contractors). This summary of some of the key points of the proposal utterly fails to convey the vast scope of this rulemaking. Many of the complaints from commentators on all sides of the debate criticized the scope of the proposed regulations and the difficulty in responding coherently. See, e.g., Comments of Democracy 21, the Campaign Legal Center, and the Center for Responsive Politics, *supra* note 6. The problem was particularly acute given that the FEC was pursuing an accelerated schedule, with the hope of finalizing regulations in time for the 2004 elections.

246. 69 Fed. Reg. 11,736 (Mar. 11, 2004) (citing 11 C.F.R. §§ 100.24(b)(1)-(3)).

organizations would automatically be treated as federal political committees.<sup>247</sup>

In short, the NPRM sought to couple a new test for political activity—“promote, support, attack, or oppose”—with the IRS definition of 527 status. That status would be sufficient to force an organization to become a “political committee” under FECA and trigger application of this ill-defined standard.<sup>248</sup>

The proposal generated a traffic jam of nearly 200,000 comments, which was more than the FEC had ever received on a single proposal.<sup>249</sup> A huge number of comments came from tax-exempt organizations that (correctly) feared that adopting the proposed rules as written would effectively curtail their legitimate election-related activities.

In April, the Commission voted to delay the rulemaking for ninety days to study the matter further, effectively ending any chance that new rules would be in effect in time for the 2004 federal elections.<sup>250</sup> In August, the FEC’s General Counsel produced a new proposed final rule that likewise would have regulated many 527s as political committees.<sup>251</sup> Although still flawed in the eyes of the authors,<sup>252</sup> the new draft was responsive to the concerns expressed in many comments the FEC received in response to the earlier NPRM. In particular, the new proposal did not sweep all 527s into the FEC’s regulatory net.<sup>253</sup> However, the

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247. *Id.* at Alternative 2-A and 2-B.

248. In practice, the “promote, support, attack, or oppose” standard may not be as clear as the *McConnell* Court seemed to suggest, at least outside the context of political parties. During the FEC’s meeting to consider Advisory Opinion 2003-37, the Commissioners engaged in an extended debate from the dais about whether or not a particular communication “attacked or opposed.” Audio tape: Fed. Election Comm’n Open Meeting (Feb. 18, 2004) (on file with authors and available from the FEC).

249. Lisa Getter, *The Race to the White House; Hearings Open on Spending by Advocate Groups; Some members of election panel call the timetable on proposed new rules unworkable*, L.A. TIMES, April 15, 2004, at A24.

250. See Minutes of an Open Meeting of the Federal Election Commission May 13, 2004 (Agenda Document 04-51, Approved June 10, 2004).

251. Draft Final Rules for Political Committee Status (Agenda Document No. 04-75 for FEC Open Meeting Agenda for Aug. 19, 2004), <http://www.fec.gov/agenda/mtgdoc04-75.pdf> (last visited Oct. 3, 2004).

252. See Letter of August 17, 2004, from Harmon, Curran, Spielberg & Eisenberg to FEC, <http://www.harmoncurran.com/HCSE%20PolComLtr.pdf> (last visited Oct. 3, 2004) (criticizing certain flaws in the draft and requesting that the FEC seek further public comment before proceeding with the rulemaking to define “political committee”).

253. See Draft Final Rules for Political Committee Status, *supra* note 252, at

proposal failed to muster the four votes necessary for adoption.<sup>254</sup> Instead the FEC passed only the portion of the proposal related to the rules for allocating disbursements between federal and non-federal political committee accounts, and the portion expanding the definition of “contribution” to include funds received in response to certain fundraising solicitations.<sup>255</sup>

Campaign reformers have expressed their anger at what they see as the latest FEC derogation of its duty and have threatened to pursue regulation of 527s through possible congressional action or litigation.<sup>256</sup>

## 2. *Vagueness*

It is unnecessary to restate the detailed criticism of the vagueness of the tax standards for defining political activity. As should be clear from the discussion above, the apparent simplicity of the tax law’s definition of political activity and the seeming consistency of the regulatory scheme encompassing different types of tax-exempt organizations masks the fundamental problem with the system: its inherent vagueness and subjectivity. These problems are insurmountable in the context of the constitutional review that federal election laws face.

FECA regulates core political speech and imposes criminal penalties for violations. Thus, FECA is especially intolerant of vague standards. As the Court explained in *Buckley*:

Due process requires that a criminal statute provide adequate notice to a person of ordinary intelligence that his contemplated conduct is illegal, for ‘no man shall be held criminally responsible for conduct which he could not reasonably understand to be proscribed.’ Where First Amendment rights are involved, an even ‘greater degree of specificity’ is required.<sup>257</sup>

Given the strict scrutiny with which the courts would view any

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proposed § 100.5 (proposed regulations that would treat some, but not all, 527 organizations and other organizations as federal political committees).

254. Kenneth P. Doyle, *FEC Votes 4-2 to Adopt Limited New Rule Requiring “Hard Money” for Some 527 Groups*, BNA MONEY & POLITICS REPORTER, Aug. 20, 2004.

255. *Id.*

256. *Id.*

257. *Buckley v. Valeo*, 424 U.S. 1, 77 (1976) (citing *U.S. v. Harriss*, 347 U.S. 612, 617 (1954) and *Smith v. Goguen*, 415 U.S. 566, 573 (1974)).

general restriction on political activity, no court could possibly find that the IRS definition of political exempt-function activities for 527 organizations would provide the necessary “adequate notice” to survive a constitutional challenge for vagueness.

### 3. *Overbreadth*

To survive Supreme Court review, any law regulating federal electoral activities must be necessary to achieve a compelling governmental purpose. The Supreme Court has been willing to find the compelling purpose in the need to protect the democratic process from the threat of corruption.<sup>258</sup> However, in attempting to import the tax-law definitions of political activity, the reformers have attempted to restrict activities far in excess of those necessary to achieve that goal.

An effort to bring all 527 organizations under FECA’s restrictions on political committees, as was suggested in the most recent political committee rulemaking and by some submitting comments, would regulate a wide range of activities protected under the First Amendment.<sup>259</sup> The IRS has long recognized that its standards for identifying political activity by tax-exempt organizations capture far more activity than is regulated under federal election law.<sup>260</sup> As discussed above, many examples exist of legitimate activities that would be swept into the regulatory net of the FEC if all 527s are treated as political committees under federal election law.

At the outset, it should be obvious that any federal attempt to regulate *all* 527 organizations would be excessive. Many organizations that qualify for tax exemption under I.R.C. § 527 are not primarily engaged in influencing federal elections. These 527 organizations operate, in whole or in part, to influence state or

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258. *Id.*

259. See NPRM 2004-6, *supra* note †, at 11,741; Letter from Democracy 21 et al., to FEC, *supra* note 6.

260. The IRS has recognized that its congressionally granted authority to restrict political activities of tax-exempt organizations is appreciably greater than the Commission’s authority to regulate political speech more generally. In its training manual for IRS examiners and other staff, the IRS states, “[t]he language of IRC 501(c)(3) indicates a much broader scope to the concept of participation or intervention in a political campaign.” See *Memorandum for Churches on Election “Voter Guides,”* 30 EXEMPT ORG. TAX REV. 193, 196 (2000) (contrasting the ruling of the court in *Federal Election Commission v. Christian Coalition, Inc.*, 52 F. Supp. 2d 45 (D.D.C. 1999), in which the court held that a narrow definition of political activity was constitutionally necessary under federal election law).

local elections or to influence nominations for appointed offices such as judicial nominations.<sup>261</sup>

Even in the context of races for federal elective office, there are numerous activities that the tax code recognizes as 527 exempt function activities—activities that could lead the IRS to classify an organization as a 527—that are beyond the constitutional reach of FECA. Some 527s engage in activities related to federal election activities that fall within this gap, making *per se* treatment of them as federal political committees inappropriate. Drawn from the rulings discussed above, each of the following examples describes an organization that the IRS would consider to be a 527 organization subject to FECA restrictions regulating all 527s organizations as a class:

- The sole activity of a 527 organization created to “elevat[e] the standards of ethics and morality . . . in the conduct of campaigns for [political office]” is seeking candidate commitment to the organization’s “code of fair campaign practices.” The organization produces materials that list the names of candidates who support the code. The IRS has ruled that an organization that approaches all candidates for office and asks that they sign or endorse such a code has engaged in an activity that “constitutes participation or intervention in a political campaign.”<sup>262</sup> Under current

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261. The 2004-6 NPRM’s Alternative 2-B would have regulated all 527s, but Alternative 2-A would have exempted 527s that engage in some of these purposes other than influencing races for federal elective office. Yet even Alternative 2-A would only have exempted 527s engaged “solely” in these non-federal activities. It is possible that a 527 organization might engage in some federal election activities but be primarily engaged in efforts to influence state and local elections. For example, a 527 organization might dedicate twenty percent of its efforts and resources to federal election activities with the remainder going to non-federal ‘exempt function’ activities. Yet under Alternative 2-A, the slightest taint of activity related to federal elections would have forced the 527 organization to operate under the restrictive rules governing federal political committees. 2004-6 NPRM, *supra* note †. Finally, as noted above, the most recent draft rules from the FEC’s General Counsel would not have regulated all 527 organizations, but even this draft would have applied more stringent standards to 527s than to other types of tax-exempt organizations. See Draft Final Rules for Political Committee Status, *supra* note 252, at proposed sections 100.5(a)(3)–(6) (setting forth proposed rules making it more likely that certain 527 organizations would be treated as political committees).

262. Rev. Rul. 76-456, 1976-2 C.B. 151 (modifying Rev. Rul. 66-258, 1966-2 C.B. 213).

federal election law, this activity would not be an “expenditure”; it would not require federal “hard money.”<sup>263</sup> Yet a 527 organization engaged solely in this activity would be treated as a federal political committee if the FEC were to import the tax law definition into election law.

- The sole activity of a 527 organization is to publish advertisements to promote a particular state ballot measure. None of these advertisements refer to a candidate for elective office, but the organization has evidence that the effort will likely bring out voters who tend to support a federal candidate running for reelection on the same ballot. The IRS has ruled that this organization would qualify as a 527 organization and would not qualify as a 501(c) organization.<sup>264</sup> Under current federal election law, this activity would not be an “expenditure”; it would not require federal “hard money.” Yet a 527 organization engaged solely in this activity would be treated as a federal political committee if the FEC were to import the tax law definition into election law.
- The sole activity of a 527 organization devoted to improving the quality of elected officials is rating the qualifications of all candidates for Congress and publishing the results prior to an election. The ratings are not based on political ideology but rather on nonpartisan criteria including the candidates’ prior governmental experience, a survey that asks public officials (such as state legislators, governors, mayors, and other members of Congress) and members of the press to identify those candidates who are “effective,” and an evaluation of the candidates’ responsiveness to constituent requests for assistance. In many cases, the

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263. See 11 C.F.R. 114.4(c)(5)(i) (2004). (For purposes of this and all subsequent examples, we assume that there is no issue of coordination with candidates.)

264. See Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999) (effort to support ballot measure is ‘exempt function’ activity if organization has evidence to show that work would support or oppose a candidate for elective office).

ratings do not indicate the preferred candidate in a particular race because all candidates for that race share the same rating. Faced with a tax-exempt organization that conducted a similar nonpartisan rating project for state judicial candidates, the IRS ruled that the organization had intervened in an election, and the court considering an appeal from the IRS decision stated that although this activity was nonpartisan and in the public interest, it nevertheless constituted participation or intervention in a political campaign.<sup>265</sup> Under current federal election law, this activity would not be an “expenditure”; it would not require federal “hard money.” Yet a 527 organization engaged solely in this activity would be treated as a federal political committee if the FEC were to import the tax law definition into election law.

- The sole activity of a 527 organization is publishing a voter guide for its members and others concerned with environmental issues. The guide compiles incumbents’ voting records on selected environmental legislation of importance to the organization and provides a factual, objective summary of the policy issues that underlie each bill. The guide contains no express statements in support of or in opposition to any candidate. The guide is widely distributed among the electorate during an election campaign. In analyzing a similar example as a 501(c)(3) activity, the IRS stated, “while the guide may provide the voting public with useful information, its emphasis on one area of concern indicates that its purpose is not nonpartisan voter education.”<sup>266</sup> In a later Private Letter Ruling, the IRS confirmed this analysis, suggesting that a voting record distributed during the election season and focusing on selected

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265. *Ass’n of the Bar of New York v. Comm’r*, 858 F.2d 876 (2d Cir. 1988), *cert. denied*, 490 U.S. 1030 (1989).

266. Rev. Rul. 78-248, 1978-1 C.B. 154. As discussed above, several IRS rulings suggest that failure to cover a broad range of issues in a voter guide, *id.*, a legislative scorecard, *id.*, or a candidate debate, Rev. Rul. 86-95, 1986-2 C.B. 73, will cause the IRS to treat the activity as political. As a result any organization that focuses on a single issue and that wishes to engage in one of these activities as the organization’s primary purpose, must be organized as a 527 organization.

issues of importance to the organization would be an “exempt function” activity under § 527 of the I.R.C.<sup>267</sup> Under current federal election law, this activity would not be an “expenditure”; it would not require federal “hard money.” Yet a 527 organization engaged solely in this activity would be treated as a federal political committee if the FEC were to import the tax law definition into election law.

It is hard to imagine Supreme Court approval of a wholesale adoption of the IRS definitions of political activity when they could lead to criminal penalties under federal election law for organizations engaged in activities such as these.

#### VIII. CONCLUSION

In the months preceding the 2004 presidential elections, it was a beautiful time for a drive. Campaign reform proponents had gotten a brand new car from Congress, and the Supreme Court had just finished gassing it up for them. It is perhaps understandable that their collective foot may have been a little heavy on the accelerator as they headed down the highway.

At the same time, the FEC decided to take a short cut through the intersection of tax and election law. Unfortunately, the recently proposed rules skidded on the tax law’s slippery pavement and plowed headlong into the Constitution. The regulatory vehicle is going to be in the shop until at least after the November elections. We hope that when it returns to the road, it will follow a wiser route to reform. Although we cannot provide a comprehensive roadmap to that destination, we hope that this article has at least pointed out some potholes along the route.

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267. Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997).