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Lobbying Restriction on Section 501(c)(3) Organizations Held Unconstitutional: First Amendment Implications of *Taxation With Representation of Washington v. Regan*

Courts have traditionally upheld the constitutionality of the lobbying restriction in section 501(c)(3) of the Internal Revenue Code which denies tax benefits to charitable organizations that engage in substantial lobbying.[1] The United States Court of Appeals for the District of Columbia Circuit recently departed from this view in *Taxation With Representation of Washington v. Regan*[2] when it held on rehearing en banc that the limitation was unconstitutional.

The plaintiff in *Taxation* relied on two principal theories. First, it contended that the lobbying restriction was an abridgment of first amendment rights because it placed an unconstitutional condition on the receipt of tax benefits. Second, because the restriction was not applied to veterans' organizations, it was a denial of plaintiff's equal protection rights implicitly guaranteed by the due process clause of the fifth amendment.[3] In a four to three decision the court accepted only the equal protection theory and concluded that the restriction should either be removed or applied uniformly to correct the equal protection violation.[4]

The court correctly deemed the lobbying restriction uncon-

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1. Section 501(c)(3) tax-exempt organizations include:

> Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, *no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, (except as otherwise provided in subsection (h))*, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

I.R.C. § 501(c)(3) (1976) (emphasis added).

2. 676 F.2d 715 (D.C. Cir. 1982).

3. *Id.* at 716-17.

4. *Id.* at 740-45.

stitutional, but the proper remedy would have been the removal of the restriction altogether without the recommendation that a uniform application of the restriction might also be appropriate. The court's remedy responded to its holding that discriminatory treatment of lobbying activities was a violation of equal protection. But the court erred in not recognizing that the lobbying restriction also violates the first amendment. Had it found a first amendment violation, the court would have then concluded that no governmental interests are strong enough to justify the violation.[5]

I. THE LOBBYING RESTRICTION

Section 501(c) of the Internal Revenue Code (the Code) lists the types of organizations that are exempt from income tax.[6] Charitable organizations described in section 501(c)(3) receive two tax benefits. The first benefit is an exemption from income tax.[7] The second is the eligibility to receive tax deductible contributions.[8] This second benefit results not in a tax saving to the organization, but in a tax deduction to the contributor. It nevertheless is vital to the existence of most charities. Qualifying organizations appear in a cumulative list of charitable organizations prepared by the IRS, and many people simply will not contribute to organizations not appearing on the list since those contributions will not provide a tax deduction.[9]

These tax benefits, however, are not absolute. If a 501(c)(3) organization engages in substantial lobbying, it loses both bene-

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5. Several comments and articles have been written recently on the tax consequences of section 501(c)(3), though few deal with the first amendment implications. For good discussions of both aspects, see Troyer, *Charities, Lawmaking, and the Constitution: The Validity of the Restriction on Influencing Legislation,* 31 ANN. N.Y.U. INST. 1415 (1973); Garrett, *Federal Tax Limitations on Political Activities of Public Interest and Educational Organizations,* 59 GEO. L.J. 561 (1971).

6. For the sake of brevity, all of these organization will be referred to in this Note as "charities," "charitable organizations," or "charitable groups," unless otherwise specified.

7. I.R.C. § 501(a) provides that an organization described in § 501(c) shall be exempt from income tax. Tax exemption of a 501(c)(3) organization also includes exemption from federal social security (FICA) taxes, I.R.C. §§ 3121(a), 3121(b)(8)(B), and exemption from federal unemployment (FUTA) taxes, I.R.C. §§ 3306(b), 3306(c)(8).

8. I.R.C. § 170(c) states that a deduction shall be allowed for charitable contributions made to any organization listed in I.R.C. § 501(c)(3) unless that organization loses its 501(c)(3) status by engaging in substantial lobbying activities. I.R.C. § 170(c) (1976).

9. Bob Jones Univ. v. Simon, 416 U.S. 725, 730 (1974) (citing Internal Revenue Service Publication No. 78, "Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1954").

fits.[10] A group that plans to lobby actively may organize itself under section 501(c)(4) of the Code as a social welfare group and receive tax exempt status, but it will not be able to receive tax deductible contributions.[11] Because the lack of these contributions may be fatal to an organization that depends on them, many organizations are faced with the difficult decision of whether to forego the receipt of tax deductible contributions or to refrain from lobbying activities.

Before 1934, charities were not expressly restricted from lobbying by the Code.[12] The pre-1934 Code allowed taxpayers to

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10. I.R.C. §§ 501(c)(3), 170(c)(2)(B) (1976).

Whether an organization has engaged in "substantial lobbying" is determined by the IRS. Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955). Certain organizations may alternatively elect under I.R.C. section 501(h) to have the permissible lobbying level quantitatively determined. Section 501(h)(2)(B) defines the "lobbying ceiling amount for any organization for any taxable year [as] 150 percent of the lobbying nontaxable amount for such organization for such taxable year, determined under section 4911."

I.R.C. § 4911(c)(2) provides that:

> The lobbying nontaxable amount for any organization for any taxable year is the less of (A) $1,000,000 or (B) the amount determined under the following table:

If the exempt purpose expenditures are:	The lobbying nontaxable amount is:
Not over $500,000	20 percent of the exempt purpose expenditures.
Over $500,000 but not over $1,000,000	$100,000 plus 15 percent of the excess of the exempt purpose expenditures over $500,000.
Over $1,000,000 but not over $1,500,000	$175,000 plus 10 percent of the excess of the exempt purpose expenditures over $1,000,000.
Over $1,500,000	$225,000 plus 5 percent of the excess of the exempt purpose expenditures over $1,500,000.

I.R.C.]] 4911(c)(2) (1976).

11. I.R.C. § 501(c)(4) exempts from income tax

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

I.R.C. § 501(c)(4) (1976). Section 170(c) does not list social welfare organizations among those to which tax-deductible contributions can be made. *See supra* note 8.

12. Clark, *The Limitations on Political Activities: A Discordant Note in the Law of*

deduct gifts made to corporations "organized and operated exclusively for religious, charitable, scientific, literary or educational purposes . . . or for the prevention of cruelty to children or animals."[13] The courts interpreted "organized and operated exclusively" to mean that charities could not purposefully engage in any noncharitable activity, and lobbying was determined to be such an activity. The courts' reasoning was that the Treasury should stand neutral in political controversies.[14] The courts did recognize that efforts to influence legislation were justifiable in some cases and held that if an organization's lobbying activities were ancillary to its main purpose, it would not lose its eligibility to receive tax deductible contributions.[15]

The lobbying limitation which expressly denied tax benefits to charitable organizations engaging in substantial lobbying first appeared in the Internal Revenue Code of 1934.[16] Discovering the purpose behind the limitation is difficult because of the scant legislative history for this amendment.[17] The proponents of the amendment appear to have wanted to prevent the contribution of selfishly motivated gifts that would advance the personal interests of the contributor. However, statements in the Congressional Record indicate that Congress viewed political and charitable activities as inherently incompatible. In addition, there is no evidence that the amendment was intended to codify any implicit restriction in the statutes, since the record does not indicate Congress was aware of any case law on the subject.[18] Thus, it could be argued that Congress intended to add a new restriction on the receipt of tax benefits, rather than to codify current case law.[19]

Charities, 46 VA. L. REV. 439, 445 (1960).

13. Revenue Act of 1921, Pub. L. No. 67-98, § 214(a)(11)(B), 42 Stat. 227, 241 (1921).

14. *See, e.g.*, Slee v. Commissioner, 42 F.2d 184, 185 (2d Cir. 1930).

15. *Id.*

16. Revenue Act of 1934, Pub. L. No. 73-216, § 23(o)(2), 48 Stat. 680, 690 (1934).

17. Troyer, *supra* note 5, at 1421.

18. Senator Reed stated, " 'There is no reason in the world why a contribution made to the National Economy League should be deductible as if it were a charitable contribution if it is a selfish one made to advance the interests of the giver of the money. That is what the committee was trying to reach . . . .' " 676 F.2d at 736 (quoting 78 CONG. REC. 5861 (1934)).

19. Troyer, *supra* note 5, at 1421.

The dissent in Taxation felt Congress' intent to impose a regulation was strongly indicated in the section's legislative history even though the discussion of the amendment was brief. 676 F.2d at 752 (MacKinnon, J., dissenting).

Several other amendments have affected lobbying activities. Some were intended to do so; others were not. Among the changes intended to affect lobbying was the addition of section 162(e) in 1962.[20] Under this section, businesses could deduct most expenses incurred in influencing legislation.[21] Also, the Tax Reform Act of 1976 added section 4911, which quantitatively defined "substantial lobbying." A charity that elects to be covered by this section may spend a specified portion of its total annual expenditures on lobbying without incurring a penalty.[22]

Other changes to the Code unintentionally removed the lobbying restriction for some organizations. When the Internal Revenue Code of 1954 was enacted, fraternal societies were exempted from income tax under section 501(c)(8) and 501(c)(10), and in 1972 veterans' groups were exempted under section 501(c)(19).[23] Because the lobbying restriction applies only to organizations listed in section 501(c)(3) and not to the organizations listed in the other subsections of 501(c), these changes incidentally resulted in freeing veterans' and fraternal organizations from the lobbying restriction. Consequently, they could now engage in political activities without impairing their tax benefits. The disparity in tax treatment between fraternal and veterans' groups and 501(c)(3) organizations seems to have been inadvertent. The legislative history of these particular amendments indicates that Congress did not intend to be discriminatory in its lobbying limitations.[24]

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20. Revenue Act of 1962, Pub. L. No. 87-834, § 3, 76 Stat. 960, 973 (1962).

21. I.R.C. § 162(e)(1) allows a deduction for:

> all the ordinary and necessary expenses . . . paid or incurred during the taxable year in carrying on any trade or business—
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> (A) in direct connection with appearances before, submission of statements to, or sending communications to, the committees, or individual members, of Congress or of any legislative body of a state, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the taxpayer, or
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> (B) in direct connection with communication of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization . . . .

I.R.C. § 162(e)(1) (1976).

22. *See supra* note 11.

23. The separate section for veterans' groups was first added to the Internal Revenue Code in 1924. Revenue Act of 1924, Pub. L. No. 68-176, § 214(a)(10)(D), 43 Stat. 253, 271 (1924). Section 501(c)(19) was added to the Internal Revenue Code by amendment. Pub. L. No. 92-418, § 1(a), 86 Stat. 656 (1972).

24. Taxation With Representation of Washington v. Regan, 676 F.2d at 732-33.

In recent years, some taxpayers have challenged the lobbying restriction.[25] First amendment issues have been raised in these suits by groups asserting that the restriction impinged on their rights of free speech. Most of these groups also contended that their equal protection rights under the fifth amendment were denied because charitable organizations were treated unequally.[26] The courts, however, consistently upheld the constitutionality of the section 501(c)(3) lobbying limitation until *Taxation With Representation of Washington v. Regan.*[27]

The leading case relied on by the courts in these earlier challenges is *Cammarano v. United States.*[28] In *Cammarano,* individual taxpayers filed a refund suit for taxes paid. They argued that the first amendment required that they be allowed a business expense deduction for lobbying expenditures. If they were not permitted this deduction, the taxpayers claimed their ability to receive a tax deduction would be unconstitutionally conditioned upon their waiver of first amendment rights.[29] The court denied their refund and dismissed their first amendment claim, reasoning, "Petitioners are not being denied a tax deduction because they engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own pockets, as everyone else engaging in similar activities is required to do . . . ."[30] Although this case does not mention the section 501(c)(3) lobbying restriction, and the taxpayers were not charitable organizations, subsequent cases dealing with section 501(c)(3) have relied heavily on the *Cammarano* decision.

In *Christian Echoes National Ministry, Inc. v. United States,*[31] the Tenth Circuit held that a charitable organization's loss of tax exemption status because of its substantial lobbying

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25. Taxation With Representation v. United States, 585 F.2d 1219 (4th Cir. 1978); Haswell v. United States, 500 F.2d 1133 (Ct. Cl. 1974); Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972).

26. Because the unequal treatment resulted from federal rather than state law, the constitutionality is challenged under the fifth amendment, not the equal protection clause of the fourteenth amendment. "Thus, if a classification would be invalid under the Equal Protection Clause of the Fourteenth Amendment, it is also inconsistent with the due process requirement of the Fifth Amendment." Johnson v. Robinson, 415 U.S. 361, 364 n.4 (1974).

27. 676 F.2d 715 (D.C. Cir. 1982).

28. 358 U.S. 498 (1959).

29. *Id.* at 512-13.

30. *Id.* at 513.

31. 470 F.2d 849 (10th Cir. 1972).

activities was not a violation of the first amendment or of equal protection rights. The taxpayer, a religious organization, filed for a refund of Federal Insurance Corporation Act (FICA) taxes it had paid. It had become liable for these taxes after losing its 501(c)(3) status because of substantial lobbying.[32] The court, by applying a balancing test, upheld the constitutionality of the lobbying limitation. It explained that Christian Echoes' interest in exercising its freedom of speech was overridden by the governmental interest in the separation of church and state.[33]

Two years later the Court of Claims, following both *Cammarano* and *Christian Echoes,* upheld a denial by the IRS of a charitable contribution deduction in *Haswell v. United States.*[34] The contribution was made by the taxpayer to an association organized under section 501(c)(3). A deduction for the contribution was denied because the association's substantial lobbying activities had prevented it from qualifying under section 501(c)(3). The taxpayer raised both first amendment and equal protection objections. However, the Court of Claims dismissed the first amendment theory, quoting extensively from *Cammarano* and *Christian Echoes.*[35] The court then rigorously scrutinized the classifications created by the Code and held that the Congressional interest in preventing the use of Treasury funds for lobbying was compelling; therefore, the limitation was not a violation of equal protection.[36]

In 1978, Taxation With Representation, a predecessor organization of the plaintiff in the present case, appealed in the Fourth Circuit a lower court decision that denied the taxpayer a refund of Federal Unemployment Tax Act (FUTA) taxes.[37] A charitable organization is liable for FUTA taxes if it loses its 501(c)(3) status by engaging in substantial lobbying activities.[38] Unable to qualify as a 501(c)(3) organization because of its extensive lobbying activities, the plaintiff brought first amendment and equal protection challenges in *Taxation With Representation v. United States.* Relying on *Cammarano v. United States,*[39] the Fourth Circuit rejected the first amendment claim,

32. *Id.* at 852-53.
33. *Id.* at 856-57.
34. 500 F.2d 1133 (Ct. Cl. 1974).
35. *Id.* at 1148-49.
36. *Id.* at 1149-50.
37. Taxation With Representation v. United States, 585 F.2d 1219 (4th Cir. 1978).
38. I.R.C. §§ 3306(b), 3306(c)(8) (1976).
39. 358 U.S. 498 (1959).

and, after examining the disparity of treatment between the plaintiff and veterans' organizations, it also rejected the equal protection argument. In rejecting these claims, the court reasoned that the governmental interest in treating groups differently was compelling.

II. THE *Taxation* CASE

Taxation With Representation of Washington (Taxation) was formed to take over the lobbying activities of Taxation With Representation and the educational activities of another related organization, Taxation With Representation Fund.[40] Taxation's function was to represent the general public on federal tax matters before the legislature, the courts, and the executive branch.[41] Taxation then applied for tax exemption under 501(c)(3), but the IRS denied the application because of Taxation's lobbying plans.[42]

After exhuasting administrative remedies, Taxation brought a declaratory judgment action in federal district court seeking a declaration that the lobbying restriction was unconstitutional.[43] The district court granted summary judgment for the Treasury, upholding in a memorandum opinion the constitutinality of the section 501(c)(3) lobbying limitation. Taxation appealed and a divided panel of the United States Court of Appeals for the D.C. Circuit affirmed the district court's order.[44]

Taxation then filed for rehearing en banc. Granting the petition, the D.C. Circuit vacated the panel opinion and stated that in the rehearing, the court would address in particular the appropriate standard of review and the constitutionality of the lobbying restriction.[45]

Judge Mikva, writing for the majority upon rehearing, designated the determination of the appropriate standard of review as the starting point for a constitutional analysis.[46] The court found that a high level of scrutiny was warranted "because the lobbying restriction of section 501(c)(3) constititutes a limitation

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40. 585 F.2d at 1223-24.

41. Supplemental Brief of Plaintiff-Appellant on Rehearing En Banc, Taxation With Representation v. Regan, 676 F.2d 715 (D.C. Cir. 1982).

42. 676 F.2d at 717-18.

43. *Id.* at 718.

44. *Id.* at 746 (MacKinnon, J., dissenting).

45. *Id.*

46. *Id.* at 723-24.

on protected First Amendment activity, and because Taxation's equal protection argument therefore involves what is clearly a fundamental right."[47] The lobbying restriction would be upheld only if "a substantial governmental interest supports the classification and [if] the classification is narrowly drawn to serve that interest."[48]

In discussing the first amendment implications the court recognized that lobbying comes within the protection of the first amendment. The court refused to conclude, however, that "First Amendment rights [were] abridged . . . merely because the government refuse[d] to subsidize those rights."[49] Taxation argued that the receipt of a government tax benefit should not be made contingent upon a waiver of constitutional rights. Because section 501(c)(3) expressly conditioned tax benefits on a charity's willingness to refrain from substantial lobbying, Taxation contended that this condition was unconstitutional.[50]

The court agreed that in some situations the denial of a benefit could be equivalent to a penalty for speech.[51] In this case, however, the court rejected the argument that the restriction was actually a condition on the receipt of tax benefits. It noted that:

> [a] group such as Taxation can easily structure itself along dual lines, under both Sections 501(c)(3) and 501(c)(4) of the Code, using the latter organization only for lobbying purposes. Because Section 501(c)(4) organizations may lobby freely without losing tax benefits for which they qualify, the use of both subsections accords a charitable organization full tax benefits *other than* the ability to lobby with tax-deductible contributions . . . . Charitable organizations are simply not required to waive their First Amendment rights in order to obtain public benefits . . . .[52]

The court concluded that "Taxation has not shown that Section 501(c)(3)'s lobbying restriction abridges its First Amendment rights."[53]

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47. *Id.* at 724.
48. *Id.*
49. *Id.*
50. *Id.* at 725.
51. *Id.*
52. *Id.* at 726 (footnote omitted). See *supra* note 1, for a definition of 501(c)(3) organizations and *supra* note 12 for a definition of 501(c)(4) organizations.
53. 676 F.2d at 726.

The court then examined the equal protection claim. It recognized that when the government subsidizes first amendment rights in a discriminatory fashion, the statute that allows the subsidy should be reviewed to determine whether it creates classifications that violate equal protection.[54] The Treasury argued that only a rational basis standard was required because no United States Supreme Court case has ever measured a federal tax statute by a more rigorous standard.[55] The court nevertheless chose a heightened scrutiny test as the appropriate standard of review. The court pointed out that Supreme Court cases dealing with tax statutes had not contained claims of first amendment violations, and when such a claim is involved, a standard more exacting than a rational basis test must be applied.[56]

The majority relied on *Buckley v. Valeo*[57] to dictate the appropriate standard of review. In *Buckley* public financing provisions for presidential campaigns were challenged because they provided greater financial support to major parties than their minor counterparts.[58] The Supreme Court chose to analyze these provisions under a heightened scrutiny test. The *Taxation* court found *Buckley* analogous to the present case because both involved congressional approval of unequal subsidization of first amendment activities. It stated that the "standard of review [selected] in this case must be no lower than that applied in *Buckley,* even though neither situation involves a 'direct burden' on First Amendment expression."[59]

Under a heightened scrutiny analysis the discriminatory framework of section 501(c) would be upheld only if it serves a substantial government interest and if the statute is narrowly tailored to serve that end.[60] The *Taxation* court focused on the preferential treatment of veterans' organizations after it found that the Treasury Regulations had corrected any omission in the Code that might have allowed fraternal societies to lobby freely without losing their tax benefits.[61]

The Treasury offered two reasons for the preferential tax treatment veterans' organizations received. First, it contended

54. *Id.*
55. *Id.* at 730 n.28.
56. *Id.*
57. 424 U.S. 1 (1976).
58. *Id.* at 14.
59. 676 F.2d at 729.
60. *Id.* at 738.
61. *Id.* at 720-21.

that veterans deserve tax benefits in return for their service to the country. Second, the Treasury argued that because the legislature provides veterans' benefits, the government has an interest in protecting those benefits.[62] The court rejected these interests because "there is no indication in the legislative history of [section 501(c)(3)] that Congress intended to grant any tax-exempt organization a lobbying advantage over any others."[63]

The court also examined three government interests found substantial by the district court below. The first of these interests was the assurance of Treasury neutrality in lobbying activities. The government has long justified its imposition of the lobbying limitation as a desire to refrain from underwriting political activities. However, the addition of section 162(e) to the Code, which allows businesses to deduct lobbying expenses, demonstrates Congress' willingness to depart from its former position of Treasury neutrality. This addition severely undercuts any argument that the government should refrain from encouraging efforts to influence legislation.[64]

The second interest articulated by the district court was the prevention of abuse by private interests. Although this interest might be valid, the majority did not find section 501(c) to be narrowly tailored to serve that interest because it allowed veterans' groups to lobby freely. The court noted that no evidence was provided to show that lobbying by veterans' organizations was any less subject to abuse than lobbying by section 501(c)(3) organizations.[65]

The final government interest suggested by the court below was the desire to strike a balance between charitable and noncharitable organizations. This interest also failed for lack of evidence that Congress ever had this purpose in mind when it enacted the restriction in 1934. "Even if charities before that time could lobby with deductible contributions, there is no indication that charities had become so powerful that they threatened to drown out the voices of those whose lobbying was not similarly subsidized."[66]

The *Taxation* court concluded that "[t]he governmental purposes said to require special restrictions on lobbying by Sec-

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62. *Id.* at 732.
63. *Id.* at 732-33.
64. *Id.* at 738.
65. *Id.* at 739.
66. *Id.*

tion 501(c)(3) organizations are therefore either illegitimate, insubstantial, or inadequately promoted by a statute that is not narrowly tailored to serve them."[67] The court continued, "Because no substantial purpose justifies the disparate treatment of lobbying by Section 501(c) when that statute is subjected to careful scrutiny, the discriminatory treatment of Taxation's First Amendment activities constitutes a denial of equal protection, and is unconstitutional."[68]

The final task performed by the court was the shaping of a constitutional remedy. Judge Mikva introduced two possibilities. First, the lobbying restriction could be struck down and all charitable organizations could lobby freely. But the court doubted whether this would be satisfactory: "If we permitted Section 501(c)(3) groups to lobby as freely as veterans' organizations, there would be a clear risk of abuse by private interests and an increase in the amount of 'selfish' contributions 'made to advance the personal interests of the giver of the money.' "[69] The court further noted that "[e]ven when they attempt to remedy constitutional violations, courts must resist ordering relief that clearly exceeds the legitimate expectations of Congress."[70]

The second form of relief suggested was to uphold the lobbying limitation, but to deny preferential treatment to the veterans' organizations.[71] The court noted that the Supreme Court had recognized that benefits may be taken away from one group to cure unconstitutionally unequal treatment.[72] The D.C. Circuit, however, refused to apply the restriction to the veterans' groups since "[c]ourts must always be cautious when dealing with the interests of those who have not had an opportunity to

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67. *Id.*

68. *Id.* at 740.

69. *Id.* at 742 (quoting 78 CONG. REC. 5861 (remarks of Senator Reed)).

70. *Id.* at 742.

71. *Id.* at 743-44.

72. *Id.* at 743. In Welch v. United States, 398 U.S. 333 (1970), Justice Harlan observed:

> Where a statute is defective because of underinclusion there exists two remedial alternatives: a court may either declare it a nullity and order that its benefits not extend to the class that the legislature intended to benefit, or it may extend the coverage of the statute to include those who are aggrieved by exclusion.

Id. at 361 (Harlan, J., concurring). *Cf.* Iowa-Des Moines Nat'l Bank v. Bennett, 284 U.S. 239, 247 (1931) ("The right invoked is that to equal treatment; and such treatment will be attained if either their competitor's taxes are increased or their own reduced").

present their own arguments and defenses . . . ."[73] The case was then remanded to the district court with the instruction that veterans' groups be invited to participate in framing the relief. This would afford them the opportunity to offer evidence, if any, of a congressional intent to give veterans preferential treatment.[74]

In an opinion authored by Judge MacKinnon, the three dissenting judges showed greater sensitivity to the first amendment issue than did the majority, even though they ultimately rejected the first amendment argument. The dissent argued that a thorough first amendment analysis was needed.[75] The dissent noted a distinction between placing on an organization a condition that has a direct effect upon speech and one that has a direct effect merely on fund-raising.[76] "This fact does not, however, render the protections of the first amendment inapplicable, for it is established that 'the Constitution's protection is not limited to a direct interference with fundamental rights.' "[77] The dissent explained, " 'Even where a challenged regulation restricts freedom of expression only incidentally' the first amendment demands heightened judicial sensitivity."[78] Applying its first amendment analysis, the dissent found that the lobbying restriction was not an unconstitutional condition on the receipt of tax benefits because the governmental interests in imposing the restriction were substantial.[79]

The dissent responded to Taxation's equal protection claim by asserting that no discrimination between veterans' groups and 501(c)(3) organizations existed, so the lobbying restriction on 501(c)(3) organizations could not be a violation of equal protection. "[W]hen Congress determines that two organizations serve significantly different purposes . . . the Constitution does not require it to afford them identical treatment."[80] According to the dissent, the purposes of veterans' organizations were to aid disabled veterans, assist their families, and provide for those who had served in war.[81] In contrast, Taxation was formed pri-

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73. 676 F.2d at 743-44.
74. *Id.* at 744.
75. *Id.* at 748-56 (MacKinnon, J., dissenting).
76. *Id.* at 748.
77. *Id.* (quoting Healy v. James, 408 U.S. 169, 183 (1972)).
78. *Id.* (quoting Schad v. Borough of Mount Ephraim, 452 U.S. 61, 68 n.7 (1981)).
79. *Id.* at 749 (MacKinnon, J., dissenting).
80. *Id.* at 757.
81. *Id.* at 760.

marily for lobbying Congress on public finance matters. Because veterans' groups played such a unique public role, the dissent concluded that Congress was justified in allowing these groups to lobby freely without losing their tax benefits.[82]

Both the Treasury and Taxation have appealed the D.C. Circuit's decision. The United States Supreme Court noted probable jurisdiction in October 1982,[83] but as of the date of this printing, the case has not been decided. The Treasury is appealing the finding of an equal protection violation; Taxation's appeal presents two questions: whether the lobbying restriction constitutes an unconstitutional condition upon the exercise of first amendment rights, and whether the remedy favored by the D.C. Circuit is the proper one to cure an equal protection defect.[84]

III. Analysis

The D.C. Circuit is the first court to hold unconstitutional the lobbying restriction contained in Internal Revenue Code section 501(c)(3). Its holding was based on the premise that although the restriction is not an abridgment of freedom of speech, it is a violation of equal protection because it does not apply uniformly to all charitable organizations. In effect, the Treasury subsidizes some groups' lobbying activities but not those of others. Instead of requiring that all organizations be allowed to lobby freely, the court favored removal of the inequities by restricting lobbying of all charitable organizations including veterans' groups, and as a result satisfied only Taxation's equal protection claim. The first amendment implications require a careful evaulation to determine whether the remedy suggested by the majority sufficiently eliminated the constitutional violations or whether the lobbying restriction must be removed altogether to satisfy the first amendment claim.

A. The Unconstitutional Condition

The threshold for applying a first amendment analysis is that the statute in question must limit a protected first amend-

82. *Id.* at 762.

83. *Prob. jur. noted,* 51 U.S.L.W. 3253 (U.S. Oct. 4, 1982) (No. 81-2338).

84. *Appeal filed,* 51 U.S.L.W. 3108 (U.S. June 22, 1982) (No. 81-2338); *Cross-appeal filed,* 51 U.S.L.W. 3188 (U.S. July 23, 1982) (No. 82-134).

ment freedom.[85] If limitation is found, the statute, as well as the governmental interests involved, must be carefully scrutinized to determine whether the statute may still be upheld. Both the majority and the dissent in *Taxation* agreed that lobbying is a form of speech that comes within the protection of the first amendment.[86] At this point, though, the two opinions diverge. The majority insisted that the government's refusal to subsidize lobbying activities is not an abridgment.[87] The dissent, on the other hand, argued that this refusal creates an incidental restriction on lobbying which "deserves a thorough examination."[88]

The majority rejected Taxation's argument that "even though a person has no 'right' to a valuable governmental benefit . . . [the government] may not deny a benefit to a person on a basis that infringes his constitutionally protected interests."[89] Taxation contended that its receipt of tax benefits was unconstitutionally conditioned on its willingness to forego the exercise of free speech. The court relied primarily on *Cammarano v. United States*[90] as a basis for its rejection of Taxation's argument. The *Taxation* court, following *Cammarano,* concluded that "[c]haritable organizations are simply not required to waive their First Amendment rights in order to obtain public benefits—they simply may not lobby with tax-deductible contributions."[91]

There is, however, a significant difference between *Cammarano* and the instant case that leads to a conclusion that *Cammarano* should not be controlling here. In *Cammarano,* the taxpayers attempted to receive a tax deduction for lobbying expenses incurred by their businesses.[92] However, that suit was instituted prior to the addition of section 162(e) of the Internal Revenue Code, which now allows businesses to deduct lobbying expenses. The taxpayers were trying to receive a tax benefit that

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85. Community-Service Broadcasting of Mid-America, Inc. v. F.C.C., 593 F.2d 1102, 1114 (D.C. Cir. 1978).

86. 676 F.2d at 724; *Id.* at 748 (MacKinnon, J., dissenting). *See also,* California Motor Transp. Co. v. Trucking Unlimited, 404 U.S. 508 (1972); New York Times Co. v. Sullivan, 376 U.S. 254 (1964); Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961).

87. 676 F.2d at 726.

88. *Id.* at 748 (MacKinnon, J., dissenting).

89. *Id.* at 725 (quoting Perry v. Sindermann, 408 U.S. 593, 597 (1972)).

90. 358 U.S. 498 (1959).

91. 676 F.2d at 726.

92. 358 U.S. at 500-02.

had never existed. They were not being denied a tax benefit to which they had been previously entitled.

Cammarano has little application to the present case. Whereas *Cammarano* involved a court refusal to grant a nonexistent tax benefit, Taxation, because of its substantial lobbying activities, was being denied tax benefits usually allowed charitable organizations. An organization enumerated in section 501(c)(3) is entitled to tax exemption and tax deductible contributions. When it engages in substantial lobbying activities, the benefits are terminated. As pointed out earlier, when Congress added the lobbying restriction to section 501(c)(3) in 1934, Congress arguably was adding a new restriction to the receipt of tax benefits rather than trying to clarify an inherent limitation.[93]

Requiring Taxation to refrain from substantial lobbying can therefore be construed as a condition upon receiving benefits provided by section 501(c)(3). If the government can deny a benefit to an organization that chooses to exercise a first amendment right, the organization is actually being penalized for exercising that right. This permits the government to bring about indirectly a result which it could not directly command.[94] Because *Cammarano* and *Taxation* deal with two entirely different situations, *Cammarano* should not control the outcome in the *Taxation* case, and the lobbying restriction should be found to be an unconstitutional condition upon the exercise of first amendment rights.

B. The Appropriate Standard of Review

The proper level of scrutiny in testing the constitutionality of a statute depends on the nature of the right that is infringed. The court in *Taxation* applied a heightened scrutiny analysis to determine whether the classifications created by section 501(c) could pass constitutional muster. This analysis was directed only at the equal protection claim, as the court had dismissed the first amendment argument. A separate first amendment review, therefore, should be conducted to determine whether the lobbying restriction, which places a condition on the exercise of first

93. *See supra* notes 19-20 and accompanying text.

94. A statute that required a taxpayer, before receiving a tax exemption, to sign a statement on his tax return declaring that he did not advocate the overthrow of the government was held to be a violation of free speech. Speiser v. Randall, 357 U.S. 513 (1958).

amendment rights, can be justified by governmental concerns.

If the lobbying restriction was intended to suppress free expression because of the content or subject matter of that expression, a strict level of scrutiny would be necessary.[95] Under a strict scrutiny analysis, a statute that impinges upon fully protected free speech must be found unconstitutional unless the suppression is justified by a compelling governmental interest and the statute employs means closely drawn to avoid unnecessary abridgment.[96] The lobbying restriction is not, however, intended to restrict the content or subject matter of protected speech. The restriction in section 501(c)(3) does not in any way attempt to define impermissible lobbying in terms of subject matter; therefore, strict scrutiny would not be an appropriate standard of review.

Incidental restraints on first amendment rights require a less rigorous standard of review. If the statute's purpose is unrelated to the suppression of free speech, its restraints are subject only to a heightened level of scrutiny.[97] The lobbying restriction is not intended to directly suppress political activities. Proponents of the restriction claimed that its purpose was to discourage selfishly motivated contributions advancing the personal interests of the donor.[98] A heightened level of scrutiny is, therefore, the appropriate standard of review for determining the consitutionality of the restriction in section 501(c)(3) because the restraint is only incidental to the statute's purpose.

The heightened scrutiny standard of review contains a two-pronged test. This standard has been defined in a first amendment context to mean that a statute can be upheld only if it furthers a substantial governmental interest and if the incidental restriction is no greater than is necessary to serve that interest.[99] This level of scrutiny is very similar to that applied by the majority to the preferential treatment of veterans' groups. The court's analysis, however, was only directed at the equal protection claim. Further examination is needed to determine whether the restraint on first amendment rights can be justified by substantial governmental interests.

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95. Widmar v. Vincent, 454 U.S. 269, 274 (1981); First Nat'l Bank v. Bellotti, 435 U.S. 765, 784-86 (1978); Police Dep't v. Mosley, 408 U.S. 92, 95 (1972).

96. *Bellotti,* 435 U.S. at 786. *See also* Buckley v. Valeo, 424 U.S. 1, 25 (1976).

97. United States v. O'Brien, 391 U.S. 367, 376-77 (1968).

98. *See supra* note 19.

99. 391 U.S. at 376-77 (1968).

1. Interests of the government

The governmental interests involved in this review of the first amendment restraint imposed by section 501(c)(3) are similar to those discussed by the court while addressing Taxation's equal protection claim. These interests failed to support the government's claim under that analysis. Similarly, they must be found insubstantial under a first amendment analysis.

The Treasury has frequently justified its imposition of the lobbying restriction as a desire to refrain from underwriting political activities.[100] In the past it has taken the position that by subsidizing lobbying activities of charities it would be improperly supporting certain viewpoints. This neutrality argument has been undercut by the addition of the Code section 162(e) which allows businesses to deduct lobbying expenses.[101] Because this section allows such a deduction, it has the effect of subsidizing businesses in their lobbying activities. It could be argued that remaining neutral in political activities by the Treasury is not a valid concern when it actually subsidizes those activities for businesses. By including this amendment for deduction by businesses, Congress revealed its new position that Treasury neutrality was no longer a legitimate concern.[102]

The second interest discussed by the majority in *Taxation* is the prevention of charitable lobbying abuse by private interests.[103] It has been argued that lobbying is inherently undesirable because it promotes self-interest of the donor rather than

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100. Garrett, *supra* note 5, at 582.

101. *Id.* at 583.

102. Congress had several purposes in mind when it enacted § 162(e). It recognized the administrative and enforcement problems that would result from the difficult segregation of deductible business expenses and previously nondeductible lobbying expenses. In addition, the Senate report pointed out several policy considerations. The legislature felt that the deduction of lobbying expenses was necessary to provide a true reflection of taxable income. It also seemed anomalous that costs of appearing before the legislature were nondeductible, but expenses incurred with respect to appearances before the executive and judicial branches were deductible. By adding § 162(e), Congress intended to place presentations before the legislative branch on equal footing with those before the other two government branches.

Most importantly, though, Congress wished not to discourage taxpayers from presenting to the legislature information they have which might be relevant to present laws. "The presentation of such information to the legislators is necessary to a proper evaulation on their part of the impact of present or proposed legislation. . . . [M]aking sure that legislators are aware of the effect of proposed legislation may be essential to the very existence of a business." S. REP. No. 1881, 87th Cong., 2d Sess., *reprinted in* 1962 U.S. CODE CONG. & AD. NEWS 3304, 3324-25.

103. 676 F.2d at 739.

the public welfare and that it supplies only one-sided information to the legislator.[104] However, little support has been found for this position. In 1934, the lobbying restriction was added to the Code after Congress reviewed the possibility of selfishly motivated gifts to charities. The proponents of the amendment seemed to focus primarily on a single organization, the National Economy League.[105] They did not, however, express the view that political activities by charitable organizations were inherently improper.[106] Any argument that Congress implicitly desired to prevent lobbying abuse by private interests is also undercut by the addition of section 162(e). Congress certainly would not have allowed businesses to deduct lobbying expenses if it had actually feared such abuse.

The majority also mentioned the interest that government might have in preserving a balance between the lobbying activities of charitable organizations and those of noncharitable organizations.[107] If this is a valid concern, the government could achieve a more effective balance if charitable lobbying were encouraged. Issues that concern charities are often the subjects of legislative proceedings and many charitable goals can be advanced only with the aid of legislation. When issues that deal with charitable organizations are presented to the legislature, these organizations are often the only ones that have the expertise to present their viewpoint. The legislature should want to have all available data when an issue comes before it. By restricting charities' lobbying activities, an important channel of information is blocked, and the information that is received is likely to be one-sided as a result.[108]

A final governmental interest that has never been recognized by Congress or the courts nevertheless merits some discussion. Because the tax structure is progressive, it could be argued that the removal of the lobbying limitation would lend a stronger voice in political activities to the wealthy.[109] A charitable deduction taken by an individual in the highest tax bracket produces for him greater tax benefits than it would for an indi-

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104. *See* Garrett, *supra* note 5, at 582.

105. *See supra* note 19.

106. Clark, *supra* note 13, at 447.

107. 676 F.2d at 736, 739.

108. Caplin & Timbie, *Legislative Activities of Public Charities*, LAW AND CONTEMP. PROBS., Autumn 1975, at 197-98.

109. Troyer, *supra* note 5, at 1448-49.

vidual in a lower bracket. The wealthy person is arguably more motivated to make charitable contributions and could contribute to an organization that lobbies his point of view. Once again, section 162(e) provides the major counterargument. A section 162(e) deduction is available to individuals as well as corporations. A business deduction for lobbying, like a charitable contribution, provides a larger reduction of taxes for the individual in the higher tax bracket. If Congress had been concerned about lobbying by the rich, it would not have added section 162(e).

2. *The tailoring of the lobbying restriction*

In order to pass constitutional muster, a statute that incidentally restricts protected first amendment freedoms must not only serve a substantial government interest: it must also be narrowly tailored to serve that interest.[110] As the suggested governmental interests have already been shown to be insubstantial or illegitimate, the question of whether the statute is narrowly tailored need not be considered. However, even if the interests in limiting lobbying were found substantial, the lobbying restriction contained in section 501(c)(3) is too broad to be a constitutional restraint on first amendment rights because less restrictive means exist to discourage lobbying.

A restriction on freedom of speech is impermissible if the purpose of the statute could have been achieved by less intrusive means.[111] The statute must not be more restrictive than is required to accomplish its purpose. These rules of law lead to the conclusion that the restriction imposed by the lobbying limitation is too broad, because the limitation penalizes the charitable organizations that engage in substantial lobbying more severely than is necessary to discourage lobbying.

When a 501(c)(3) organization lobbies beyond the level ac-

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110. *See* United States v. O'Brien, 391 U.S. 367, 377 (1968). The *Taxation* dissent addressed the argument that the lobbying restriction was too broad and therefore not narrowly designed to serve the government interests involved. *Taxation* had pointed out that substantial lobbying denied a 501(c)(3) organization the ability to receive any tax-deductible contributions, not just contributions specifically made for lobbying purposes. 676 F.2d at 753. The dissent maintained that the Code section was sufficiently narrow to accomplish its purpose. It argued that legislation was not to be invalidated merely because Congress failed to engage in superior fine-tuning. *Id.* (citing Buckley v. Valeo, 424 U.S. 1, 30 (1976)). The legislature was allowed some inaccuracies, especially where taxation was concerned. *Id.* (citing San Antonio Indep. School Dist. v. Rodriguez, 411 U.S. 1, 43 (1973)).

111. Schad v. Borough of Mount Ephraim, 452 U.S. 61, 70 (1981).

ceptable to the IRS, it loses both tax-exempt status and eligibility for tax-deductible contributions. As pointed out earlier, the denial of this second benefit can prove fatal for organizations that depend on charitable contributions for their existence. The penalty imposed is even more severe than that recommended in *Cammarano v. United States.*[112] *Cammarano* prescribed a remedy through which the financial consequences of lobbying were directly related to the magnitude of the lobbying activities. More simply stated, lobbying expenditures were not allowed as tax deductions to the taxpayer, but all other deductions were allowed.[113] Taxation's penalty was much harsher. Because of its intended lobbying, Taxation was denied the right to receive any tax-deductible donations, with possibly fatal consequences.

Taxation suggested a less severe alternative. Its proposal was to deny a tax deduction to the contributor only in an amount proportionate to the share of total expenditures the organization spent on lobbying. The majority felt that this would not be an appropriate alternative because this procedure would create tremendous complications for the IRS. The IRS would be required to calculate the percentage of each organization's expenditures that represented lobbying costs. It would then have to trace that proportion to the individual donations before determining the deductible amount.[114] "[T]his remedy could easily overload and destroy any IRS capacity for monitoring these organizations and become an administrative nightmare subject to widespread disregard or abuse."[115] In light of these consequences, Taxation's suggested alternative might not be feasible; the government would have a substantial interest in avoiding "nightmarish" complexities.

However, another approach would be less complicated for the IRS and also less restrictive than the present lobbying limitation. An excise tax on monies expended for lobbying could be

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112. 358 U.S. 498 (1959).

113. *Id.* at 513.

114. 676 F.2d at 742 n.52. Taxation claimed that "the most repugnant feature of the current lobbying limitation in section 501(c) is that organizations that engage in 'substantial lobbying' lose their right to receive *any* tax-deductible contributions and not just those contributions used specifically for lobbying." *Id.* (emphasis in original). The majority noted that Justice Douglas, in his concurring opinion in Cammarano v. United States, emphasized that a statute would be found invalid if it denied all deductions to an organization that lobbied rather than simply denying a tax deduction for lobbying expenses. 358 U.S. 498, 515 (1959) (Douglas, J., concurring).

115. 676 F.2d at 743 n.52.

an effective deterrent, discouraging lobbying by charities without depriving them of their tax benefits. Section 4911 of the Internal Revenue Code already imposes an excise tax on excessive lobbying by those public charities which elect under section 501(h) to have the lobbying ceiling amount quantitatively determined.[116] The tax is equal to twenty-five percent of the amount of the excess lobbying expenditures for the taxable year, and is currently imposed in addition to the loss of tax exemption and qualification to receive tax-deductible contributions when a section 501(c)(3) organization lobbies substantially. Such a severe penalty should alone be a sufficient deterrent of lobbying activities. If Congress felt this present tax was insufficient to discourage lobbying, it could apply the tax to all lobbying expenditures made by charities. This excise tax would be more narrowly tailored to limit lobbying than the denial of tax benefits to organizations that engage in substantial lobbying. This excise tax would better serve the governmental interest than the lobbying restriction in section 501(c)(3) because it focuses directly on discouraging charitable lobbying activities and does not unnecessarily impair the charity's other operations.

IV. Conclusion

The D.C. Circuit in *Taxation With Representation of Washington v. Regan* correctly concluded that the lobbying limitation contained in section 501(c)(3) of the Internal Revenue Code was unconstitutional. However, the court should have removed the section 501(c)(3) restriction instead of leaving the remedy open on remand, with the consequence of possible uniform application of the restriction. By suggesting that the lobbying restriction apply uniformly to all 501(c) organizations, the court satisfied only the equal protection claim. The restriction should also have been subjected to a thorough first amendment analysis because it places an unconstitutional condition on charities' receipt of tax benefits. Had this been done, the court would have found the limitation an unconstitutional abridgment of free speech because of the lack of substantial government interests sufficient to justify the limitation. Even if substantial government interests had been found, the lobbying limitation would

116. Excessive lobbying as defined by I.R.C. § 4911(a)(1) is the amount of expenditures over the nontaxable amount. I.R.C. § 4911 was only recently enacted by the Tax Reform Act of 1976. *See supra* note 11.

still be unconstitutional because it is not narrowly tailored to serve those interests. Therefore, to protect first amendment rights of all charitable organizations, the lobbying restriction should be removed from Internal Revenue Code section 501(c)(3).

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