

**COMMENTS OF THE INDIVIDUAL MEMBERS OF THE EXEMPT
ORGANIZATIONS COMMITTEE'S TASK FORCE ON SECTION 501(c)(4) AND
POLITICS**

The following comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments were prepared by individual members of the Committee on Exempt Organizations of the Section of Taxation. Principal responsibility was exercised by Greg Colvin and Miriam Galston. Substantive contributions were made by Beth Kingsley, Lloyd Mayer, Barbara Rhomberg, and Rich Thomas. The Comments were reviewed by Doug Mancino of the Section's Committee on Government Submissions, by Betsy Buchalter Adler, Chair of the Committee on Exempt Organizations, and by Carolyn Osteen, the Council Director for the Committee on Exempt Organizations.

Although many of the members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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TASK FORCE ON SECTION 501(c)(4) AND POLITICS

Executive Summary

This submission contains the Task Force's final report and recommendations based on our research, writing, and deliberations throughout the year 2003. This report presents a series of interpretations of existing tax law related to Internal Revenue Code ("I.R.C.") § 501(c)(4) and political activity that we think will bring clarity to the issues faced by the Internal Revenue Service ("IRS"), practitioners, and organizations seeking to qualify for or maintain exemption. These comments also present a detailed safe harbor proposal for a revenue procedure keyed to the annual Form 990 filing. As an alternative to a safe harbor, we recommend that satisfaction of our proposed bright line standards create a rebuttable presumption of qualification for exemption under I.R.C. § 501(c)(4).

Our analysis focuses mainly on the extent of the political activities permissible for § 501(c)(4) organizations. The analysis includes under the rubric of "political activity" for this purpose (which is different in some ways from the definition of "exempt function" for purposes of I.R.C. § 527), both candidate campaign intervention activities and private activities of a partisan and political nature such as were at issue in *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989). In order to clarify the requirement that a § 501(c)(4)'s political activities be less than primary, we have proposed a bright line expenditure test.

We caution that a § 501(c)(4) organization that meets the bright line test cannot qualify for or maintain exemption unless it operates primarily for social welfare purposes. Thus, as is discussed below, an organization that has unrelated business, private benefit, or other non-social welfare activities in addition to its political activities will need to aggregate all its non-social welfare activities, including the political activities, to determine whether it operates primarily for social welfare purposes.

On a second, but very important topic affecting the tax treatment of large contributions to § 501(c)(4) organizations, we address the application of gift tax under I.R.C. § 2501. In view of the apparent lack of enforcement, we recommend that the IRS take this matter under advisement and announce that the Service will not assert that such gifts are taxable while review of the issue is pending.

The timing of our comments could not be more propitious. As this work is being finalized, the nation is in the midst of the first Presidential election season after the enactment of the McCain-Feingold campaign finance reform legislation (the Bipartisan Campaign Reform Act of 2002). With new barriers to financing of traditional political parties, a great deal of money, energy, and popular interest is shifting to alternative vehicles for political activism, especially organizations tax-exempt under I.R.C. § 527 and § 501(c)(4). However, those who lead and

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advise § 501(c)(4) social welfare organizations face two huge uncertainties. (1) How much political activity might cause them to lose their (c)(4) tax exemption and be re-classified as a 527 political entity, with enormous tax consequences? (2) Are they, and their large donors, liable for federal gift tax under § 2501? A number of forces are currently at play that may make these questions even more critical:

- A public policy debate is coursing through major daily newspapers and the Federal Election Commission, with massive input from partisan and nonpartisan interested groups, as to whether a greater range of § 527 and even § 501(c) organizations ought to be regulated as federal “political committees.”
- The Service’s recent publication of Rev. Rul. 2004-6, 2004-4 I.R.B. 328, is immensely helpful in the qualitative assessment of a § 501(c)(4) group’s issue advertising and other communications in an election year, but it leaves open the quantitative question of “how much” political activity is consistent with its tax exempt status.
- When the litigation over the Christian Coalition’s § 501(c)(4) tax exemption is settled or resolved in some manner, which could occur at any time, there are likely to be important implications for distinguishing between partisan and nonpartisan voter guide activities, affecting how § 501(c)(4) entities will judge their annual levels of political activity. *Christian Coalition Int’l v. U.S.*, No. 00-CV-136 (filed Feb. 25, 2000, E.D. Va.) , 2000 TNT 41-49. For the history of the litigation, *see* 90 TAX NOTES 1611 (March 19, 2001).
- If the Service and Treasury do not use the administrative rulemaking process to specify the amount of political activity that is acceptable for § 501(c)(4) organizations, Congress or another agency (e.g., the Federal Election Commission) may attempt to do so in order to further the cause of campaign finance reform.
- Without regulatory action now to clarify standards for § 501(c)(4) groups on the issues of political activity and gift tax, the constitutional defects of overbreadth and vagueness in an area of speech protected by the First Amendment are likely to result in years of protracted litigation, uncertainty, and wide variations in tax compliance practices, giving the edge to the risk-tolerant over the risk-averse in the political arena.

These comments are organized as follows. First, we present our conclusions interpreting existing law and our recommendations to the IRS for administrative guidance, reflecting extensive telephone conference deliberations on the exemption qualification and gift tax issues. Then, we present the in-depth research and analysis we conducted, elaborating on the various nuances of Federal tax law that pertain to the § 501(c)(4) exemption.

Conclusions and Recommendations

I. Qualification for I.R.C. § 501(c)(4) Exemption

A. Definitions

1. Primary activities

To qualify, a civic organization must be (i) “not organized or operated for profit” and (ii) “operated exclusively for the promotion of social welfare.” Requirement (ii) is met if the organization is “primarily engaged in promoting in some way the common good and general welfare of the people of the community.” Treas. Reg. § 1.501(c)(4)-1(a)(2).

2. Activities that, taken together, must be less-than-primary

a. Political campaign intervention

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.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii). Any activities that are prohibited campaign intervention for I.R.C. § 501(c)(3) organizations will not be considered as promoting social welfare for § 501(c)(4) organizations. Rev. Rul. 81-95, 1981-1 CB 332. The set of activities described as “exempt functions” under § 527(e)(2) is not exactly coterminous with the definition of political campaign intervention under § 501(c)(3), despite substantial overlap. For instance, attempts to influence judicial and other executive branch appointments are not political campaign intervention activities and may promote social welfare, despite the inclusion of such attempts in the § 527(e)(2) definition of exempt function and despite the Service’s stated view in Gen. Couns. Mem. 39,694 (January 21, 1988) that such attempts are taxable under § 527(f).

For purposes of this analysis, we assume that Rev. Rul. 81-95, 1981- 1 C.B. 332 should remain in place and that activities deemed campaign intervention for purposes of § 501(c)(3) would be treated the same for purposes of § 501(c)(4) qualification. Although we recognize that many uncertainties remain as to the exact activities considered campaign intervention in the § 501(c)(3) context, it is not within the scope of this Task Force to develop that standard. We have addressed the need for such standards in prior submissions to the Service. We would point out, however, that to the extent that IRS interpretations of the intervention standard are vague and uncertain, § 501(c)(4) entities may be in a stronger constitutional position to challenge them than § 501(c)(3) entities. Political activities involve core political speech, and because § 501(c)(4) groups do not have the tax subsidy of deductible donations, the government has less justification for curtailing their speech. While tax-exempt status is itself a subsidy, the loss of an entity’s § 501(c)(4) status and reclassification as a § 527 political organization could lead to taxes and

penalties that exceed the value of any subsidy received.¹ This possibility could give § 501(c)(4) organizations a stronger basis to argue that political intervention standards under § 501(c)(4) are void for vagueness.

As these comments were being completed, the IRS announced the issuance of Revenue Ruling 2004-6, a ruling on issue advertising during election campaigns, an important activity conducted by some § 501(c)(4)s and other exempt organizations. The factors set forth in that Ruling should be very helpful in classifying activities both for purposes of complying with the tax imposed under § 527(f) and the primary purpose test essential for § 501(c)(4) exemption. We applaud the issuance of the new ruling, and believe that the political activity tests set forth in the ruling are, on the whole, quite compatible with the bright line measurement standards we propose here.

Despite our reluctance to address the exact types of activity falling within or outside of the definition of campaign intervention in this report, we repeatedly encountered the fact that § 501(c)(3) and § 527(e)(2) present a fundamental difficulty. The two Code sections embrace two different, though greatly overlapping, sets of political processes leading to selection of an individual to serve in a specific office and regulate those processes a bit differently. Given the resurgence of alternative political processes in contemporary American political life, such as impeachment, recall, and controversial recounts, it is often hard for exempt organizations to discern whether they are involved in a political intervention under either or both Code sections. In the hopes of advancing discussion of this problem, we made an initial effort to classify these contests conceptually by using the § 501(c)(3) intervention definition, based on the assumption that it applies to § 501(c)(4)s as well:

* The § 501(c)(3) intervention standard applies to elective, not appointive, public offices, while the § 527 definition applies to both.

* Appointments made to fill vacancies in elective offices (due to resignation, death, etc.) are not within the § 501(c)(3) intervention prohibition, but are within the § 527 definition.

* Impeachment proceedings, because they involve a legislative/judicial process rather than an elective process, are within neither the § 501(c)(3) intervention prohibition nor the § 527 definition. However, for an organization's effort to influence such a proceeding to have a charitable/social welfare purpose, it must be germane to the organization's public or community benefit purposes, and not simply driven by a partisan desire to remove a person from or keep a person in a public office.

¹ The U.S. Court of Appeals for the 11th Circuit in *Mobile Republican Assembly v. United States.*, 353 F. 3d 1357 (2003), although extending the subsidy argument to tax-exempt § 527 organizations with respect to the disclosure requirements imposed on such organizations by § 527(i) and (j), did not address this definitional issue with respect to either § 527 or § 501(c)(4) organizations.

* Popular votes to confirm or extend the terms of appointed officials, such as judges, are within both the § 501(c)(3) intervention standard and the § 527 definition, because these are elective processes by which the voters may remove or retain a public official.

* Recall votes (despite their classification under some state laws as ballot measures) and votes held to replace a recalled official are within the § 501(c)(3) intervention standard and the § 527 definition, because those rules cover campaigns both in support of and in opposition to the service of a person in public office.

* Proceedings held to determine the outcome of an election, such as recounts, litigation, or even a Presidential race thrown into the House of Representatives, are presumptively within the § 501(c)(3) intervention standard and the § 527 definition. However, just as an organization may further charitable or social welfare purposes by conducting voter registration or otherwise promoting the involvement of under-represented groups in the regular election process, a charity or social welfare organization could engage in activities related to recounts or litigation over election results if it seeks to prevent disenfranchisement of a charitable class of voters rather than promoting a specific outcome.

* Proceedings to select persons to serve in political party offices are within the § 527 definition, but are within the § 501(c)(3) intervention standard only where the office is a public office, e.g., a precinct committee person in the state addressed in Gen. Couns. Mem. 39,811 (Feb. 9, 1990). Other party offices may not be public offices.

b. Private benefit to partisan interests

The promotion of social welfare also does not include activities that confer substantial private benefit upon partisan political interests, even though they may not constitute political campaign intervention. The same private benefit activity that prevented the organization in *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989), from qualifying as a § 501(c)(3) organization would also be regarded as not promoting social welfare for § 501(c)(4) organizations. See 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.

c. Other

The promotion of social welfare does not include a number of activities that do not necessarily have any political character. These include for-profit and unrelated business activities such as investment activities as well as unrelated trade or business activities. See Treas. Reg. § 1.501(c)(4)-1(a)(1) and -(2)(ii) (implying that the unrelated business income activities described in I.R.C. §§ 511-514 would be regarded as not promoting social welfare, regardless of whether they are subject to the unrelated business income tax).

Activities that do not promote social welfare also include social activities for members, *see* Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii); activities for the common business interests of members, *see* Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) by cross-reference to I.R.C. § 501(c)(6); and other activities for the private benefit of members, *see e.g. People’s Educational Camp Society v. Commissioner*, 331 F.2d 923, 931 (2d Cir. 1964), *cert. denied*, 379 U.S. 389 (1964). *See also* Rev. Rul. 68-45, 1968-1 C.B. 259 (income was principally from bingo, but organization’s veterans’ activities were still primary); Rev. Rul. 61-158, 1961-2 C.B. 11 (lottery was primary activity of two employees); Rev. Rul. 75-286, 1975-2 C.B. 210 (block association benefited property owner members substantially, but primarily benefited the community as a whole).

3. Definition of “primary” activity

All facts and circumstances are taken into account in determining a § 501(c)(4) organization’s primary activity or activities. Rev. Rul. 68-45, 1968-1 C.B. 259. Simply put, the organization’s social welfare activities must be greater than those activities that do not promote social welfare, but the margin by which social welfare activities must predominate has not been defined in the I.R.C., regulations, judicial decisions, or precedential administrative authority. There is no single method for measuring whether certain activities are primary or less-than-primary. Factors such as the levels and uses of expenditures, revenues, assets, resources, surpluses, the number of beneficiaries, or the time devoted by employees or volunteers, the levels of management and general expenses, and fundraising expenses may or may not be relevant depending on the circumstances.²

No percentage along any scale of measurement has been set as the dividing line between primary and less-than-primary. Although it is presumed that an organization must qualify for exemption during each of its tax years, nothing precludes consideration of factors occurring in other years in the determination. Organizations seeking to qualify under § 501(c)(4) bear the burden of proof to demonstrate that social welfare activities are primary and that all other activities, taken together, are less-than-primary. In our view, this implies that an organization cannot qualify under § 501(c)(4) even though its largest and most prominent single activity promotes social welfare if the combined size (however measured) of its non-social welfare activities is greater.

B. Proposed Bright Line Option

One of the Task Force’s objectives has been to provide guidance for § 501(c)(4) organizations that engage in political activities and who are uncertain as to whether their political activities are less than primary. Rather than attempt to narrow or refine the elements of the “facts and circumstances” test described above, we propose that the IRS design a simplified, clear, and predictable alternative test for § 501(c)(4) qualification. We recommend that the

² *See* Raymond Chick & Amy Henchey, *Political Organizations and I.R.C. § 501(c)(4)*, IRS EXEMPT ORG. CONTINUING PROF. EDUC. TECHNICAL INSTRUCTION PROGRAM 192 (1995).

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Service develop an elective, bright-line, safe harbor standard that politically active § 501(c)(4) organizations could use to establish their entitlement to and maintain their exemptions. This standard could be promulgated in a revenue procedure with precise definitions and illustrative examples, and be linked to financial information reported on the annual Form 990 return. The safe harbor would be a “shield” protecting those organizations that elect (and qualify under) it from loss of exemption. It is not intended to be a “sword” for the IRS to use against groups that prefer to rely on the “facts and circumstances” test rather than the expenditure-only test.³

Creation of such a safe harbor is within the general rulemaking authority of Treasury and the IRS under I.R.C. § 7805(a), particularly given that the exclusion of political activity from the definition of social welfare and the primary activity test are regulatory interpretations of § 501(c)(4). For example, in determining whether a § 501(c)(3) organization is publicly supported within the meaning of I.R.C. § 170(b)(1)(A)(vi), Treasury and the IRS have created both a bright-line one-third test based only on revenues and a “facts and circumstances” test. Similarly, here the proposed safe harbor would create a bright-line test based only on expenditures while the existing “facts and circumstances” test would remain available for § 501(c)(4) organizations that did not meet the safe harbor requirements. Another example is Rev. Proc. 96-32, 1996-1 C.B. 717, setting safe harbor standards for low-income housing projects to qualify under § 501(c)(3). The safe harbor will serve to ease tax administration and help § 501(c)(4) organizations ensure compliance with the I.R.C., thereby promoting appropriate rulemaking goals.

In order to ensure that all organizations meeting this safe harbor unquestionably are not engaged primarily in political activities, we have adopted many definitions that are not necessarily appropriate under the “facts and circumstances” test. In fact, the discussion of this safe harbor test that follows contains conclusions that at least some members of the Task Force believe would not be correct under the “facts and circumstances” analysis. However, we have agreed they should be included here in order to avoid creating a safe harbor that could be used as a loophole by organizations seeking to avoid both the requirement that they be engaged primarily in social welfare activities and the disclosure obligations of § 527.

The safe harbor utilizes expenditures, cash or in-kind, as the sole measure of political activity and does not require that the time or efforts of volunteer workers be taken into account in calculating whether an organization’s political activities are primary. The Task Force acknowledges that this may permit an organization to obtain the safe harbor’s protection if, for example, it spends \$100,000 on social welfare activities and \$35,000 on political expenditures, and it mobilizes hundreds of volunteers to campaign door to door or in shopping mall parking lots. We decided, nonetheless, to exclude volunteer activities from the safe harbor calculation for several reasons.

³ In this way, the safe harbor would be similar to the lobbying expenditure test available to public charities under §§ 501(h) and 4911, which protects electing organizations from revocation if the test is met, but non-electing charities may still assert that lobbying is insubstantial under all relevant facts and circumstances.

First, many costs associated with volunteer efforts will be accounted for under the safe harbor, including the costs of soliciting and training volunteers, preparing and copying any materials used by the volunteers, and tracking volunteer efforts. Secondly, measuring the value of volunteer time is extremely difficult, which may account for the fact that volunteer activities are not covered under I.R.C. § 501(h) in the analogous lobbying context and are generally not regulated by federal or state election laws. Thirdly, strong public policy interests are served when individuals become actively involved in civic life on a volunteer basis. Balancing these factors against the unlikely chance that arguably abusive § 501(c)(4) political vehicles will emerge with low levels of social welfare expenditures coupled with extremely high levels of volunteer political activities, we concluded that volunteer activities should be excluded.⁴

The bright line test would have the following features:

1. *The principal requirement would be that the organization's expenditures for political activities must be no more than 40% of total program service expenditures during the year.* If the organization met this requirement, it would not lose its § 501(c)(4) exemption for excessive political activities, and it would be safe from re-classification as a § 527 political organization. In many cases, the organization would thereby establish that it is primarily operated for social welfare purposes. However, if the organization had large segments of its operation devoted to unrelated business activities and/or the private interests of its members, those non-political programs, together with the political programs, could be greater than the organization's social welfare programs and the organization could fail the § 501(c)(4) "primary purpose" test. Our proposal would apply an expenditure-only test to political activities; hence an organization with significant activities that are neither political nor social welfare could not prove its qualification for § 501(c)(4) exemption using only the safe harbor and would have to fall back on the "facts and circumstances" test.

2. *The sole method of measurement would be a test of the organization's expenditures made during each tax year.* Organizations desiring a longer measurement period, due to start-up costs or capacity-building in early years or other circumstances, may need to rely on the "facts and circumstances" test.

We discussed the possibility that a multi-year test might more accurately reflect the overall nature of an organization's activities, and be less susceptible to distortion because political expenditures are concentrated in a brief period of time around elections, while other social welfare programs are likely to be conducted on an ongoing basis. Some of us felt strongly that as a policy matter, a 2- or even 4-year period would be more appropriate for measurement. However, we recognized that tax status is typically examined and determined on a single tax year basis. There are exceptions, including qualification under I.R.C. § 509(a)(1) and I.R.C.

⁴ Considerable authority defining true volunteers exists under § 513(a)(1) in the context of unrelated business taxable income.

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§ 509(a)(2), or maintenance of § 501(c)(3) status under § 501(h). In both of those cases, there is either explicit statutory authority to base qualification on a multi-year analysis, or it was adopted as a regulatory interpretation of statutory language that strongly suggested a time frame of longer than a year. Without any such statutory authority to consider a longer period of time, there are serious concerns about the Service's ability to create a multi-year test. Thus, we decided to propose a test that would be applied to each year individually without eliminating the idea of a multi-year analysis from our consideration.

3. *Part III of the organization's Form 990 would identify all those program services that constitute political activities.* The total expenses reported for those activities (the numerator) must not exceed 40% of Part II, line 44, column (B), total functional expenses for program services (the denominator). In Part III, a box to check could be provided for § 501(c)(4) organizations wishing to elect the safe harbor measurement.

4. The organization would be required to describe briefly in Part III of Form 990 those program services that are "political activities" because they fall within the definition of (1) political candidate campaign intervention and/or (2) private benefit to partisan political interests. This will facilitate IRS and public review of the organization's safe harbor election.

5. Management and general expenses, reported on Form 990, Part II, column (C), would be excluded from the measurement completely. This would include the expenses of investment activity. Expenses related to rental income are not included in column (C) but would also be excluded from the measurement because they are reported in Part I, line 6b.

6. Fundraising expenses to solicit support for the organization itself, reported on Form 990, Part II, column (D), would be excluded from the measurement. We understand that some organizations may have joint costs of combined educational and fundraising communications allocated among program, management/general, and fundraising. That allocation, assuming it is reasonable, would apply here and may cause a portion of the joint cost to be included as a political program expense, while excluding amounts properly allocated to management/general and fundraising.

Further, we have come to the view that, for purposes of this measurement only, fundraising for tax entities other than the organization itself ought to be treated as a program expense and classified as social welfare or non-social welfare based on the status of the recipient entity (and, if relevant, the restricted purpose of contributions). Fundraising for other entities, if they are political, ought to be treated as a political program expense, including solicitations for "bundled" contributions to candidates and for donations to § 527 entities, including the organization's own § 527(f) separate segregated fund ("SSF"). If the organization conducts joint fundraising solicitations, e.g., in which the donor is asked or given the option to donate to the § 501(c)(4) organization, to a related § 501(c)(3) fund, and/or to a § 527 SSF, the portion of the solicitation cost attributable to the § 527 SSF fundraising should be treated as a political program cost and the portion attributable to the § 501(c)(3) should be treated as a social welfare program cost, following any reasonable, fair, and consistent allocation method. We think the Service

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should recognize that a method allocating such joint costs in proportion to revenues received for the various entities is presumptively reasonable, although other methods may also be reasonable under the circumstances.

In excluding fundraising expenses, as a general rule, we considered the fact that fundraising expenses earmarked for a § 501(c)(4)'s own political activities would not be counted under the test. Our concern was alleviated in part because the resulting political activity expenses themselves would ultimately be accounted for under the test.

We felt differently about fundraising for other tax entities. A § 501(c)(4)'s fundraising expenses for its SSF, for instance, are not ultimately accounted for by the § 501(c)(4) since the SSF is the one making the political expenditures. We did not want the safe harbor to provide protection for a § 501(c)(4) that, for instance, spent \$100,000 on social welfare activities and \$900,000 on fundraising for its SSF.

We recognized that inclusion of fundraising for other tax entities has the potential to prevent certain § 501(c)(4)s from meeting the test that are closer calls than the above example. A § 501(c)(4) that spends \$3 million on social welfare activities, \$1 million on political activities, and \$1.5 million on fundraising for its SSF will not meet the safe harbor. We concluded, however, that such organizations could utilize the "facts and circumstances" test to show that their political activities were less than primary.

7. The organization's normal accounting method, whether cash or accrual, would be used to perform the expenditure test.

8. To clarify the relationship between the bright line test and the reporting of the organization's direct or indirect political expenditures in Part VI, line 81a, of Form 990, the following comparison with expenditures treated under § 527(f) is needed:

a. The expenditures made by a § 527(f)(3) SSF established and maintained by the organization are not reflected anywhere on the organization's Form 990, and are not included in the bright line test or on line 81a.

b. Expenditures made to influence appointments to judicial, administrative, executive, or other appointive public offices are treated as not within the bright line calculation of political program expenses (the numerator) on Form 990, regardless of whether such costs are included on line 81a.

c. Prompt and direct transfers of dues and other member payments collected by the organization for an SSF are not reflected anywhere on the organization's Form 990 revenues or expenditures, and are not included in the bright line test or on line 81a. However, transfers of the organization's own funds to an SSF are regarded as political program expenses under the bright line test and are included on line 81a.

d. Indirect expenses (including overhead, record keeping, fundraising, etc.) of establishing and maintaining a political entity are treated as follows, regardless of whether such costs are included on line 81a and regardless of whether such costs are free of tax under § 527(f) (“reserved” under the regulations): If the expense is part of the organization’s management and general costs, it is disregarded under the bright line test. If the expense is made to raise funds for a separate political tax entity, it is a political program expense subject to any reasonable method used to allocate joint communication costs as discussed above.

e. Expenditures allowed by the Federal Election Campaign Act (FECA) or similar state statute are treated as follows, regardless of whether such costs are included on line 81a and regardless of whether such costs are free of tax under § 527(f) (“reserved” under the regulations): Costs of internal communications with members are political program expenses under the bright line test if they constitute political campaign intervention and/or private benefit to partisan interests, subject to any reasonable method used to allocate joint communication costs. Costs of establishing and administering an SSF are management/general expenses and can be disregarded. As discussed above, fundraising costs to support an SSF are political program expenses and fundraising costs to support the organization’s own political activities are to be disregarded. This list of expenditures allowed by FECA, etc. reflects activities mentioned in current Treasury regulations but is not intended to be exhaustive.

f. Taxes incurred or paid by the organization due to the application of § 527(f) to the lesser of the organization’s investment income or its political expenditures are treated as management and general expenses reported in Part II, line 43, column (C), just like unrelated business income taxes, and are disregarded under the bright line test. Such taxes are best understood as a cost of producing investment or other business income to support the organization.

9. An organization may elect the safe harbor option for a specific tax year by checking a box on Form 990, Part III, indicating that it wishes to be governed by the 40% political expenditure limit for the tax year reported on that Form 990. The organization can decide each year whether it wants to make the election. It must also provide the required descriptive and financial information and perform the political expenditure calculation necessary to show that it qualifies under the safe harbor on its Form 990, where it is accessible to public view. If the organization does not elect on its Form 990, it cannot later assert the protection of the safe harbor on audit.⁵ If an organization claims the safe harbor but upon IRS examination is found to have failed to meet the safe harbor test, it may still claim exemption under the “facts and circumstances” test.

10. The Task Force recognizes that the IRS and Treasury may have concerns about the safe harbor, because it would essentially immunize from loss of exemption a

⁵ In appropriate cases, extensions would be available under the relief provisions of Treas. Reg. § 301.9100. May 25, 2004

§ 501(c)(4) entity that meets the 40% test. We have tried to anticipate and minimize the ways in which an entity could adapt its expenditures to the safe harbor and yet be devoted mainly to political activities. It is difficult to absolutely eliminate the chance that abuses, perceived or real, may occur, e.g., massive partisan volunteer mobilization not reflected in expenditures, gaming the calculations with cash/accrual/fiscal year manipulations, large partisan internal fundraising, or heavy management/general expenditures to support a separate segregated fund.

In light of that enforcement problem, the Task Force recommends, as a second choice, that the safe harbor (otherwise the same in every way) could be translated into a presumption that an entity meeting the 40% expenditure test is a § 501(c)(4) and not a § 527 organization. The presumption could be rebutted by negative facts and circumstances indicating that the reported expenditures conceal a primary level of political activity. Because the current “facts and circumstances” standard contains little regulatory guidance, even a rebuttable presumption setting forth a methodology by which an organization could demonstrate its prima facie qualification under § 501(c)(4) would be a great step forward.

II. Gift Tax on Donations to I.R.C. § 501(c)(4) Organizations

In preparing these comments, we have studied the existing authorities bearing upon the potential applicability of the § 2501 gift tax to donors who make contributions to § 501(c)(4) organizations that exceed the I.R.C. § 2503(b) annual exclusion amount (currently \$11,000 per recipient per year) and have concluded that the authorities can be construed to both support and oppose imposition of the gift tax. This lack of clarity has led to a situation in which some donors pay the tax while others do not. Many taxpayers and their advisors have not even recognized the potential applicability of the gift tax as an issue. Section 501(c)(4) organizations, which may theoretically be secondarily liable for unpaid gift taxes under I.R.C. § 6324, are thus exposed to tax liability because of the uncertainty of the law.

There have been no public indications of IRS enforcement of gift tax on donations to § 501(c)(4) entities for at least a decade, even in the obvious cases where individual donors have made very large, publicly-disclosed contributions to § 501(c)(4) organizations, such as ballot measure committees.

We consider this situation unfortunate because it results in an uneven playing field in which ignorance of the law or the willingness to take aggressive tax return positions is rewarded. As a consequence, we recommend that the Service promptly publish guidance regarding the imposition of the gift tax on contributions to § 501(c)(4) organizations that: (1) modifies Revenue Ruling 82-216 by indicating that it remains unclear under existing authorities whether and in what circumstances the gift tax applies to contributions to § 501(c)(4) social welfare organizations, (2) provides interim guidance to taxpayers stating that the Service will not assert that contributions to § 501(c)(4) organizations are taxable gifts while review of the issue is pending, and (3) solicits public comments on the issues discussed in the Notice. The Notice should also indicate that if the Service ultimately determines that some or all contributions to § 501(c)(4) organizations are taxable, the gift tax will be applied prospectively only. The Service

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has authority to issue guidance to taxpayers under § 7805, and has previously used such authority to provide interim guidance while study of legal issues was underway.⁶

We further recommend that, following the public comment period announced in the Notice and the completion of its study of the issue, the Service publish its decision on applicability of the gift tax in a revenue ruling. We believe that strong arguments can be made to distinguish various types of contributions to § 501(c)(4) entities and the contexts in which they are made, with the result that it may be impossible to sustain a rule of general applicability treating all such contributions as taxable. Because of the complexity of the issues, we request that the IRS publish the revenue ruling in proposed form for comment during the course of its investigation.

Further detail on our conclusions is provided below. For background, see the article by Task Force member Barbara Rhomberg, *The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions* (pt. 2), 15 TAXATION OF EXEMPTS, Sept./Oct. 2003, at 62, attached.

A. The I.R.C. § 2501 Gift Tax

The gift tax is imposed on the gratuitous transfer of cash and property by individuals; it does not apply to transfers made by corporations. Donations to § 501(c)(3) entities are generally not subject to gift tax because an offsetting deduction is provided in I.R.C. § 2522. Donations to § 527 entities are also exempt from gift tax, as provided in § 2501(a)(5).

B. Rev. Rul. 82-216 as Applied to Gifts to I.R.C. § 501(c)(4) Organizations

According to Rev. Rul. 82-216, 1982-2 C.B. 220, “gratuitous transfers to persons other than organizations described in § 527(e) of the Code are subject to 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.” The word “persons” is not defined in the ruling, but “person” is defined in I.R.C. § 7701 to include corporations, trusts, and associations. Because § 501(c)(4) entities are “persons” but no specific statute exempts contributions to them from gift tax, the ruling appears to leave no doubt that contributions made by individuals to § 501(c)(4) organizations are taxable gifts.

C. Legal Precedents and Other Authorities

⁶ See, e.g., I.R.S. Notice 2001-69, 2001-2 C.B. 491 (stating that while the Service studied the possible amendment of I.R.C. §61 regulations, the Service would not assert that payments made by an employer to an organization described in §170(c) in exchange for vacation, sick, or personal leave that the employee elects to forgo constitute gross income or wages of an employee); I.R.S. Notice 2001-14, 2001-1 C.B. 516 (stating that in light of the lack of clear administrative guidance, the IRS would not treat the disposition of stock acquired through the exercise of statutory stock options before January 1, 2003 as subject to income tax withholding, and would not assess FICA and FUTA tax upon the exercise of such options); I.R.S. Notice 2002-59, 2002-2 C.B. 481 (providing interim guidance on split-dollar life insurance).

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1. There are reported court decisions dating back to the 1940s and 1950s upholding gift tax on donations to social welfare organizations. *See Est. of Blaine v. Commissioner*, 22 T.C. 1195 (1954); *Dupont v. United States*, 97 F. Supp. 944 (1951); *Faulkner v. Commissioner*, 41 B.T.A. 875 (1940).

2. There is considerable support for the argument that payments to § 501(c)(4) organizations to fund specific lobbying or advocacy activities desired by the donor are not gifts but are made for full and adequate consideration, either because the donor expects to benefit from the outcome of the advocacy, or because the advocacy is treated as a service performed for the donor. *Stern v. United States*, 304 F. Supp. 376, *aff'd on other grounds*, 436 F.2d 1327 (5th Cir. 1971). However, this results in a somewhat counter-intuitive distinction and questionable tax policy—the self-interested donation, earmarked for a particular campaign, is rewarded by not applying the gift tax, while the gift tax is imposed on the donation made for the selfless general support of a § 501(c)(4) organization’s public interest work.

3. Even if a transfer (payment) is not made for full and adequate consideration, Treas. Reg. § 25.2512-8 provides an exception from gift tax for transfers “made in the ordinary course of business (a transaction which is bona fide, at arm’s length, and free from any donative intent).” A political contribution to promote the donor’s financial interests has been held to qualify as a transfer made in the ordinary course of business. *See Stern*, 304 F. Supp. at 376. The Service has also ruled, in Rev. Rul. 68-558, 1968-2 C.B. 415, that the exception may be available even if the connection to the donor’s business or economic interests is fairly loose. It is therefore plausible to argue that a donor’s contribution to a § 501(c)(4) to influence public policy is not a gift because it is a transfer in the ordinary course of business under Treas. Reg. § 25.2512-8.

4. Before Congress enacted a specific statutory exclusion for contributions to § 527 organizations, one case held that “campaign contributions . . . when considered in light of the history and purpose of the gift tax, are simply not ‘gifts’ within the meaning of the gift tax law.” *See Carson v. Commissioner*, 71 T.C. 252 (1978), *aff'd*, 641 F.2d 864 (10th Cir. 1981). This interpretation of the gift tax statute could also apply to contributions to social welfare organizations.

5. There are serious constitutional First Amendment and Equal Protection objections to the imposition of gift tax on donations to § 501(c)(4) entities. These arguments are presented at length in a second article by Task Force member Barbara Rhomberg, *Constitutional Issues Cloud the Gift Taxation of Section 501(c)(4) Contributions* (pt. 4), 15 TAXATION OF EXEMPTS, Jan./Feb. 2004, at 176, attached.

D. Suggested Issues for IRS Study

1. Whether contributions to § 501(c)(4) organizations in support of lobbying, political, or other public policy advocacy activities meet the statutory and regulatory requirements for taxability, including:

a. Lack of full and adequate consideration

b. Transactions not made in the ordinary course of business (bona fide, at arm's length, and free from donative intent)

2. Whether contributions to § 501(c)(4) organizations meet the statutory and regulatory requirements for taxability under any circumstances, in the context of advocacy activities or otherwise.

3. Whether application of gift tax on contributions to § 501(c)(4) organizations in support of lobbying, political, or other public policy advocacy activities may be subject to constitutional objections based on the First Amendment freedoms of association and expression or the Fourteenth Amendment rights to equal protection.

4. The extent of current taxpayer awareness of and compliance with the requirements to report and pay gift tax on donations to § 501(c)(4) organizations in excess of the annual exclusion.

We turn now to a more in-depth discussion of our research and analysis on the topic of qualification for the § 501(c)(4) exemption.

In-Depth Research and Analysis

I. Definition of Political Activities

Section 501(a) exempts from income taxation organizations described in any paragraph of § 501(c). Section 501(c)(4) describes organizations “operated exclusively for the promotion of social welfare.”⁷ According to the associated regulations, “operated exclusively” is satisfied if the organization “is primarily engaged in promoting in some way the common good and general welfare of the people of the community.”⁸ 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”⁹ (hereinafter the “political activity” limitation). Rev. Rul. 81-95 makes explicit what is implied in the § 501(c)(4) regulations: § 501(c)(4) organizations may engage in political activity so long as they are engaged primarily in social welfare activities.¹⁰

What the regulations do not tell us is precisely what constitutes political activity. Existing authority is both scant and contradictory. Discussed below are alternative legal standards for defining § 501(c)(4) “political activity,” some of which may prove to be mutually inconsistent.

A. Campaign Intervention (the I.R.C. § 501(c)(3) Standard)

1. Some precedential authority suggests, but does not expressly state, that § 501(c)(4) political activity is the same as prohibited campaign intervention for § 501(c)(3) organizations.

Section 501(c)(3) organizations are subject to an absolute prohibition against “participat[ing] in, or interven[ing] in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office”¹¹ (hereinafter campaign intervention).

This language is very similar to the § 501(c)(4) regulations quoted above and thus it is highly likely that the intent in drafting the § 501(c)(4) regulatory language was to refer to the

⁷ I.R.C. § 501(c)(4).

⁸ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

⁹ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

¹⁰ 1981-1 C.B. 332 (stating as a fact that the organization was primarily engaged in activities designed to promote social welfare).

¹¹ I.R.C. § 501(c)(3).

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activities that constitute campaign intervention under § 501(c)(3). This interpretation is consistent with the principle that one should read similar language to mean similar things, absent evidence to the contrary.

Only one revenue ruling addresses a specific activity that was found to be political. Rev. Rul. 67-368 says that rating candidates, even on a nonpartisan basis, is political activity for purposes of § 501(c)(4).¹² This is consistent with interpretations of the § 501(c)(3) campaign intervention prohibition.¹³

Other revenue rulings shed light on the meaning of the political activity limitation. Rev. Rul. 81-95, 1981- 1 C.B. 332 involved an organization that 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 also cites Rev. Rul. 67-368 and, in passing, existing § 501(c)(3) rulings for other examples of what constitutes campaign intervention under § 501 (c)(4). Thus, Rev. Rul. 81-95 appears to assume that anything which 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, it is unlikely to include a broader set of activities than is covered by § 501(c)(3) campaign intervention.¹⁴ It is true that the scope of § 501(c)(4) political activity is nowhere expressly limited to campaigns for elective office; the regulations refer only to “public office.” In contrast, the implementing regulations under § 501(c)(3) expressly limit the campaign intervention prohibition to candidates for “elective public office.”¹⁵ However, the § 501(c)(3) regulations do not purport to impose an additional limitation that would narrow the statutory prohibition. Rather, they set forth a clarifying reading in as much as 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 include only campaigns for elected public office.

There is certainly no policy reason to adopt a definition that would treat as political for § 501(c)(4) entities any activity that would be permissible for § 501(c)(3) entities. What is charitable for a § 501(c)(3) organization would presumably also promote social welfare,

¹² 1967-2 C.B. 194.

¹³ *See Ass’n of the Bar of the City of New York v. Commissioner*, 858 F.2d 876 (2d Cir. 1988).

¹⁴ 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 an action 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).

¹⁵ Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).
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although social welfare may be a broader concept, perhaps covering activities and purposes that do not satisfy the definition of “charitable.”¹⁶ Hence, as a logical matter, political activity for § 501(c)(4) purposes should not include any activities permissible for a charitable organization under § 501(c)(3).

2. Non-precedential interpretations also support this conclusion.

This approach is consistent with non-precedential IRS positions that are cited in the 2002 CPE discussion of the primary test for § 501(c)(4) organizations.¹⁷ However, neither that discussion nor the article on political activity by § 501(c) organizations in the I.R.C. 501(c)(4) Organizations, 2003 CPE¹⁸ directly addresses whether § 501(c)(4) political activity is determined by the same standard as § 501(c)(3) campaign intervention.

A series of private letter rulings (PLRs) in the late 1990s includes express statements by the Service that the activities considered prohibited campaign intervention for § 501(c)(3) organizations are the same as activities that constitute political activity for § 501(c)(4) organizations. The rulings arose in the context of taxpayers seeking a determination that certain activities were exempt function activity under § 527, which 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) entity. The first of these rulings looked at Rev. Rul. 81-95 and made explicit what was implicit in its reasoning: that prohibited § 501(c)(3) campaign intervention is the same thing as political activity under § 501(c)(4).¹⁹ Subsequent PLRs repeated this reasoning in sketching out the scope of § 527 exempt function activity. They thus provide strong evidence that the Service views the activities that constitute prohibited campaign intervention under § 501(c)(3) as identical to those considered political activity under § 501(c)(4).

3. Areas of clarification

The conceptual framework just outlined is of limited value, however, because of the lack of clear guidance about the precise scope of campaign intervention for purposes of the § 501(c)(3)

¹⁶ See Treas. Reg. § 1.501(c)(3)-1(d)(2) (charitable purposes include the promotion of social welfare); John Francis Reilly et al., *I.R.C. 501(c)(4) Organizations*, EXEMPT ORGANIZATIONS TECHNICAL INSTRUCTION PROGRAM FOR FY 2003, at I-25 [hereinafter *I.R.C. 501(c)(4) Organizations*, 2003 CPE] (“[T]here is considerable overlap between § 501(c)(4) and § 501(c)(3). Many organizations could qualify for exempt status under either Code section.”).

¹⁷ Judith E. Kindell & John Francis Reilly, *Election Year Issues*, EXEMPT ORGANIZATIONS CONTINUING PROF. EDUC. TECHNICAL INSTRUCTION PROGRAM FOR FY 2002, at 335,433 [hereinafter *Election Year Issues*, 2002 CPE].

¹⁸ John Francis Reilly & Barbara A. Braig Allen, *Political Campaign and Lobbying Activities of I.R.C. § 501 (c)(4), (c)(5), and (c)(6) Organizations*, EXEMPT ORGANIZATIONS TECHNICAL INSTRUCTIONS PROGRAM FOR FY 2003 (hereinafter *Political Campaign and Lobbying Activities*, 2003 CPE).

¹⁹ Priv. Ltr. Rul. 96-52-026 (October 1, 1996).
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prohibition. The standard articulated for § 501(c)(3) organizations is simply an inquiry whether under all the facts and circumstances the organization has intervened in an election. A handful of rulings have identified specific activities that are necessarily prohibited campaign intervention, but in other cases the characterization of an activity depends upon the context. Section 501(c)(4) organizations interested in participating in public debate around both elections and policy issues are thus faced with a great deal of uncertainty about what to classify as political.²⁰

This degree of uncertainty may be more acceptable for § 501(c)(3) organizations than for § 501(c)(4) entities because they enjoy the significant benefit of receiving tax-deductible contributions in addition to tax exemptions. However, as discussed below (Part I.D), this level of uncertainty surrounding the nature of political activities for § 501(c)(4) organizations may rise to the level of unconstitutional vagueness.

B. Private Benefit to Partisan Interests

The § 501(c)(3) campaign intervention standard requires that there be a candidate or candidates on whose behalf (or in opposition to whom) the organization is intervening. Even without a requirement that the candidate(s) be clearly identified (as is the case under federal election law), this limitation means that “campaign intervention” fails to capture a variety of activities that would be considered “political” according to the ordinary use of term.²¹ Such activities may nonetheless be considered outside the purview of social welfare because they provide a private benefit to partisan interests.

1. Social welfare requires furthering the common good and community welfare rather than promoting private benefit.

As was noted above, the relevant Treasury regulations provide that an organization will be considered “operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the community.”²² Numerous cases and rulings contrast this concept of the common good and community benefit with the

²⁰ The recent issuance of Rev. Rul. 2004-6, 2004-4 I.R.B. 328 may alleviate some of this uncertainty. Although the ruling expressly addresses only the question of whether expenditures for certain activities trigger the tax under § 527(f), the result may reasonably be seen as shedding some light on whether those activities are treated as political or social welfare in evaluating an organization’s primary purpose. *See* remarks of Cathy Livingston, Assistant Chief Counsel, TE/GE, IRS, to Exempt Organizations Committee, Tax Section, American Bar Association, on January 30, 2004, 44 EXEMPT ORGANIZATION TAX REV. 32-33 (April 2004).

²¹ The exempt function of § 527, discussed further below, similarly pertains to the election/selection process and may fail to capture some purposes and activities that more broadly further a political agenda.

²² Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).
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provision of private benefit.²³ For instance, a cooperative housing project did not qualify as a social welfare organization because it operated primarily to benefit its members and provided only incidental community benefit.²⁴ Similarly, an organization formed to purchase groceries on a cooperative basis was found to operate for the private benefit of its members who enjoyed lower prices.²⁵ An organization that repaired only damage to streets caused by its members was found to operate primarily for its members' economic interests despite the associated benefit to the city.²⁶ And an organization formed to promote the common interests of tenants in an apartment complex did not operate primarily for the common good and general welfare of the community, but for the private benefit of the residents.²⁷ In contrast, an organization undertaking similar advocacy activities was found to qualify as a § 501(c)(4) organization because it promoted the legal rights of all tenants in a community.²⁸

The thrust of these cases and rulings is that otherwise exempt activities and purposes may be tainted if the organization's benefits are confined to or targeted towards a limited class of members rather than to the neighborhood, region, or public at large.

2. Private benefit applied to partisan interests

The private benefit doctrine was applied to the advancement of partisan interests in the seminal § 501(c)(3) case of *American Campaign Academy v. Commissioner*.²⁹ The organization in that case was formed to train campaign workers, an activity formerly conducted by the National Republican Congressional Committee ("NRCC"). 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 practice. Other evidence and inferences indicated that most, if not all, of the Academy's graduates went to work for Republican candidates. The instructional program was found to be legitimately educational, but portions of the curriculum indicated an explicit bias towards Republican interests, with no corresponding

²³ The following discussion touches on a few such rulings in order to illustrate the parameters of the §501(c)(4) private benefit standard. A lengthier summary of precedents addressing community versus private benefit is found in *I.R.C. 501(c)(4) Organizations*, 2003 CPE, *supra* note 13.

²⁴ *Commissioner v. Lake Forest, Inc.*, 305 F.2d 814 (4th Cir. 1962).

²⁵ Rev. Rul. 73-349, 1973-2 C.B. 179.

²⁶ *See Contracting Plumbers Cooperative Restoration Corp. v. United States*, 488 F.2d 684 (2d Cir. 1973), *cert. denied*, 419 U.S. 827 (1974).

²⁷ Rev. Rul. 73-306, 1973-2 C.B. 179.

²⁸ Rev. Rul. 80-206, 1980-2 C.B. 185.

²⁹ 92 T.C. 1053 (1989).

examination of Democratic materials. Finally, the organization's primary source of funding was the NRCC.

The court affirmed the Service's determination that the Academy did not qualify as a § 501(c)(3) organization because it had the substantial nonexempt purpose of furthering the private interests of Republican entities and candidates.³⁰ *American Campaign Academy* thus confirmed that partisan interests, no matter how large the group affected, served private rather than community interests and that activity which is both educational and partisan simultaneously will be treated as partisan and private for § 501(c)(3) purposes.³¹

No precedential authority has applied the analysis identifying partisan interests with private benefits in the § 501(c)(4) context. However, the implication of the rulings discussed above concerning the community benefit required for a § 501(c)(4) organization is that the nature of private benefit is the same for § 501(c)(4) and § 501(c)(3) organizations. The difference in application to the two types of organization is quantitative not qualitative.³²

3. Theory may be difficult to apply.

Private benefit to partisan interests thus appears to be a theoretically viable basis to exclude certain non-campaign § 501(c)(4) activities from the purview of social welfare. However, its application presents significant practical difficulties. In all but the most extreme cases, an organization that is not merely the arm of a political party will be able to point to differences with partisan entities sufficient to undermine a partisan benefit challenge. As the recent application for § 501(c)(4) status by Empower America shows, while conservative interests may have significant overlap with policies and priorities of the Republican party, that overlap alone is not sufficient to find that promoting a conservative agenda confers impermissible private benefit on partisan Republican interests. Similarly, the Service concluded that the Progress and Freedom Foundation ("PFF"),³³ associated with a course taught by Congressman Newt Gingrich,

³⁰ The idea that a legitimate educational program could be conducted so as to impermissibly advance private interests was not novel, as remarked in an extended discussion of this case published in the 2002 CPE text. *Election Year Issues*, 2002 CPE, *supra* note 14, at 452 Appendix 2.

³¹ The court declined to consider Republican entities and candidates to constitute a charitable class that would be the appropriate recipient of § 501(c)(3) benefits, despite the large size of the class. The partisan affiliation indicated that the interests defining the class were private.

³² See Letter from Edward K. Karcher, Chief of Exempt Organizations Technical Branch 3, to Empower America (Feb. 21, 1997), *available in* Paul Streckfus's EO Tax J., Dec. 22, 1977, at 28, 34. The IRS expressly stated this as its opinion 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 weighing of the private benefits (i.e., the amount of private benefits), not the standard.

³³ The TAM was unpublished, but its full text was made available by the organization. Tech. Adv. Mem. (Dec. 1, 1998), *available in* Tax Analysts Doc. No. 1999-5081 *or* 1999 TNT 24-25. May 25, 2004

qualified as a § 501(c)(3) organization even though individuals involved with PFF intended to use themes and ideas developed in the course for partisan purposes.³⁴

The differences between a political party's legislative agenda and the policies promoted by a § 501(c)(4) issue advocacy organization may be slight, but that alone is unlikely to be sufficient to deny exemption. Any important public policy issue will undoubtedly enjoy the support of (or opposition from) political parties and/or prominent politicians. Social change and political movements have historically availed themselves of many different forms of exempt organizations in order to promote their policy goals. Yet, most genuinely independent issue organizations, even those with a strong ideological inclination toward one party or another, will likely disagree with their favored party from time to time, and/or agree with the other party's position on an issue, thus providing a basis to argue that they do not operate to further specific partisan interests. Thus, while building a movement or promoting an ideology may further partisan interests, its advocates will usually be able to argue convincingly that they seek to promote social welfare.

In sum, while existing authorities provide numerous examples of the private benefit doctrine as applied to § 501(c)(4)s, they do not provide any guidance to § 501(c)(4) issue groups concerned that they may be accused of furthering private partisan interest.

C. Section 527 Exempt Function – Influencing the Candidate Selection Process

Section 527 provides for the taxation of political organizations, which are 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.”³⁵ “Exempt function,” in turn, means the function of influencing or attempting to influence the selection,

³⁴ Another § 501(c)(3) organization involved in related activities, the Abraham Lincoln Opportunity Foundation (“ALOF”), lost its exemption on the basis of operating for the private benefit of partisan Republican interests. Because ALOF had already been dissolved at the time, it lacked standing to challenge the revocation so the use of the theory in that case was not further tested. *Abraham Lincoln Opportunity Found. v. Commissioner*, No. 4436-99X (11th Cir. 2001), available in Tax Analysts Doc. No. 2001-17798. Its exemption was restored in early 2003, after a special review of the file conducted by the IRS. I.R.S. Announcement 2003-30, 2003-1 C.B. 929. Notably, however, the IRS original revocation letter asserted that ALOF received substantial funding via loans from GOPAC, a political organization, and that it was active in GOPAC's efforts to train Republican political activists, so that it was operated for the private benefit of GOPAC. These facts, if correct, could distinguish this case from PFF. The public record does not indicate whether the IRS determined that these facts did not in fact indicate that ALOF operated for partisan purposes, or if there was some other basis for the Service's reversal. The PFF TAM distinguished *American Campaign Academy* 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.

³⁵ I.R.C. § 527(e)(1).

nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.³⁶

Various rulings have interpreted this standard broadly 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.³⁷ “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.³⁸

1. Arguments that § 527 exempt function activity is coterminous with § 501(c)(3) campaign intervention and § 501(c)(4) political activity

a. Legal authority

No explicit precedential authority addresses the connection between the § 527 exempt function and § 501(c)(4) political activity.³⁹ However, a series of private letter rulings in the late 1990s contained reasoning based on the idea that § 501(c)(4) non-primary activity is the same as the § 527 exempt function.

The first of these rulings concerned a § 501(c)(4) organization that had set up a separate segregated fund (“SSF”) to conduct a voter education program to raise awareness of the importance of certain issues and the position of candidates on those issues, but without engaging in express advocacy for or against any identified candidates so as to avoid coming within the ambit of federal or state election laws.⁴⁰ Although few specific facts remain in the heavily redacted ruling, it appears that the program would be designed *not* to follow the guidelines set out in existing guidance on permissible § 501(c)(3) voter education. For instance, issues were to be selected not because of “their importance and interest to the electorate as a whole,”⁴¹ but “based on their importance to [the organization]’s agenda and their expected resonance with the public.” Selected issues and themes would be “linked to the * * * records and positions of

³⁶ I.R.C. § 527(e)(2).

³⁷ Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 1.

³⁸ See, e.g., Tech. Adv. Mem. 93-20-002 (Jan. 14, 1993).

³⁹ The new Rev. Rul. 2004-6, 2004-4 I.R.B. 328 applies to § 501(c) entities, but is limited to the identification of taxable § 527(f) activity only.

⁴⁰ Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996).

⁴¹ Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 2.
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incumbents and candidates in order to reinforce the significance of those connections in the minds of the voters.” 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.⁴² Both voter guides and incumbent voting records would be designed to indicate the organization’s stance on the issues covered, implicitly comparing that position to the views of the candidates and legislators covered.

The Service 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.⁴³ The Service stated explicitly what had been implicit in previous rulings, namely, that prohibited § 501(c)(3) campaign intervention is the same thing as a § 501(c)(4) political activity and that those same activities “are, in turn, activities that are exempt functions for a § 527 organization.” Noting that whether an activity qualifies as § 527 exempt function depends on all the facts and circumstances,⁴⁴ the Service 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. Letter rulings issued in 1997 addressed what was termed “dual-character activities”; e.g., grass roots lobbying messages that served both legislative and political purposes.⁴⁵ The rulings stated that this activity was nonetheless permissible for a § 527 fund, although not exclusively directed towards influencing elections, because it served § 527 exempt function. What this means for § 501(c)(4)s conducting such activity is uncertain. Will it be considered exempt function activity and therefore trigger the tax? Or can a § 501(c)(4) argue that its activity is primarily directed towards lobbying and therefore should not be treated as a § 527 expenditure?⁴⁶ The same questions of the treatment of dual-character activities that arose in the context of private benefit apply here as well.

Finally, a 1999 letter ruling pushed the § 527 envelope even further.⁴⁷ The ruling concluded that a whole host of activities that, at least generically, could be legally conducted by a §

⁴² 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 with regard to voter education materials, which are obviously only of use to the public when made available during an election campaign.

⁴³ See, e.g., Rev. Rul. 78-248, *supra* note 38; Rev. Rul. 80-282, 1980-2 C.B. 178.

⁴⁴ See Treas. Reg. § 1.527-2(c)(1).

⁴⁵ Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997). See also Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997).

⁴⁶ Rev. Rul. 2004-6, *supra* note 36 begins to address this issue.

⁴⁷ Priv. Ltr. Rul. 19-99-25051 (Mar. 29, 1999).

501(c)(3) organization would be treated as § 527 exempt function. The Service based its ruling 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. The covered activities included ballot measure advocacy and other lobbying activity which had traditionally been presumed permissible for § 501(c)(3) organizations (and which therefore would constitute the promotion of social welfare for § 501(c)(4) organizations).⁴⁸ This ruling opened up the possibility that this type of 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 § 501(c)(3) entities, but it could be treated as § 527 exempt function solely because of the taxpayer's intent. Because the ruling was issued to a taxpayer seeking to establish its political motivation, it gives little insight into how this test might be applied to advocacy by § 501(c)(4) or § 501(c)(3) organizations that would prefer not to have their ballot measure activities characterized as political.

In 2000, an IRS field service advisory memorandum ("FSA") concluded that an organization applying for § 501(c)(4) status did not qualify, because its primary activities were campaign intervention.⁴⁹ Similar factors supporting that conclusion led to a finding that the organization was primarily operated to conduct § 527 exempt functions. There are not enough facts in the FSA to let us know whether this is based on a belief that the § 501(c)(4) political and § 527 exempt function standards are the same, or the activities were so clearly over both lines that the distinction did not matter to the conclusion reached.

b. Areas of clarification

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. They thus 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. Also, as discussed below, it is probably incorrect to state that § 501(c)(4) political activity and § 527 exempt

⁴⁸ 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 (April 16, 1991). Even if the message did not identify a candidate it could be an exempt function if the advocacy was carried out to encourage turnout of voters favorable to candidates supporting the issue. Tech. Adv. Mem. 92-49-002 (June 30, 1992).

⁴⁹ I.R.S. Field Serv. Adv. 20-03-7040 (June 19, 2000).
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functions are the same thing; the areas of disjunction between the § 527 exempt function activity and § 501(c)(3) campaign intervention are significant.

A further area that would benefit from clarification is the treatment of “dual purpose” activities conducted by a § 501(c)(4) organization. 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? A reasonable approach would be to make an allocation between lobbying (social welfare) and political campaign intervention, based on the relative weights of the organization’s intent or the anticipated proportionate effect of the activity. Unfortunately, no authority exists to support such an allocation or to provide guidance on how to make it. Also, the logic of Rev. Rul. 2004-6 suggests that allocation of dual-character activities is not appropriate, although it does not squarely address this issue.

Before release of these rulings, many advisors to nonprofits believed 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, at least 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 had previously thought they could safely protect the exempt status of a § 501(c)(3) organization by conducting any questionable activities within § 501(c)(4). Now they must be concerned about whether this would cause the § 501(c)(4) organization to be primarily engaged in political activities. 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.

2. Section 527 exempt functions include activities not covered by the § 501(c)(3) prohibition that are presumably also not political activity for a § 501(c)(4).

a. Legal authority

The definition of § 527 “exempt function” in the statute explicitly extends to areas that are not within the § 501(c)(3) campaign intervention prohibition, because the statutory definition of exempt function in § 527 applies to non-elected public offices, as well as to offices in a political organization.⁵⁰ The regulations do not further elaborate the scope of offices with which the

⁵⁰ The separate listing of public office and office in a political organization suggests that they are not identical. Gen. Couns. Mem. 39,811 (Feb. 20, 1990) did conclude that the office of precinct committeeman in a particular state is indeed a public office. However, the analysis applied was specific to the facts of the situation, where the office was created by statute, and appeared on the public ballot. It does not suggest that all political organization offices would constitute public offices within the § 501(c)(3) definition of campaign intervention. The Code also includes special
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§ 527 exempt function is concerned. Most of the examples provided in the regulations assume an elected office or do not state whether the office is elected or appointed. However, one example 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 an appointive cabinet position in response to a written request from a congressional committee.⁵¹ It is certainly plausible to read this example as defining a narrow region where activity by a §527 will be treated as exempt function, but the same activity by a § 501(c)(4) organization would not be considered political.⁵²

There is no additional precedential authority clarifying the extent to which § 527 exempt function covers activity outside the area defined as § 501(c)(3) campaign intervention. General Counsel Memorandum 39,694 confirmed that § 527 exempt function and § 501(c)(3) campaign intervention are not coterminous.⁵³ It concluded that § 501(c)(3) organizations may seek to influence the appointments of federal judges because that position is not an elective public office, but seeking to influence the appointments of federal judges is nonetheless § 527 exempt function activity that triggers the § 527(f) tax (discussed in 3 below) if conducted by a § 501(c) organization.⁵⁴ No further guidance has been forthcoming, leaving the General Counsel Memorandum as a non-precedential indication that § 501(c)(3)s may legally engage in some activities that constitute § 527 exempt function.

As discussed in Part I.A, an activity or purpose that is considered charitable for a § 501(c)(3) organization should per se qualify as the promotion of social welfare for § 501(c)(4) purposes. Thus, the logic of General Counsel Memorandum 39,694 suggests that a § 501(c)(4) could be organized primarily to attempt to influence federal judicial or executive branch appointments and qualify under § 501(c)(4). On the other hand, because this is exempt function activity for a § 527, this same organization could also qualify as a § 527 political organization. Similarly, attempting to influence elections or appointments of individuals to certain offices in political parties should be considered both § 527 exempt function activity and the promotion of

treatment for newsletter funds maintained by a candidate or officeholder as a § 527 political organization. Newsletter funds, however, may not be used for campaign expenses. Treas. Reg. § 1.527-7(d). 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. *See* I.R.C. § 527(e)(2).

⁵¹ Such activity is not even regarded as lobbying for § 501(c)(3) charities, falling under the technical advice exception defined by §§ 4911(d)(2)(B) and 4945(e)(2).

⁵² Illegal expenditures are also not for an exempt function, but presumably would be treated as campaign intervention for a § 501(c)(3) organization if made to influence an election. *See* Treas. Reg. §§ 1.527-2(c)(5)(vi) and 1.527-2(c)(4).

⁵³ Gen. Couns. Mem. 39,694 (Feb. 1, 1988).

⁵⁴ *See* I.R.S. Announcement 88-114, 198-37 I.R.B. 26, which publicized the conclusion of Gen. Couns. Mem. 39,694 and solicited public comment.

social welfare under § 501(c)(4). For instance, an organization established to promote social welfare by increasing the number of African-Americans in important leadership positions might choose to advocate for the selection of a specific African-American as a chair of a national party committee. Were the organization to engage solely (or primarily) in this activity, it would appear to qualify under both § 501(c)(4) and § 527.

b. Areas of clarification

There may be only a narrow set of activities that constitute § 527 exempt function but not campaign intervention for a § 501(c) organization, and few if any actual organizations engage primarily in carrying out these activities. Nonetheless, it is a theoretical possibility under (relatively) undisputed provisions of current law that an organization's primary activities could simultaneously be the promotion of social welfare and constitute certain § 527 exempt functions. 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 must be less than the primary activities of a section § 501(c)(4) organization, which are, in turn, activities that are exempt functions for a section § 527 organization,"⁵⁵ 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 offices, their reasoning did not address the overlap between exempt functions and § 501(c) activity in those cases. Exempt organizations active in this area of advocacy would benefit from a clearer statement of the interrelationship of § 527 and § 501(c)(4) political activity primary in the context of a guidance document that acknowledges these complexities.

3. The § 527 regulations address § 501(c) organizations in the context of imposing the § 527(f) tax on investment income.

Section 527(f) subjects § 501(c) organizations to tax on the lesser of their investment income or their exempt function expenditures. In setting out the application of this tax, the regulations create some exceptions that presumably would be exempt function activities otherwise, but will not trigger the § 527(f) tax. There is some logical appeal to considering whether § 501(c)(4) political activity may to be defined as activity that would trigger the § 527 tax, as distinct from the somewhat broader class of activity that constitutes an exempt function for a § 527 political organization.

It may be worth noting that Rev. Rul. 81-95, 1981-1 C.B. 332 mentioned the § 527 tax as potentially applying to a § 501(c)(4) organization's political activities, but *did not* assume that all

⁵⁵ Priv. Ltr. Rul. 96-52-026 (Dec. 27, 1996); Priv. Ltr. Rul. 97-25-036 (June 20, 1997); Priv. Ltr. Rul. 98-08-037 (Feb. 20, 1998).

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activities constituting campaign intervention are § 527 exempt function activities that trigger the tax. It was carefully worded only to say that those expenditures which are for § 527 exempt function would subject the § 501(c)(4) organization to tax under § 527(f). It is unclear whether this implicitly suggests that § 501(c)(4) political activity was not considered the same as § 527 exempt function, or if the question was simply not addressed.

a. 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. These exceptions set out as applying 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.

i. Treas. Reg. § 1.527-6(b)(4) – Appearances before a legislative body for the purpose of influencing the confirmation or appointment of an individual to a public office in response to a written request from the legislative body. 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, while not being considered an exempt function for purposes of the § 527(f) tax when conducted by a § 501(c)(4).⁵⁶ Of course, this conclusion is difficult to reconcile with the clear statutory language about application of the tax.

ii. Treas. Reg. § 1.527-6(b)(5) – “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. To qualify as “nonpartisan,” the campaign may not be explicitly identified with a party or candidate. 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 that do not name a candidate or party might be considered prohibited for a § 501(c)(3) organization, and indeed may be intended to influence an election. Nonetheless, there is a reasonable 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,

⁵⁶ 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). However, the example is limited to activity 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. Compare the treatment of invited testimony as a technical advice exception to the definition of “influencing legislation” under §§ 4911(d)(2)(B) and 4945(e)(2) for § 501(c)(3) entities.

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 suggest this provision was intended to cover GOTV and voter registration activities permitted by federal and state election laws.⁵⁷ Because those laws allow § 501(c)(4) organizations to engage in voter motivation campaigns that focus more narrowly on divisive issues than would be permitted to a § 501(c)(3) organization, it is at least arguable that this exception exempts from § 527(f) tax some activities that would might constitute § 501(c)(3) campaign intervention.

Priv. Ltr. Rul. 1999-25051 (June 25, 1999) also concluded that voter registration, voter motivation, and GOTV communications would be treated as exempt functions when conducted by the § 527 organization, even though they were not always identified with a specific party or candidate. It is not clear whether this was intended as a narrow reading of Treas. Reg. § 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 conducted by a § 527, yet not trigger the tax when conducted by a § 501(c)(4) due to the exception.

Both of these 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 an exempt function.

b. Reserved regulations

When regulations under § 527 were first proposed, a number of comments pointed out that there are sound reasons that § 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. Lack of consistency between FECA and tax law would create a significant burden on these organizations. In order to maximize their use of non-PAC⁵⁸ 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.⁵⁹

⁵⁷ T.D. 7744, 1981-1 C.B. 360 (Dec. 30, 1980).

⁵⁸ “PAC” is used here as simpler and more easily understood than the more technically accurate term. In this discussion, a “PAC” refers to a separate segregated fund maintained in compliance with the restrictions of applicable campaign finance laws.

⁵⁹ See 122 Cong. Rec. H4353 (daily ed. 1976) (statement of Rep. Ullman).

A desire to maintain consistency between the two sets of laws was also made express:

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 Congress annually on the steps it has taken to comply with this subsection.⁶⁰

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 § 527(e)).”⁶¹ The statute includes no exceptions. The legislative history indicates an intent that § 501(c) organizations and § 527 entities should be treated on an equal basis for tax purposes to the extent they engage in the same activities.⁶²

Unable to resolve this tension satisfactorily, the Service adopted final regulations that put off making a final decision on the tax treatment of electoral activity permitted by campaign finance law. 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.” Upon publication of the final § 527 regulations, the Service indicated that any tax imposed on a § 501(c) organization based on activities falling within the ambit of the reserved regulations would be applied only prospectively.

One class of expenditures clearly covered by the reserved regulations is indirect costs – expenditures for establishing, maintaining, and fundraising for an SSF. The other category is expenditures “which are otherwise allowable under the Federal Election Campaign Act or similar State statute.” There is no precedential authority further explaining the scope of this provision. Based solely on the published regulations, one could read it 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.⁶³ This approach

⁶⁰ 2 U.S.C § 438(f).

⁶¹ The tax is imposed on the lesser of the organization’s exempt function expenditures or its net investment income. I.R.C. § 527(f)(1).

⁶² S. Rep. No. 93-1357, 93d Cong., 2d Sess., 29 (1974); 1975-1 C.B. 517, 533.

⁶³ Recent amendments to FECA added restrictions on “electioneering communications” and further modified the law. These amendments, the Bipartisan Campaign Reform Act (“BCRA”), were upheld for the most part by the U.S. Supreme Court in *McConnell v. Federal Election Commission*, 124 S. Ct. 619 (Dec. 10, 2003). However, the clear implication of the recent Rev. Rul. 2004-6 is that some issue ads falling within the *per se* definition of “electioneering communications” under BCRA may still fall outside the § 527(e)(2) definition of exempt function if sufficiently nonpartisan under all the facts and circumstances.

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would be consistent with the reasoning behind the decision to reserve the regulations, that is, consistency between tax and election law.

Some IRS texts suggest a more limited reading. The Service's discussion of the final § 527 regulations cites some specific types of activities expressly permitted by the statutory language of FECA. Subsequent CPE texts have reiterated these types of activities as determining the coverage of this reserved section. The activities include member communications and SSF administrative and fundraising costs.⁶⁴ 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. Regardless of the intent of the drafters, the interpretation of what has been written is certainly open to argument, whether one must, or even could, read "permitted by FECA" to embrace only those exceptions set forth in the statutory language and not others developed through case law and mandated by the constitution. 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) organization under the campaign finance law as interpreted by regulatory and judicial decisions.⁶⁵

Recently issued Rev. Rul. 2004-6 suggests that the Service may view the scope of activities contemplated by the reserved regulations as limited. That ruling applies the § 527(f) tax to expenditures for certain public media advertisements that would clearly be permissible for a corporation under FECA, as they are not express advocacy, electioneering communications, or coordinated with a candidate or party.

In addition, there is no further federal tax authority as to what is a "similar state statute." 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) associations engaged in advocacy related to state offices, 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 if conducted within the context of Federal elections. 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?⁶⁶

⁶⁴ See, e.g., *Political Campaign and Lobbying Activities*, *supra* note 15, at L-10.

⁶⁵ 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 *FEC v. Mass. Citizens for Life*, 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.

⁶⁶ For instance, FEC regulations permit de minimis use of corporate resources by employees who are volunteering for political campaigns; de minimis is defined to be no more than 4 hours per month. If a state law (e.g., California) May 25, 2004

There is no precedential authority to resolve this ambiguity. A 1985 letter ruling concluded that a union's contributions to state candidates, permitted by applicable campaign finance law, would trigger the § 527 tax.⁶⁷ It did not clarify the underlying reasoning. 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. 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.

c. Areas of clarification

When the § 527 regulations were promulgated, the Service indicated that these sections were reserved pending resolution of the relationship between tax law and FECA. This resolution may prove difficult to achieve administratively. Certainly it would be difficult to craft a regulation defining an activity as a simultaneously exempt function for a § 527 and not an exempt function (that is, not taxable) for a § 501(c) organization yet avoid a conflict with the plain language of § 527(f).

A related difficulty was illustrated in I.R.S. Announcement 88-114, 1988-37 I.R.B. 26, which pointed out that if influencing senate confirmation of judicial appointees is not treated as § 527 exempt function (and therefore taxable) for § 501(c)s, it would not be an exempt function when conducted by a political organization (and expenditures for that purpose would be included in the § 527 political organization's gross income). This indicates the Service's discomfort with an activity being permitted without negative tax consequences for a § 501(c)(4) and a § 527 simultaneously.

A 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 federal (and state) election laws, so organizations have only one set of administrative rules to apply.

The absence of other pronouncements, together with anecdotal evidence from advisers to exempt organizations, suggests that as a practical matter the Service has not been aggressively enforcing § 527 taxation of activities that fall in the area between § 501(c)(3)-permissible and

allows a corporation to permit volunteers to use its offices up to 10% of their time (i.e., 16 hours) per month, would the value of the additional 12 hours' use constitute a taxable exempt function expenditure?

⁶⁷ Priv. Ltr. Rul. 85-02-003 (Sept. 27, 1984).
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FEC-regulated (e.g., single issue legislative voting records distributed publicly, such as via a web site). The only existing (non-precedential) ruling concerns a fairly extreme type of activity – actual monetary contributions. This suggests that as an administrative practice the IRS has been willing to read the reservation broadly, or at a minimum that this is a low priority area for both enforcement and resolution, at least in close cases.

However, the reserved regulations are to be read, they (and other provisions discussed in this section) apply only to the imposition of the § 527(f) tax on a § 501(c) organization conducting certain activities. To what extent do they illuminate the definition of campaign intervention for the primary purpose test? One could certainly argue if a set of election-related activities are found to be excluded from taxation under § 527, they at least ought not to be counted on the “political” side of a § 501(c)(4)’s primary purpose. In other words, if it is correct that “exempt function” means slightly different things when applied to a § 527 political organization and to a § 501(c)(4) in applying the § 527(f) tax, and if § 527 exempt function defines the line of § 501(c)(4) political activities, one would have to decide *which* § 527 line-exempt function to apply.⁶⁸

D. Other Approaches

As the discussion above makes clear, there is a great deal of uncertainty in existing law about definition of political activity that must be less than primary for a § 501(c)(4). Even if one theoretically determines that it is in fact the same as § 501(c)(3) campaign intervention, it must be acknowledged that this line has not been drawn with any precision. The “facts and circumstances” test may have the benefit of allowing a decision-maker to reach what s/he perceives as the “right” outcome in every case. However, some argue that a test that puts this much discretion in the hands of the tax administrator suffers from constitutional weaknesses. It certainly provides no assurance to a § 501(c)(4) organization that it will not be subject to tax or even loss of its §501(c)(4) 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.

Similar objections can be raised with regard to definition of § 527 exempt function. Particularly under the analysis of the letter rulings in the late ’90s, how an activity will be treated for tax purposes may turn on evidence of subjective intent of the organization. It is 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.⁶⁹

⁶⁸ Interestingly, Rev. Rul. 2004-6 uses a “facts and circumstances” analysis only to determine whether the activities of a § 501(c) entity would be subject to the § 527(f) tax, and mentions the primary purpose test for § 501(c) qualification only in passing. The ruling is silent as to whether the § 501(c) and § 527 definitions are coterminous.

⁶⁹ 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 *Election Year Issues*, 2002 CPE, *supra* note 14, at 350-352.

Congress need not subsidize protected political speech.⁷⁰ However, constitutional principles require that citizens must be given reasonable notice of proscribed conduct. A law will be struck if “men of common intelligence must necessarily guess at its meaning.”⁷¹ Laws are also invalidated if they are “wholly lacking in ‘terms susceptible of objective measurement.’”⁷² The void-for-vagueness doctrine further requires explicit standards for government officials, who might otherwise engage in arbitrary and discriminatory enforcement.⁷³

Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) sets the standard that 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.” 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. After all, this is core political speech protected under the First Amendment. Adopting taxable status may also not be an option, as an organization whose primary activities are political may be forced into § 527 status. I.R.S. Field Serv. Adv. 20-03-7040 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.⁷⁴ There is no safe area of operations for an organization uncertain how its activities

⁷⁰ See *Regan v. Taxation with Representation*, 461 U.S. 540 (1983).

⁷¹ *Hunes v. Mayor of Oradell*, 425 U.S. 610, 620 (1976) (quoting *Connally v. General Construction Co.*, 269 U.S. 385, 391 (1926)). See also *Buckley v. Valeo*, 424 U.S. 1, 77 (1976) (hereinafter *Buckley*).

⁷² *Keyishian v. Board of Regents*, 385 U.S. 589, 604 (1967) (quoting *Cramp v. Board of Public Instruction*, 368 U.S. 278, 286 (1961)).

⁷³ 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 District Court. See Complaint at paragraphs 46-54, *The Christian Coalition International v. United States*, No. 2:01CV377, at Comp. ¶¶ 46-54 (ED.Va. 2002); Tax Analysts, Doc. No. 2001-21101. The case was scheduled for a hearing in the spring of 2003, but that hearing appears to have been indefinitely postponed to allow for ongoing settlement discussions. It is unknown whether a settlement or a decision this year will be forthcoming in the case to shed further light on the questions discussed herein.

⁷⁴ The appellate court in the recent *Mobile Republican Assembly v. United States*, 353 F.3d 1357 (11th Cir. 2003), held, to the contrary, that § 527 tax status is elective. The District Court in the same case held that organizations that fall within the § 527 definition of a political organization may not elect out of the § 527(b) tax, but may elect out of treatment as an exempt political organization, giving up general tax exemption in exchange for not being subject to the disclosure requirements imposed by § 527(i) and (j).

will be classed by the Service. 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 conclusion. The organization that guesses wrong not only stands to lose its § 501(c)(4) status, but faces 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. 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. When faced with similar problems of legal restrictions on political advocacy that were not drawn with sufficient clarity, the *Buckley* court found only one standard that provides sufficient notice of its scope: expressly advocating the election or defeat of a clearly identified candidate.⁷⁵ A somewhat broader scope of political activity that avoids the constitutional pitfall of vagueness was attempted under BCRA. "Electioneering communications" are broadcast, cable, or satellite communications that refer to a clearly identified candidate for federal office and are made within 60 days before a general or 30 days before a primary election.⁷⁶ By using objective factors, such as clearly identified candidate, specific media in which a communication is made, and a strict temporal test, this definition draws a bright line other than express advocacy.⁷⁷ Another area of potentially permissible FEC regulation is expenditures that are coordinated with a candidate.⁷⁸ These are two additional areas beyond express advocacy that could in theory be included in a narrowed definition of § 501(c)(4) political activity that attempts to avoid unconstitutional vagueness.

Interestingly, this approach is consistent with a broad reading of the reserved § 527 regulations. If the line for § 501(c)(4) political activity under the primary purpose test is the same as the line defining political activity that may constitutionally be regulated by campaign finance laws, it makes sense that the same line would define expenditures triggering the § 527(f) tax. Thus, § 501(c)(4)s would not have to contend with two definitions of "political": one for determining their primary activities in order to maintain § 501(c)(4) status and another for determining any obligation to pay tax under § 527(f). This can be accomplished by reading the

⁷⁵ See, e.g., *Buckley*, *supra* note 67, at 44, 80.

⁷⁶ 2 U.S.C. § 434(f)(3)(A)(i), *added by* Pub. L. No. 107-155 § 201(a) (2002).

⁷⁷ In *McConnell v. FEC*, the Supreme Court upheld the constitutionality of BCRA's bright-line ban on the use of corporate funds to pay for electioneering communications *McConnell v. FEC*, *supra* note 59.

⁷⁸ The FEC has historically had difficulty regulating effectively in this area. See *FEC v. The Christian Coalition*, 52 F. Supp. 2d 45 (D.D.C. 1999). Pursuant to BCRA it has promulgated new regulations regarding coordinated activity; whether they and the underlying statute survive judicial scrutiny will likely be seen in the near future. In any case, we can assume for purposes of this discussion that coordinated expenditures treated as in-kind candidate contributions under FECA could and should be considered political activity by a § 501(c)(4) organization.

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reserved regulations as applying to any activity legally permissible under FECA, not just to a few specific statutory provisions.

II. Permitted Extent of Political Activities

Once a § 501(c)(4) organization determines that one or more of its activities constitute political campaign intervention or private benefit to partisan interests, it must ensure that it does not exceed the permissible levels of such activities or benefits.

As was noted in Part I, the regulations under § 501(c)(4) provide for the exemption of civic leagues and organizations operated primarily for the promotion of social welfare. *See* Treas. Reg. § 1.501(c)(4)-1(a)(2)(i); *People’s Educational Camp Society, v. Commissioner*, 331 F.2d 923, 931 (2d Cir. 1964), *cert. denied*, 379 U.S. 839 (1964) (“The word ‘exclusively’ as used in the statute has not been given a strict interpretation, so as to foreclose every operation for a non-exempt purpose no matter how insubstantial, but rather has been interpreted to mean ‘primarily.’”).⁷⁹ As is discussed below, a § 501(c)(4) organization that engages in political activity is primarily engaged in the promotion of social welfare if: (a) its political campaign intervention activities do not constitute its primary activity; and (b) its activities do not primarily benefit partisan private interests rather than the community as a whole.⁸⁰ While the standard is easily stated, determining whether the standard has been met remains elusive.

A. Assessing the Level of Political Activities

1. Less-than-primary political campaign intervention – “facts & circumstances” test

⁷⁹ The court, citing to *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945), also stated that “[t]he presence of a single (non-exempt) purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.” *People’s Educational Camp Society v. Commissioner*, 331 F.2d at 931. This interpretation can be found in other decisions involving § 501(c)(4) organizations where also it would appear to apply a “substantial purpose” standard to § 501(c)(4) organizations. *See, e.g., Contracting Plumbers Cooperative Restoration Corporation v. United States*, 488 F.2d 684, 686 (2d Cir. 1973), *cert. denied*, 419 U.S. 827 (1974). The IRS, however, has not adopted this rationale. *See I.R.C. 501(c)(4) Organizations*, 2003 CPE, *supra* note 13, at I-25 (“Since the test for exemption under I.R.C. § 501(c)(4) looks to the organization’s primary activities, an organization exempt under I.R.C. § 501(c)(4) may engage in substantial non-exempt activities. In contrast, under the reasoning of *Better Business Bureau v. United States*, 326 U.S. 279 (1945), the presence of a single noncharitable purpose, if substantial in nature, will disqualify an organization from I.R.C. § 501(c)(3) status.”); *see also* Rev. Rul. 75-286, 1975-2 C.B. 210.

⁸⁰ As was noted earlier, the promotion of social welfare also does not include a number of activities that do not have any political character. These include for-profit and unrelated business activities such as investment activities as well as unrelated trade or business activities, social activities for members, activities for the common business interests of members, and other activities for the private benefit of members. *See* Treas. Reg. § 1.501(c)(4)-1(a)(1) and -(2)(ii); *People’s Educational Camp Society*, 331 F.2d at 931.

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The promotion of social welfare, according to Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii), “does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”⁸¹ As a result, a § 501(c)(4) organization may engage in political activity provided the political activity (together with any other non-social welfare activity) is not the organization’s primary activity. *See* Rev. Rul. 81-95, 1981-1 C.B. 332; Rev. Rul. 67-368, 1967-2 C.B. 194.

Many practitioners believe that “less than primary” means less than 50% of an organization’s expenditures in a year. The Service, however, has never officially endorsed this position.⁸² Instead, the Service has long taken the position that all “facts and circumstances are taken into account in determining a § 501(c)(4) organization’s primary activity.” Rev. Rul. 68-45, 1968-1 C.B. 259. The 1995 CPE Article on § 501(c)(4) Political Organizations described the test as follows:

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.⁸³

This list of factors is not exhaustive. In its initial revocation letter to Empower America in 1997,⁸⁴ the Service examined factors such as the composition of the organization’s board of

⁸¹ Unlike § 501(c)(3), which explicitly bars political intervention, no statutory basis exists under § 501(c)(4) for the principle that social welfare does not include political intervention. The regulation defining social welfare to preclude political intervention activities was adopted in 1959 without explanation. *See* T.D. 6391, 24 Fed. Reg. 5217, 5217 (June 26, 1959). Earlier proposed language for the regulation did not contain this limitation. *See* Notice of Proposed Rulemaking, 21 Fed. Reg. 460, 465 (Jan. 21, 1956).

⁸² On one occasion the IRS provided unofficial support for the 49% analysis, albeit based on an organization’s income rather than expenditures. Speaking at a conference in 1990, then Director of the IRS’s Exempt Organizations Technical Division Marc Owens responded to a question about how much political activity a § 501(c)(4) organization could engage in by stating “[w]hen it comes to political activities, that is, giving money to a candidate, telling people to vote for a certain candidate, the rule is that it has to be less than primary. If it’s 49 percent of their income, that is less than primary.” *See Practicing Law Institute Program on Corporate Political Activities*, 3 EXEMPT ORG. TAX REV. 471 (June 1990).

⁸³ Raymond Chick & Amy Henchey, “*Political Organizations and I.R.C. 501(c)(4)*,” EXEMPT ORGANIZATIONS CONTINUING PROF. EDUC. TECHNICAL INSTRUCTION PROGRAM 192 (1995).

⁸⁴ As discussed earlier, the IRS applied the community vs. private benefits test to Empower America. The IRS first applied the “facts and circumstances” test, however, in assessing whether Empower America’s activities were primarily political campaign intervention activities. May 25, 2004

directors, officers, and key personnel. It also focused on the political party affiliation of candidates attending Empower America's candidate schools. These factors, combined with the partisan nature of the organization's public communications, led the Service to conclude initially that the organization was a "partisan issues-oriented organization." Since the partisanship permeated all of the organization's activities, the Service did not compare the level of political activity with other activity.

During the same year, the Service applied the "facts and circumstances" test somewhat differently in finding that the Christian Coalition failed to qualify for exemption under § 501(c)(4). The Service first analyzed each of the organization's major activities to determine if they constituted direct or indirect campaign intervention. Having found that the Coalition's precinct organization, congressional scorecards, and voter guides constituted political activity, the Service compared these activities with the Coalition's lobbying and educational activities and concluded:

While lobbying is usually mentioned in these speeches and literature, and we recognize that lobbying activities are being pursued, those activities are not the primary activity of the organization. An analysis of all the "facts and circumstances" contained in the administrative file, including the utilization of the precincts, the voter guides, the congressional scorecards, the video and audio tapes from the training materials, the lobbying materials, and the Road to Victory Conferences, leads us to the conclusion that the primary activity of the Christian Coalition constitute political intervention.⁸⁵

As the IRS letters to Empower America and the Christian Coalition demonstrate, because of the subjective nature of the "facts and circumstances" test, it provides little guidance as to how to assess the level of a § 501(c)(4)'s primary activities.⁸⁶ Neither letter states the amount or percentage of resources or expenditures that may be devoted to political activity or the period of time taken into account to determine an organization's primary activities.

Given the lack of precedent for determining a politically active § 501(c)(4)'s primary activity, practitioners and the Service frequently look at how a "facts and circumstances" test is applied to other "primary activity" limitations under § 501(c)(4) such as the provisions that a § 501(c)(4) organization is not "operated primarily for the promotion of social welfare if its primary activity ... is carrying on a business with the general public similar to organizations which are operated for profit." *See* Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

The fact that an organization's principal source of income is from the conduct of nonexempt activities does not mean that such activities are the organization's primary activity.

⁸⁵ *See* Letter from IRS to Christian Coalition of 9/18/97 at 33 (Sep. 18, 1997).

⁸⁶ The Christian Coalition has challenged the Service's ruling in federal court, providing some hope that a court decision or settlement could provide guidance in this area.

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In Rev. Rul. 68-45, 1968-1 C.B. 259, the principal source of income for a war veterans' post came from bingo games open to the general public. Since the post's other activities, such as veterans' programs and assistance to needy veterans, were its primary activities, the IRS ruled that the organization was entitled to exemption under § 501(c)(4).

At the same time, if in addition to the nonexempt activity being the primary source of income, an organization's primary activity is carrying on a business activity with the general public, it will not qualify for exemption under § 501(c)(4). In Rev. Rul. 61-158, 1961-2 C.B. 11, an organization, through two paid employees, conducted weekly lottery drawings and used the majority of the income for the payment of its general expenses. The Service held that under these facts the organization was primarily operating a business for profit.

Finally, despite the Service's reluctance to consider a percentage or expenditure limit for political activity, courts have compared the organization's expenditures for social welfare activities with revenue, expenses, surplus or other categories. For example, in *People's Educational Camp Society*, 331 F.2d at 931, the Court pointed to the fact that over the course of a five-year period, the organization's expenditures for social welfare activities represented "a small fraction of its total revenues [4%] and paled in comparison with the total accumulated surplus." The Court found that such evidence supported the Tax Court's decision that the organization was primarily running a commercial resort.

Perhaps, in this area, the Service could look to federal election law, where the U.S. Supreme Court, in the context of a § 501(c)(4) organization, equated the adjectives "major" and "primary" under FECA and noted that the group would be a "political committee" if the ratio of its electoral to non-electoral expenditures showed that "its primary objective is to influence political campaigns."⁸⁷

2. Less-than-primary private benefit to partisan political interests – No articulated test

The promotion of social welfare also does not include activities that confer substantial private benefit upon partisan political interests, even though they may not constitute political campaign intervention. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) requires that a § 501(c)(4) organization engage primarily in promoting the common good and general welfare of the community, such as bringing about civic and social improvements. Under this standard, an organization's activities must not primarily benefit private interests, such as partisan political interests.⁸⁸

⁸⁷ *FEC v. Massachusetts for Life, Inc.*, 479 U.S. 238, 262 (1986). See also Edward Foley & Donald Tobin, *Tax Code Section 527 Groups Not an End-Run Around McCain-Feingold*, BNA MONEY & POLITICS AND DAILY TAX REP. (Jan. 7, 2004) (arguing for a similar "ratio of expenditures" analysis for § 501(c)(4) tax exemption).

⁸⁸ See *Political Campaign and Lobbying Activities*, supra note 15, at I-3. May 25, 2004

Although the Service has frequently reviewed the community and private benefits of § 501(c)(4) organizations, the Service has never defined “primarily,” and, for better or worse, has not articulated an itinerary of “facts and circumstances” to be used in determining if a § 501(c)(4)’s activities primarily benefit public or private interests.

The Service’s application of the test to exempt organizations engaged in the political process has been relatively recent and has mainly focused on § 501(c)(3) organizations such as American Campaign Academy, Coalition for Freedom, and the Progress & Freedom Foundation. The Service stated in its initial revocation letter to Empower America, that “[t]he private benefit standard used in *American Campaign Academy* is similar under § 501(c)(4). The difference is in the weighing of the private benefits (i.e., the amount of private benefits), not the standard.⁸⁹ However, the Service did not provide any clear guidance as to the amount of private benefits permissible in a § 501(c)(4) context. Moreover, we believe the Service presented a confusing range of possibilities. The letter first discussed earlier revenue rulings and court cases as standing for the premise that “a *sufficient* amount of benefit to select individuals will preclude an organization that would otherwise qualify for exemption from being described in § 501(c)(4).” (emphasis added) The letter then stated that “the information you submitted clearly indicates that you, like the organization described in *American Campaign Academy*, are operated *primarily* for the benefit of a select group.” Finally, the letter concluded that “your activities also *substantially* benefited the Republican Party and politicians” (emphasis added).

The use of the word “substantially” is particularly confusing to us.⁹⁰ The language of the regulations appears to allow a § 501(c)(4) to engage in activities that incidentally *and* *substantially* benefit private partisan interests, provided they do not *primarily* benefit private interests. Support for this interpretation can also be found in Rev. Rul. 75-286, 1975-2 C.B. 210, in which a block association was organized to beautify and preserve the street, including public areas. The Service found that the block association’s activities benefited the members of the association by increasing the value of their property and, thus, it could not qualify for exemption under § 501(c)(3). At the same time, however, the Service found that the organization could qualify for exemption under § 501(c)(4) because the activities primarily benefited the community as whole, thereby overcoming “the presumption that the organization was organized and operated primarily for the benefit of its members.”

⁸⁹ To date, the Service has not made a “private benefits” argument in the Christian Coalition Case, although it has appointed to the close relationship of the organization to the Republican party as a factor supporting the conclusion that the Coalition engaged primarily in political activities during certain tax years.

⁹⁰ The court in *Contracting Plumbers Cooperative Restoration Corporation v. United States*, 488 F.2d 684, 686 (2d Cir. 1973), *cert. denied*, 419 U.S. 827 (1974), also limited the permitted private interest benefits of a 501(c)(4) organization to “less than substantial.” The Court found that an organization that only fixed the cuts made in the streets resulting from the plumbing work of its members substantially benefited the organization’s members and nonmembers alike and thus it could not be said to primarily benefit the public.

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Finally, the 1997 Christian Coalition letter raises the question of whether the presence of private partisan benefit activities may affect the characterization of an organization's non-political activities – lobbying and educational programs, for instance – as benefiting the same party or candidates. In that event, a § 501(c)(4) organization may choose to steer clear of political activities for fear that these activities will taint the organization's non-political activities enough to cause the organization to fail the private benefit test.

B. Possibility of a Bright Line Expenditure Limit

The uncertainty generated by the limited guidance regarding the application of the less-than-primary and private benefit tests to § 501(c)(4) organizations makes it difficult for both such organizations and the IRS to determine what level of political activity is consistent with § 501(c)(4) status. These unclear tests, therefore, unnecessarily and possibly unconstitutionally chill the ability of § 501(c)(4) organizations to engage in political activity to any significant extent. At the same time, the Service cannot easily determine whether a given § 501(c)(4) organization is in fact acting in a manner consistent with its tax-exempt status.

We believe the best way to resolve this situation is for the Service and Treasury to promulgate an elective, bright-line, safe harbor expenditure limit for the permitted amount of political activity. This alternative test could be promulgated in the form of a revenue procedure with precise definitions and illustrative examples, and be linked to financial information reported on the annual Form 990 return. Such a limit would help § 501(c)(4) organizations ensure that they meet the applicable standard. Such a limit would also ease the burden on the Service when seeking to determine whether an organization qualifies or continues to qualify as a § 501(c)(4) entity.

Creation of such a safe harbor is within the general rulemaking authority of Treasury and the Service under § 7805(a), particularly given that the primary activity test is itself a regulatory interpretation of § 501(c)(4). For example, in determining whether a § 501(c)(3) organization is publicly supported within the meaning of § 170(b)(1)(A)(vi), Treasury and the Service use both the bright-line one-third test, based only on revenues, and the “facts and circumstances” test. Similarly, the proposed safe harbor would create a bright-line test based only on expenditures while the existing “facts and circumstances” test would remain available for § 501(c)(4) organizations that did not meet the safe harbor requirements. Another example is Rev. Proc. 96-32, 1996-1 C.B. 717, establishing safe harbor standards for low-income housing projects to qualify under § 501(c)(3). The safe harbor will serve to ease tax administration and help § 501(c)(4) organizations ensure compliance with the I.R.C., thereby promoting appropriate rulemaking goals.

To create such a limit, several issues have to be addressed: (1) what the bright line should be; (2) over what period the bright line should apply; (3) how to allocate expenditures for program activities; (4) how to allocate expenditures for administrative and fundraising costs; and (5) how to allocate expenditures relating to a separate segregated fund under § 527(f)(3).

1. The bright line

“Less-than-primary” could reasonably be construed as “less-than-50 percent,” as some practitioners and at least one IRS official have done. Applying this reasoning, the appropriate limit would be 49 percent. Such a limit does not, however, recognize that expenditures are likely to be a good but not a perfect proxy for the other support and prominence that an organization may give to its political activities.

A better approach would therefore be to set the elective expenditures limit slightly below 50 percent. We therefore recommend that a limit of 40 percent of expenditures be adopted. While any figure is necessarily arbitrary to some degree, a 40 percent limit recognizes that for most organizations an activity that uses only 40 percent of an organization’s program expenditures would not qualify as a primary activity when compared to all of the organization’s other activities, even when volunteer involvement or other activity that is not fully reflected in expenditures is taken into account. The possibility that a few organizations may engage in political activity to an extent not reflected in the 40 percent of expenditures spent on such activity so as to render their political activity a “primary” activity is more than offset by the tax administration benefits to the Service and § 501(c)(4) organization’s bright line limit.

Focusing solely on expenditures ignores the time or efforts of volunteer workers that may not be reflected in an organization’s level of expenditures. We believe this is appropriate for several reasons. First, it is extremely hard to measure the level of volunteer efforts.⁹¹ Second, volunteer activities are generally not regulated by federal or state election laws. Third, volunteer activities alone do not depend on large campaign contributions. The latter two reasons mean that omitting volunteer activities from the safe harbor calculations will not have the effect of encouraging groups to use the safe harbor to circumvent campaign finance laws, including disclosure rules, since volunteer activities are not regulated or disclosed by such laws under any conditions. Fourth and finally, it is generally considered a public benefit to have more individuals actively involved in civic life on a volunteer basis so there is an argument that any potential for abuse of the proposed safe harbor should be balanced against this public good.

The proposed 40 percent limit would apply to expenditures for political activities, so an organization that did not exceed this limit would not lose its § 501(c)(4) status because of excessive political activities. Such an organization could still, however, not qualify for § 501(c)(4) status if it had significant other non-social welfare activities that, when combined with the organization’s political activities, were greater than the organization’s social welfare programs, thus, the organization did not satisfy the primary activity test. The safe harbor would not, therefore, allow an organization with significant activities that were neither political nor social welfare to prove that it qualified for § 501(c)(4) status. Such an organization would instead need to rely on the existing “facts and circumstances” test.

⁹¹ Under § 513(a)(1), clear standards exist to distinguish “paid” from “true” volunteers, and the activities of true volunteers are disregarded for purposes of the unrelated business income tax.

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2. Period of time

The proposed safe harbor would be applied on a taxyear-by-taxyear basis. While a multi-year period might be more reflective of an organizations true nature, it does not appear that the Service has the authority to use a multi-year period without at least implicit statutory authority to do so. For example, while the Service uses multi-year periods for purposes of the §§ 509(a)(1)170(b)(1)(A)(iv) and (vi) and § 509(a)(2) public support tests and the § 501(h) lobbying test, in each of those cases there is either explicit or implicit statutory language that would permit using such a longer period. Absent such statutory authority in § 501(c)(4), it appears that the default tax rule of considering matters on a year-by-year basis would have to be applied to the proposed safe harbor.

3. Allocation of expenditures for program activities

Section 501(c)(4) organizations are already required to track their expenditures for political activity for purposes of determining the amount of tax owed under § 527(f). This tax applies to the lesser of such expenditures or investment income. Detailed rules have never been provided for this tracking, however, presumably because it has been assumed that most non-527 organizations that engage in political activities have investment income less than their expenditures for political activities. This is likely to be true because non-527 organizations have the option of establishing a separate segregated fund to engage in political activities if they have significant investment income and wish to avoid exposing that income to the § 527(f) tax. The regulations under § 527(f) do, however, provide some guidance regarding how such expenditures should be calculated. If possible, then, any rules for allocating expenditures for purposes of the proposed bright line expenditure limit should track the § 527(f) rules so as to not impose on § 501(c)(4) organizations the burden of calculating two expenditure figures for political activities, one for § 527(f) purposes and one for purposes of the proposed limit.

Treasury and the Service have wrestled in the past with how best to allocate expenditures to lobbying and/or political activity in other contexts. Under both I.R.C. § 162(e) and I.R.C. §§ 501(h)/4911, the IRS generally allows organizations to use any reasonable method when making such allocations. For §162(e) purposes, however, where businesses need an exact figure for such expenditures because such expenditures are not deductible, the Service and Treasury have developed a set of detailed methods that are presumed to be reasonable. *See* Treas. Reg. § 1.162-28(b)(1). As a practical matter, organizations subject to the § 162(e) rules generally use one of the these alternate methods. For §§ 501(h)/4911 purposes, the Service has generally left it to the judgment of the organization involved to develop a reasonable method.

The proposed bright line expenditure limit is more analogous to the §§ 501(h)/4911 situation than the § 162(e) situation. The determination of how much is spent on political activity is necessary to ensure compliance with the proposed limit, not to determine the amount of any tax owed. The more general rules found in the §§ 501(h)/4911 context are therefore more appropriate than the detailed methods provided in the § 162(e) context.

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The regulations under I.R.C. § 4911 provide these general rules for allocating expenditures for program activities between lobbying and nonlobbying:

- (a) Preparation Costs: All costs of researching, drafting, reviewing, copying, publishing and mailing a lobbying communication are expenditures for lobbying. Treas. Reg. § 56.4911-3(a)(1).
- (b) Personnel Costs: All personnel costs, including current and deferred compensation, for an employee's services attributable to a lobbying communication are expenditures for lobbying. Treas. Reg. § 56.4911-3(a)(1).
- (c) Mixed Purpose Expenditures: For communications to nonmembers, lobbying expenditures include expenditures for all parts of a communication that are on the same subject of the lobbying part of the communication, including discussion of the background or consequences of the legislation involved. Treas. Reg. § 56.4911-3(a)(2)(i). For communications to members, the only standard is that a reasonable allocation must be made. Treas. Reg. §§ 56.4911-3(a)(2)(ii); Treas. Reg. 56.4911-5(f)(8).
- (d) Transfers for Lobbying Expenditures: Transfers earmarked for lobbying expenditures are treated as such expenditures. Treas. Reg. § 56.4911-3(c)(1) & (2).
- (e) Transfers to Noncharities: Transfers to noncharities that do not engage in lobbying are considered nonlobbying expenditures. Transfers to noncharities that engage in lobbying are considered lobbying expenditures, if they exceed the fair market value of any benefits, goods or services received in return, to the extent the noncharity recipient has lobbying expenditures. Exceptions to the latter rule exist for controlled grants for nonlobbying activities, for transfers that artificially inflate an organization's exempt purpose expenditures, and for substantially related activity. Treas. Reg. § 56.4911-3(c)(3).
- (f) Affiliated Group of Organizations: Expenditures of affiliated organizations are aggregated. Treas. Reg. §§ 56.4911-7, 56.4911-8.
- (g) Accounting Methodology: No specific accounting methodology, e.g. cash or accrual, is required. Presumably organizations are therefore permitted to apply the methodology they use generally.

Given the similar purposes of the proposed bright line expenditure limit and the §§ 501(h)/4911 rules, it would be appropriate to generally adopt those rules for this new test with some minor modifications. It would also be helpful to provide additional guidance regarding how an a § 501(c)(4) organization can make a reasonable allocation of certain types of program costs. We therefore propose the following rules:

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- (a) Preparation Costs: Preparation costs, including all costs of researching, drafting reviewing, copying, publishing and mailing political communications, would be counted as expenditures for political activities.
- (b) Personnel Costs: All personnel costs, including current and deferred compensation, for an employee's services attributable to a political activity would be counted as expenditures for political activity. It would also be helpful to specifically provide that such costs may be allocated through the use of employee time records, including records generated using a reasonable sampling method as opposed to requiring all employee to maintain time records throughout each year. For an example of such sampling being permitted in another context, see Treas. Reg. § 1.274-5T(c)(3)(ii)(A) (relating to personal use of employer-provided vehicles).
- (c) Mixed Purpose Expenditures: The § 4911 rule differentiating between communications to nonmembers and communications to members would also apply for political expenditures.
- (d) Transfers Earmarked for Political Activities: Transfers earmarked for political activities would be treated as expenditures for such activities.
- (e) Transfers Not Earmarked for Political Activities:
 - (i) Transfers to charities would be considered nonpolitical expenditures.
 - (ii) Transfers to noncharities that do not engage in political activities would be considered nonpolitical expenditures.
 - (iii) Transfers to noncharities that engage in political activities would be considered political expenditures, if they exceed the fair market value of any benefits, goods or services received in return, to the extent the noncharity recipient has political expenditures. Exceptions would exist for controlled grants for nonpolitical activities, for transfers that artificially inflate an organization's total expenditures, and for substantially related activity, defined in similar ways as under the § 4911 regulations.
- (f) Transfers to § 527 Organizations: Transfers to § 527 political organizations would be treated as expenditures for political activities, unless the transfers met the Treas. Reg. § 1.527-6(e) requirements discussed below.
- (g) Affiliated Group of Organizations: There is no need for an affiliated organizations rule because unlike in the §§ 501(h)/4911 context, the proposed bright line expenditure limit is not a sliding scale and does not have a ceiling, so there is no benefit to be gained by dividing expenditures for political activities among separate organizations.

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- (h) Accounting Methodology: No specific accounting methodology, e.g. cash or accrual, would be required. Organizations would be permitted to apply the methodology they use generally.

These rules should, however, be modified to reflect the rules for calculating “exempt function expenditures” by § 501(c)(4) organizations under § 527(f). While these two sets of rules are generally consistent, Treas. Reg. § 1.527-6(b) does exclude certain expenditures for program activities from consideration as exempt function expenditures. Two of those exclusions, for responding to a written request to testify about an appointment or confirmation and for nonpartisan activities, should apply based on the definition of political activities for the reasons described in Section I of our comments. Also, expenditures made to influence appointments to judicial, administrative, executive, or other public offices should in general not be considered expenditures for political activities since they do not relate to elections for public office.

A third exclusion is for expenses permitted by the Federal Election Campaign Act and similar state statutes. The current regulations provide that such expenses are not treated as expenditures for political activities under § 527(f). Treas. Reg. § 1.527-6(b)(1)(i), (3). We believe, however, that costs of internal communications with members should be considered expenditures for political activities if they constitute political campaign intervention and/or private benefit to partisan interests, regardless of the treatment of such costs for purposes of § 527(f) under the current regulations. Costs associated with a separate segregated fund should be treated as described below.

It should be noted that these definitions and rules would only apply for purposes of the proposed safe harbor and not for purposes of the facts and circumstances test. In some respects these definitions are more restrictive than would be appropriate under the “facts and circumstances” test in order to prevent any abuse of the safe harbor.

4. Allocation of expenditures for administrative and fundraising costs

Under §§ 501(h)/4911, administrative, overhead, and other general expenditures are allocated between lobbying and nonlobbying activities. Treas. Reg. § 56.4911-3(a)(1). Certain general expenditures are, nevertheless, removed from consideration by exclusion from both the numerator and denominator of the fraction through the concept of exempt purpose expenditures. These are expenditures primarily related to generating the organization’s income, including most fundraising costs and investment costs, and capital costs (although depreciation is not excluded). Treas. Reg. § 56.4911-4. Under § 527(f), however, indirect expenses such as expenses for overhead and record keeping, as well as fundraising expenses, are completely excluded from taxable expenditures for political activities pursuant to the current regulations. Treas. Reg. § 1.527-6(b)(1)(i), (2).

The treatment of expenditures for administrative and fundraising costs generally should be the same under § 527(f) and the proposed bright line expenditure limit. Otherwise, § 501(c)(4) organizations would be required to make two calculations of their expenditures for political activities. This would also prevent such expenditures from skewing the application of the proposed bright line expenditure limit, and so such expenditures should be excluded from consideration completely.

We therefore recommend that the expenditures to be considered for purposes of the proposed bright line expenditure limit be only the expenditures for program activities. Expenditures for administrative and fundraising costs should be excluded from consideration both as expenditures for political activities and as expenditures generally as long as such costs are not taken into account for purposes of § 527(f). Expenditures for investment and capital costs (except depreciation where appropriate) should also be excluded, as is the case in the §§ 501(h)/4911 context. We would include within these excluded costs the actual taxes incurred or paid under § 527(f), as those costs are most analogous to management and general expenses incurred to produce income for the organization.

We do also recommend one modification with respect to fundraising expenses for other organizations. To prevent a § 501(c)(4) organization from being used primarily as a fundraising vehicle for one or more political organizations while still meeting the safe harbor requirements, expenses incurred to conduct fundraising for other organizations should be classified as political or not based on the nature of the organization for which the fundraising is being done. For example, if a § 501(c)(4) organization engages in fundraising for its own § 527(f) separate segregated fund, the costs of that fundraising should be considered expenditures for political activities for purposes of the safe harbor test. Fundraising for non-§ 527 organizations that can engage in political activities, such as other § 501(c)(4) organizations, should be governed by the same rules that we have recommended for transfers not earmarked for political activities, *i.e.*, they should be treated as expenditures for political activities to the extent the recipient organization has expenditures for political activities, unless the funds raised are earmarked for nonpolitical activities.

The result of these exclusions is that the safe harbor would generally involve comparing the program expenditures for political activities to the total program expenses reported on Part II, line 44, column (B) of the Form 990 to determine whether the 40 percent safe harbor requirement had been satisfied. A logical place for an organization to report its expenditures for political activities and to describe its political activities would be in Part III of Form 990, which would facilitate both IRS and public review of the organization's safe harbor election. For an organization that raises funds for other organizations, those fundraising costs would also have to be taken into account and a determination would need to be made as to whether some or all of them were in fact program expenditures for political activities based on the nature of the other organizations.

5. Allocation of expenditures relating to separate segregated funds

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Generally, transfers to § 527 organizations should be treated as expenditures for political activities, as any transferred funds will be presumably used for such activities. An exception should exist to this rule, however, for transfers that meet the requirements of Treas. Reg. § 1.527-6(e) relating to the transfer of political contributions or dues for a separate segregated fund. When those a requirements are met, the § 501(c)(4) is essentially serving as a conduit instead of making expenditures of its own.

Expenditures by a § 527(f)(3) separate segregated fund should, as is currently the case, be treated as expenditures by a separate organization and so should not be counted for purposes of the safe harbor test. The payment by a § 501(c)(4) organization of indirect expenses of a separate segregated fund, such as overhead, record keeping, and fundraising costs, should, however, be treated the same as payment for management and general expenses and fundraising expenses described above. This means that to the degree such expenses represent management and general costs, they should be disregarded (since they are likely to be minor and incidental), but to the degree they represent fundraising costs they should be considered expenditures for political activities.

6. Conclusion

The proposed bright line expenditure limit would draw heavily on well-developed rules under § 4911, with which both the Service and practitioners are familiar. It would at the same time be consistent with the rules for determining the amount of exempt function expenditures by § 501(c)(4) organizations under § 527(f), thereby allowing such organizations to make one calculation of such expenditures for purposes of both § 527(f) and the proposed limit, but with certain important modifications as discussed above. Expenditures for a few types of activities should be included, such as internal political communications with members and fundraising for political organizations, to prevent abuse of the safe harbor. For other activities, such as those related to appointive rather than elective office, the expenditure should be excluded. In the main, however, the proposed limit simply represents an extension of established methods to a related area in order to resolve uncertainty and provide clear guidance.

C. Elective Nature of the Safe Harbor

If, as we have recommended, the Service and Treasury adopts a bright line expenditure limit below the theoretical limit of 49 percent, we recommend that the limit be made elective rather than mandatory. There may be any number of § 501(c)(4) organizations that have expenditures for political activities above the proposed 40 percent threshold, but for which those political activities are clearly not a primary activity because of other facts and circumstances. We do not believe those organizations should be forced to change their existing activities, which are consistent with § 501(c)(4) status, simply because it would be more administratively convenient for the other § 501(c)(4) organizations and the Service to have a bright line expenditure limit.

The election could be accomplished by the organization checking a box on its Form 990 indicating that it wishes to be governed by the safe harbor test. The organization could decide whether to make this election on a year-by-year basis. A failure to make the election would mean that the organization could not rely on the safe harbor in the event of a later IRS audit; it would instead have to rely solely on the “facts and circumstances” test.⁹²

A second option would be promulgating a rule stating that satisfying the expenditure limit creates a rebuttable presumption that an organization’s level of political activities is consistent with its § 501(c)(4) status. We believe this is a less desirable option than a clear safe harbor because it eliminates much of the certainty, for both the Service and the organization, that a safe harbor provides. We also believe, however, that even a rebuttable presumption mechanism along these lines would be a great step forward.

If our recommendations are accepted, whether in the form of a safe harbor or a rebuttable presumption, however, we would urge the Service and Treasury not to limit any guidance regarding the definitional issues identified in Section I of our comments to organizations that elect the bright line limit. The lack of guidance regarding what exactly constitutes lobbying for § 501(c)(3) public charities that have not made the § 501(h) election continues to cause difficulty for those organizations in ensuring that they comply with the substantial part test for lobbying applicable to them. We therefore urge the Service and Treasury to resolve these definitional concerns for all § 501(c)(4) organizations, regardless of whether the Service and Treasury adopt the proposed bright line expenditure limit and regardless of whether a particular § 501(c)(4) organization elects to take advantage of the safe harbor created by that limit. Rev. Rul. 2004-6 is a good first step in that direction, and we encourage the Service and Treasury to consider further guidance addressing the definitional issues we have identified.

⁹² *But see* relief available under Treas. Reg. § 301.9100, *supra* note 5.
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