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FEDERAL TAX RESTRICTIONS ON CHARITABLE ORGANIZATION POLITICAL ACTIVITY: A PENALTY REFORM PROPOSAL

*Zack D. Mason**

The federal tax law imposes severe restraints on the campaigning and lobbying activities of charitable organizations. Unfortunately, the prohibitions against certain political activities and the sanctions for violations of these restrictions are overly complex and ambiguous. As a result, the regulations force charitable organizations to act without a clear picture of the boundary between acceptable and unacceptable political activity and of the penalty to be imposed if they cross into the latter.¹ The job of restricting the political freedom of hundreds of thousands of charitable organizations² should not be left to such inexact and inefficient sanctions.

This article proposes a sanction structure which can significantly improve compliance with and uniform enforcement of political activity restrictions of charitable organizations. As a starting point for understanding the sanction proposal, Part I of the article reviews the current political activity sanctions imposed on charitable organizations. Part II discusses the weaknesses of the current sanctions and the failure of the sanctions to meet Congressional objectives. Part III proposes a new sanction structure and explains how the proposal will more effectively achieve Congressional objectives. The Appendix shows the specific legislative changes suggested by the article.

I. CURRENT POLITICAL ACTIVITY SANCTIONS

A. Types of Charitable Organizations

Congress defines the most common and well known tax exempt entities, the section 501(c)(3) "charitable organizations,"³ as follows:

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1. The current sanctions may cause at least 3 undesirable results. (1) The charitable organizations may be unaware of the potentially severe tax consequences of their actions because they lack the resources to find, interpret and apply the sanction statutes; (2) The charitable organizations may ignore the restrictions because the organizations perceive a decrease in audit risk associated with complex statutes; and (3) Charitable organizations may restrict their political activity for fear of unintentionally crossing over an unclear boundary.

2. See Cumulative List of Organizations, IRS Publication No. 78 (1988). As of June 30, 1986, the IRS exempt organization / business master files indicated a total of 371,395 section 501(c)(3) organizations. The figure includes about 37,000 private foundations. The figure does not include religious organizations which did not apply for tax exempt status. *Lobbying and Political Activities By Tax-Exempt Organizations: Hearings Before the Subcommittee on Oversight of the House Committee on Ways and Means, 100th Cong., 1st Sess. (1987) [hereinafter Hearings]* at 51.

3. The term "charitable organization" is commonly used by practitioners and commentators to mean organizations described in section 501(c)(3). The term will be so used in this article as well.

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 (or in opposition to) any candidate for public office.

Organizations that choose to fall under the section 501(c)(3) definition can take advantage of major tax benefits unavailable to other types of organizations.⁴ The primary tax benefits available to charitable organizations are:

- 1) exemption from tax on income (except for unrelated business taxable income);
- 2) exemption from FUTA tax⁵; and,
- 3) the ability to receive tax deductible contributions.⁷

Exempt organizations not described in section 501(c)(3) are exempt from tax on their income,⁸ but they cannot claim the other benefits available to charitable organizations. Only charitable organizations are exempt from the FUTA tax and, in general, only charitable organizations can receive tax deductible contributions.⁹

In exchange for these benefits, however, charitable organizations, especially those that desire to engage in political activity in order to meet their charitable objectives, suffer burdens not known to other organizations. All charitable organizations are to some degree limited in their political activities, no matter how much those activities benefit society or contribute to the charitable goals of the organization,¹⁰ but not all types of charitable organizations are restricted in exactly the same manner or to the same degree. Distinguishing among the various types of charitable organizations is important, therefore, for determining the extent of political involvement an organization can reach before the organization is subject to the imposition of sanctions (i.e., excise taxes, the loss of exempt status, or both).

For purposes of determining political activity limitations, charitable organizations fall into one of three possible categories: private foundations, electing public charities and non-electing public charities. Generally speaking, a private foundation is any charitable organization that does not receive broad-based public

4. Tax-exempt organizations include section 527 political organizations and twenty-five categories of section 501(c) organizations.

5. I.R.C. § 501(a)-(b)(1991).

6. I.R.C. § 3306(c)(8) (1991).

7. I.R.C. §§ 170(c)(2), 2055(a)(2), 2106(a)(2)(A)(ii), 2522(a)(2) and 2522(b)(2) (1991).

8. I.R.C. § 501(a) (1991).

9. Section 501(c)(19) veteran's organizations can receive tax deductible contributions. For a discussion of the constitutional issues involved in this area, see *Regan v. Taxation With Representation*, 461 U.S. 540 (1983) in which the Supreme Court held that it is constitutional to permit veteran's organizations (which can receive tax deductible contributions) to engage in lobbying which would cause a loss of exempt status if engaged in by a section 501(c)(3) organization.

10. Rev. Rul. 67-293, 1967-2 C.B. 185; *Seasongood v. Commissioner*, 227 F.2d 907 (6th Cir. 1955); *Dulles, Exr. v. Johnson*, 273 F.2d 362 (2nd Cir. 1959), *cert denied*, 364 U.S. 834 (1960); *Association of the Bar v. Commissioner*, 858 F.2d 876 (2nd Cir. 1988), *cert. denied*, (1989).

support.¹¹ A public charity is any charitable organization which is not a private foundation.¹² Public charities can make an election which allows the charitable organization's lobbying activity to be limited by an objective standard measured in dollars expended on lobbying activity.¹³ Such public charities are referred to in this article as "electing public charities." The lobbying activity of all other public charities, "non-electing public charities," is limited by the subjective "no substantial part" lobbying standard.¹⁴ Churches, organizations affiliated with churches, and private foundations cannot elect to use the objective standard.¹⁵

B. Current Restrictions on Political Activity

Private foundations, electing public charities and non-electing public charities are all subject to severe restrictions on their campaigning and lobbying activities. Congress, however, has not devised a single political activity rule applicable to all charitable organizations. Neither has Congress devised a single rule which explains the restricted political activity of any one of the categories of charitable organizations. Instead, Congress has created multiple political activity rules (including four different excise taxes¹⁶ and one campaign tax¹⁷) applicable to charitable organizations. Some of the rules apply only to one type of charitable organization; others impact more than one type of charitable organization. The effect of the current law is to require every charitable organization to look to several different statutory definitions of political behavior deemed undesirable by Congress, each with different penalties, in order to determine the consequences of their political activity.

1. Campaigning Limitations

Under current law, charitable organizations must be extremely cautious when they become involved in any activity resembling political campaigning.¹⁸ Any amount of campaigning, no matter how small, may cause loss of exempt status under section 501(c)(3). Campaigning may also subject the charitable organization to the section 527(f) campaign tax, the section 4945 excise tax (if the organization is a private foundation) and the section 4955 excise tax. These uncoordinated statutes, each with its own unique definitions and penalties, make becoming involved in campaigning a minefield for charitable organizations.

Under section 501(c)(3), a charitable organization must not "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public

11. I.R.C. § 509(a) (1991). A typical private foundation is funded by private sources, controlled by a small group of individuals and engaged in supporting a wide variety of charitable causes.

12. I.R.C. § 509(a) (1991).

13. I.R.C. § 501(h)(1) (1991).

14. I.R.C. § 501(c)(3) (1991).

15. I.R.C. §§ 501(h)(3), (4) and (5) and 170(b)(1)(A)(i) (1991).

16. I.R.C. §§ 4911, 4912, 4945 and 4955 (1991).

17. I.R.C. § 527(f) (1991).

18. See, e.g., *Association of the Bar v. Commissioner*, 858 F.2d 876 (2nd Cir. 1988), cert. denied, 109 S.Ct. 1768 (1989) (the Second Circuit reversed the Tax Court and held that the Bar association's ratings of candidates for elective judicial office is participation in a political campaign even where the evaluation of the candidates was on a nonpartisan basis).

office." An organization engaging in such campaigning loses its exempt status. Unfortunately, the section 501(c)(3) regulations do little to clarify the statutory terminology. The only clarification given in the regulations is that for purposes of section 501(c)(3), a candidate for public office is "an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local."¹⁹ The regulations leave untouched several difficult problems. For example, the regulations fail to discuss at what point a person actually becomes a candidate, what constitutes participation or intervention in political campaigns and under what circumstances participation in a political campaign by a member of an organization is attributable to the organization itself.²⁰

Even if activities are acceptable under 501(c)(3), charitable organizations may still be penalized under 527(f). The section 527(f) campaign tax applies to all 501(c)(3) organizations which are exempt from tax under 501(a) and which expend any amount for an "exempt function."²¹ The tax is imposed at the highest corporate rate on the lesser of net investment income of the organization or the amount expended during the year for an exempt function.²² For purposes of section 527(f), an "exempt function" is:

the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individuals or electors are selected, nominated, elected, or appointed.²³

The definition of exempt function is generally broader than the description of political campaigning found in section 501(c)(3) and the associated regulation. Exempt function includes participating not only in the campaign of a "candidate for public office," (an elected official) but also in the "campaign" of a person who may be selected, nominated or appointed (e.g., cabinet members, heads of agencies, federal judges).²⁴ Exempt function also includes influencing or attempt-

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

20. Because the regulations have remained so unilluminating, the more difficult questions surrounding the interpretation of the section 501(c)(3) campaigning restrictions often have remained unanswered. Occasionally, the Treasury or the courts are forced to grapple with such issues. See Rev. Rul. 78-248, 1978-1 C.B. 154 (distinction between neutral voter education and political activity); Gen. Couns. Mem. 39441 (November 7, 1985) (endorsing a candidate for public office constitutes intervention in a political campaign, even if endorsement is asserted to have been based on neutral assessments of candidates professional, intellectual, or ethical qualifications); Rev. Rul. 76-456, 1976-2 C.B. 151 (organization that asked candidates to sign a code of fair campaign practices, and released the names of candidates who signed and refused to sign, was intervening in a political campaign); *Christian Echoes Nat'l Ministry, Inc. v. United States*, 470 F.2d 849 (10th Cir. 1972) (religious organization was denied exemption under 501(c)(3) because, while it did not formally endorse candidates, it urged the public through publications and broadcasts to support some candidates and oppose others), *cert. denied*, 414 U.S. 864 (1973); *Association of the Bar v. Commissioner*, 858 F.2d 876 (2nd Cir. 1988) (Bar association's ratings of candidates for elective judicial office was prohibited campaigning activity), *cert. denied*, 490 U.S. 1030 (1989). For a discussion of the problems of political activity by "educational" organizations, see Sabbath, *Tax Exempt Political Educational Organizations: Is the Exemption Being Abused*, 41 TAX LAW. 847 (1988).

21. I.R.C. § 527(f)(1) (1991).

22. *Id.*

23. I.R.C. § 527(e)(2) (1991).

24. See I.R.S. Ann. 88-114, 1988-37 I.R.B. 26.

ing to influence the party nomination of an individual to run for an elective office. Loss of exempt status under section 501(c)(3) comes only if the organization participates or intervenes in a political campaign on behalf of a candidate for public office.²⁵ Arguably, a candidate for public office would not be a candidate until after the party nomination.²⁶ A charitable organization which participated in the nomination process, therefore, could be taxed under section 527(f), but would not lose its exempt status under section 501(c)(3).

In some senses, however, the section 527(f) tax is less restrictive than the section 501(c)(3) campaigning limitations. First, the section 527(f) tax applies only to an expenditure. Dollars (or something else of value) must change hands before the tax can be applied.²⁷ Participation by unpaid volunteers of a charitable organization in the campaign of a candidate for public office would not cause a section 527(f) tax, but would cause a loss of exempt status under section 501(c)(3). Second, the section 527(f) tax applies only to the extent that a charitable organization has net investment income.²⁸ If the charitable organization maintains a separate segregated fund for exempt function expenditures, the fund is treated as a separate organization.²⁹ The tax applies only to the extent that the separate segregated fund has net investment income. Thus a charitable organization with no investment income can engage in unlimited political activity, including the making of exempt function expenditures, without encountering a section 527(f) tax.

Because the section 527(f) definition of exempt function does not match the description of political campaigning in section 501(c)(3), it is possible for a charitable organization to engage in campaigning activity which would cause the organization to lose its exempt status, but would not cause a tax under section 527(f). The reverse could also happen. An organization could be subject to the section 527(f) campaign tax without losing its exempt status. Although sections 501(c)(3) and 527(f) limit somewhat similar, and at times overlapping, activities, the tax results of the two sections can vary greatly.

25. The Internal Revenue Service has taken the position in G.C.M. 39811 (February 9, 1990) that a tax-exempt foundation intervened in a political campaign on behalf of (or in opposition to) candidates for public office when it urged its members to seek election as Republican or Democratic precinct committeemen. The Service stated that to require the identification of particular candidates before a loss of exemption under section 501(c)(3) would undermine the clear prohibition against "any" participation contained in the regulations.

26. See *Association of the Bar v. Commissioner*, 858 F.2d 876, 880 (2nd Cir. 1988); ("One need not be a party nominee to be a candidate for public office. . . . 'A campaign for a public office in a public election merely and simply means running for office, or candidacy for office, as the word is used in common parlance and as it is understood by the man in the street.'" (citing *Norris v. United States*, 86 F.2d 379, 382 (8th Cir. 1936), *rev'd on other grounds*, 300 U.S. 564 (1937)), *cert. denied*, 490 U.S. 1030 (1989)).

27. An expenditure for purposes of section 527 is defined in section 271(b)(3). Expenditure includes a "payment, distribution, loan, advance, deposit, or gift, of money, or anything of value, and includes a contract, promise, or agreement to make an expenditure, whether or not legally enforceable." I.R.C. § 271(b)(3) (1991).

28. Net investment income is defined in section 527(f)(2) as "the excess of (A) the gross amount of income from interest, dividends, rents, and royalties, plus the excess (if any) of gains from the sale or exchange of assets over the losses from the sale or exchange of assets, over (B) the deductions allowed by this chapter which are directly connected with the production of the income referred to in paragraph (A)." I.R.C. § 527(f)(2) (1991).

29. I.R.C. § 527(f)(3) (1991).

The section 4945 excise tax applies to private foundations which make any campaigning or lobbying expenditures. The tax is ten percent of the campaigning or lobbying expenditure,³⁰ but increases to 100% if the expenditure is not corrected within the taxable period involved.³¹ The description of campaigning activity subject to the excise tax is any expenditure "influenc[ing] the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive."³² Certain nonpartisan activities carried on in several states are not considered taxable expenditures.³³

As between 501(c) and 527(f), there is an inconsistency between definitions of political activity. The section 4945 definition of campaigning activity is different than both the section 501(c)(3) and the section 527(f) definitions. The section 4945 definition limits the undesirable activity to an expenditure. This restriction is similar to the section 527(f) expenditure requirement, but the 4945 expenditure must "influence the outcome of a public election." Thus an expenditure by a charitable organization made in order to influence a judicial appointment, for example, would not be subject to the section 4945 tax on campaigning or to the loss of exempt status under section 501(c)(3), but would be subject to the section 527(f) tax.³⁴

The section 4955 excise tax for campaigning is applicable to all charitable organizations. The excise tax is 10% of the exempt organization's "political expenditure" for the year,³⁵ but is increased to 100% of the political expenditure if the expenditure is not corrected during the taxable year.³⁶ Management of the charitable organization may also be subject to an excise tax of 2.5% of the political expenditure (increased to 50% if the expenditure is not corrected³⁷) if the management knowingly agrees to the expenditure.³⁸ If the section 4955 excise tax is imposed on a private foundation for a political expenditure, the section 4945 excise tax is not imposed on the private foundation for that expenditure.³⁹

The definition of "political expenditure" under section 4955 closely corresponds to the description of campaign activity under section 501(c)(3). Under section 4955, a political expenditure is "any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."⁴⁰ The primary difference between the application of the sanctions under section 501(c)(3) and under section 4955 is that the section 4955 tax requires an amount to be paid or incurred,

30. I.R.C. § 4945(a)(1) (1991).

31. I.R.C. § 4945(b)(1) (1991).

32. I.R.C. § 4945(d)(2) (1991).

33. I.R.C. § 4945(f) (1991).

34. Ann. 88-114, 1988-37 I.R.B. 26; G.C.M. 39694 (Jan. 22, 1988); Notice 88-76, 1988-2 C.B. 392.

35. I.R.C. § 4955(a)(1) (1991).

36. I.R.C. § 4955(b)(1) (1991).

37. I.R.C. § 4955(b)(2) (1991).

38. I.R.C. § 4955(a)(2) (1991). Additionally, a manager may be imposed a penalty equal to the amount of the tax if the manager's actions were not due to reasonable cause and either (1) the manager has been liable for the tax before, or (2) the action was willful and flagrant. I.R.C. § 6684 (1991).

39. I.R.C. § 4955(e) (1991).

40. I.R.C. § 4955(d)(1) (1991).

whereas the section 501(c)(3) loss of exempt status is applicable whenever there is participation or intervention in a political campaign, whether or not there is an expenditure. Thus a loss of exempt status is possible without a section 4955 tax (i.e., when there is no expenditure); however, political campaigning requiring the imposition of the section 4955 tax should require the loss of exempt status under section 501(c)(3).

Nevertheless, IRS has recognized that in certain cases of "de minimis" campaign activity, the section 501(c)(3) sanction will not be applied.⁴¹ Although Congress expressly stated that the excise tax should not be so utilized,⁴² the section 4955 excise tax on campaigning may be used by the IRS as an alternative to the application of the heavier penalty of loss of exempt status. IRS could use the section 527(f) tax in the same manner, as a lighter penalty for campaigning activity thought too minor by the IRS to justify loss of exempt status. The IRS has not made a clear statement of when either the section 4955 or the section 527(f) tax will be used as a substitute for the loss of exempt status sanction apparently required by section 501(c)(3).

2. Lobbying Limitations on Both Non-electing Public Charities and Private Foundations: The "Substantial Part" Limitation on Lobbying Activities.

Non-electing public charities and private foundations can be involved in lobbying, but only if such lobbying activity is not "substantial."⁴³ If a charitable organization does cross over the "substantial" lobbying line, it will lose its exempt status under section 501(c)(3) and be subject to the section 4912 excise tax. Additional lobbying limitations which affect private foundations are covered in the next section of this article.

The treasury and the courts have been reluctant to use any objective criteria in defining the limits of "substantial."⁴⁴ Non-electing public charities and private foundations, therefore, have little guidance for planning the extent of their lobbying activities.⁴⁵ For purposes of section 501(c)(3), loss of exempt status

41. G.C.M. 39414 (September 25, 1985); G.C.M. 34267 (February 20, 1970) ("[T]he Service has long accorded an exclusively educational or religious status to a fairly large number of organizations that could likewise be charged with having engaged in something more than an insignificant amount of political activity from time to time."); G.C.M. 34071 (March 11, 1969).

42. H.R. REP. NO. 100-391, 100th Cong., 1st Sess. 1623-4 (1987).

43. *Id.* at 1624-5.

44. The Courts have had difficulty determining the criteria for determining "substantial." In *Seasongood v. Commissioner*, 227 F. 2d 907 (6th Cir. 1955), the Sixth Circuit held that lobbying activities constituting less than five percent of an organization's time and effort were not substantial. In *Haswell v. U.S.*, 500 F.2d 1133, 1142 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1107 (1975), the Court of Claims held that the fact that an organization spent between 16.6 percent and 20.5 percent of its budget on lobbying provided a strong indication of substantiality. The Tenth Circuit in *Christian Echoes Nat'l Ministry, Inc. v. United States*, 470 F.2d 849, 855 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973), specifically rejected the use of a percentage test because such a test "obscures the complexity of balancing the organization's activities in relation to its objectives and circumstances." See also *League of Women Voters of United States v. United States*, 180 F. Supp. 379 (Ct. Cl. 1960), *cert. denied*, 364 U.S. 822 (1960); *Robert's Dairy Co. v. Commissioner*, 195 F.2d 948 (8th Cir. 1952), *cert. denied*, 344 U.S. 865 (1952); Rev. Rul. 62-71, 1962-1 C.B. 85; and *Kuper v. Commissioner*, 332 F.2d 562 (3rd Cir. 1964), *cert. denied*, 379 U.S. 920 (1964).

45. H.R. REP. NO. 1210, 94th Cong. 2d Sess. 7-17 (1976), drafted as an explanation to the changes in the House bill leading to the enactment of sections 501(h) and 4911, states:

The language of the lobbying provision was first enacted in 1934. Since that time neither

occurs when a substantial part of the activities of the organization is "carrying on propaganda, or otherwise attempting, to influence legislation. . . ." Regulation 1.501(c)(3)-1(c)(3)(ii) states that an organization is regarded as influencing legislation if the organization either "contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation or advocates the adoption or rejection of legislation." If, however, the organization advocates, as an insubstantial part of its activities, the adoption or rejection of legislation, exempt status remains intact. The organization can lose its exempt status if the organization's main objective or objectives may be attained only by legislation or a defeat of legislation and the organization advocates, or campaigns for, the attainment of such objective. The regulations imply that an organization with such an agenda has de facto a substantial part of its activities as attempting to influence legislation.⁴⁶ The regulation describes "legislation" broadly as including "action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure."⁴⁷

The section 4912 excise tax applies to charitable organizations which have lost their section 501(c)(3) status by reason of making lobbying expenditures.⁴⁸ The tax does not apply to an electing public charity,⁴⁹ a church or certain church-related organizations,⁵⁰ or a private foundation⁵¹. The tax is five percent of the lobbying expenditure.⁵² Any organization management willfully making an expenditure which he knows will likely result in the organization exceeding the "substantial" lobbying standard will also be subject to an excise tax on five percent of the lobbying expenditures.⁵³

For purposes of section 4912, a lobbying expenditure is "any amount paid or incurred by the organization in carrying on propaganda, or otherwise attempting to influence legislation."⁵⁴ The definition differs from the description of lobbying under section 501(c)(3) in that the section 4912 definition requires an expenditure. The expenditure must be the cause of the loss of exempt status in order for the section 4912 tax to apply.

The Treasury has not issued regulations under section 4912. Therefore, organizations have a difficult time assessing their risks under the statute. An organization could reasonably assume that the courts would apply the definition of lobbying as found under section 501(c)(3) regulations when interpreting the

Treasury regulations nor court decisions have given enough detailed meaning to the statutory language to permit most charitable organizations to know approximately where the limits are between what is permitted by the statute and what is forbidden by it. This vagueness is, in large part, a function of the uncertainty in the meaning of the terms "substantial part" and "activities."

Id. at 8. The statement is equally true today.

46. Treas. Reg. § 1.501(c)(3)-1(c)(3)(iv) (as amended in 1990).

47. Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) (as amended in 1990).

48. I.R.C. § 4912(a) (1991).

49. I.R.C. § 4912(c)(2)(A) (1991).

50. The section 4912 tax does not apply to a section 501(h)(5) disqualified organization. I.R.C. § 4912(c)(2)(B) (1991).

51. I.R.C. § 4912(c)(2)(C) (1991).

52. I.R.C. § 4912(a) (1991).

53. I.R.C. § 4912(b) (1991).

54. I.R.C. § 4912(d)(1) (1991).

section 4912 tax. Such an interpretation would appear likely because engaging in section 501(c)(3) lobbying is a prerequisite to the application of the section 4912 excise tax. Additionally, the section 4912 description of lobbying exactly mimics the lobbying language of section 501(c)(3). The organization, therefore, must assume the broad interpretation of lobbying found in the section 501(c)(3) regulations is narrowed under section 4912 only to the extent that the application of the section 4912 excise tax requires an expenditure.

3. Other Lobbying Limitations on Private Foundations

A private foundation, like any charitable organization, cannot be involved in section 501(c)(3) campaigning or substantial lobbying. The private foundation, however, is also subject to the section 4945 excise tax on campaigning and on any lobbying, not just substantial lobbying.⁵⁵ Any expenditure on campaigning or lobbying is subject to the 10% excise tax to the organization (100% if the expenditure is not corrected within the taxable period involved).⁵⁶ Willful expenditures by management could result in excise taxes of 2.5% of the expenditures.⁵⁷ The excise tax on management increases to 50% of the expenditure if the expenditure is not corrected within the taxable period.⁵⁸

Section 4945 identifies two types of political expenditures. The first type of taxable expenditure is a campaigning expenditure.⁵⁹ The second type of taxable expenditure is a lobbying expenditure.⁶⁰ Section 4945(e) breaks lobbying into two categories. The first type of lobbying is defined as:

any attempt to influence legislation through communication with any member or employee of a legislative body, or with any other government official or employee who may participate in the formulation of the legislation (except technical advice or assistance provided to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be).⁶¹

Although section 4945 does not label this category, for ease of discussion the above category will be referred to in this article as section 4945 direct lobbying. The second type of lobbying, referred to in this article as section 4945 grass roots lobbying, is defined as "any attempt to influence any legislation through an attempt to affect the opinion of the general public or any segment thereof."⁶²

Section 4945(e) specifically excludes from the section 4945 definitions two exceptions: (1) making available the results of "nonpartisan analysis," and (2) "an appearance before, or communication to, any legislative body with respect to a possible decision of such body, which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation."⁶³ The "nonpartisan analysis" ex-

55. I.R.C. § 4945(b) (1991).

56. I.R.C. § 4945(b) (1991).

57. I.R.C. § 4945(a)(2) (1991).

58. I.R.C. § 4945(b)(2) (1991).

59. I.R.C. § 4945(d)(2) (1991).

60. I.R.C. § 4945(d)(1) (1991).

61. I.R.C. § 4945(e)(2) (1991).

62. I.R.C. § 4945(e)(1) (1991).

63. I.R.C. § 4945(e) (1991).

ception to lobbying activity is also found in the section 501(c)(3) regulations⁶⁴ and would apply to section 501(c)(3) lobbying and probably to section 4912 lobbying as well. The second exception, the "appearance" exception, is not found in the section 4945 regulation. The regulations do, however, provide that discussions of broad social, economic and similar problems are not lobbying activities.⁶⁵

Section 4945 regulations define "legislation" exactly as stated in the section 501(c)(3) regulations:

For purposes of this section, the term "legislation" includes action by the Congress, by any State legislature, by any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure.⁶⁶

The section 4945 regulations go much farther, however, in explaining the boundaries of lobbying activity. First, the section 4945 regulations state that legislation does not include action by executive, judicial or administrative bodies such as school boards, housing authorities and sewer and water districts.⁶⁷ The section 501(c)(3) regulations make no such statement. Second, the section 4945 regulations state that "action" includes the introduction, enactment, defeat or repeal of legislation.⁶⁸ Again, the section 501(c)(3) regulations are silent. The inconsistencies between the section 4945 regulations and the section 501(c)(3) regulations magnify the confusion already present in the statutory language differences.

4. Lobbying Limitations on Electing Public Charities

A charitable organization that is not a church or a private foundation can elect under 501(h) to have lobbying limitations determined by a specific expenditure formula rather than by the "substantial" test of non-electing charitable organizations.⁶⁹ IRS figures indicate that less than one percent of all charitable organizations make the 501(h) election.⁷⁰ The 501(h) election does not affect the complete prohibition of campaigning by charitable organizations.⁷¹ The specific expenditure formula requires the payment of an excise tax of 25% on the "excess lobbying expenditures" of the organization.⁷² The excess lobbying expenditure is the greater of:

- (1) the amount by which the lobbying expenditures made by the organization during the taxable year exceed the lobbying nontaxable amount for such organization for such taxable year, or
- (2) the amount by which the gross roots expenditures made by the organization

64. Treas. Reg. § 1.105(c)(3)-1(c)(3)(iv) (as amended in 1990).

65. Treas. Reg. § 53.4945-2(d)(4) (as amended in 1990).

66. Treas. Reg. § 53.4945-2(a)(2) (as amended in 1990).

67. Treas. Reg. § 53.4945-2(a)(2) (as amended in 1990).

68. Treas. Reg. § 53.4945-2(a)(2) (as amended in 1990).

69. I.R.C. § 501(h)(1) (1991). For a discussion of the factors which charitable organizations should consider in deciding whether to make the section 501(h) election, see generally James H. Nix, *Limitations on the Lobbying of Section 501(c)(3) Organizations - A Choice for the Public Charities*, 81 W. VA. L. REV. 407 (1979).

70. A. Mark Christopher, *Political Activities Become More Risky for Tax Exempts Due to RA '87*, 68 J. TAX'N 136, 138 (March 1988).

71. I.R.C. § 501(c)(3) (1991).

72. I.R.C. § 4911(a)(1) (1991).

during the taxable year exceed the gross roots nontaxable amount for such organization for such taxable year.⁷³

The lobbying nontaxable amount for any organization for any taxable year is the lesser of \$1,000,000 or the amount determined under the following table:

<i>EXEMPT PURPOSE EXPENDITURES</i>	<i>LOBBYING NONTAXABLE AMOUNT</i>
Not over 500,000	20% of the EPE.
500,000 to 1,000,000	100,000 + 15% of EPE over 500,000.
1,000,000 to 1,500,000	175,000 + 10% of EPE over 1,000,000.
Over 1,500,000	225,000 + 5% of EPE over 1,500,000. ⁷⁴

The "gross roots nontaxable amount" for any organization for any taxable year is 25% of the lobbying nontaxable amount for such organization for such taxable year.⁷⁵

Exempt purpose expenditures are the total amount paid to accomplish the organization's exempt (religious, charitable, educational, etc.) purposes. The amount includes amounts paid or incurred for the purpose of influencing legislation.⁷⁶

If a charitable organization "normally" has lobbying expenditures that exceed 150% of the lobbying nontaxable amounts, the organization loses its exempt status.⁷⁷ Although the code does not define the term "normally," IRS generally revokes exempt status where the organization has lobbying expenditures averaging in excess of the 150% limit during four consecutive years.⁷⁸

Lobbying expenditures are defined for purposes of both section 501(h) and section 4911 as "expenditures for the purposes of influencing legislation."⁷⁹ Influencing legislation is in turn defined as:

- (A) any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof, and
- (B) any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation.⁸⁰

Gross roots expenditures are defined for purposes of both section 501(h) and section 4911 as "any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof."⁸¹

Section 4911(e)(2) defines legislation as in the section 501(c)(3) and section 4945 regulations. Section 4911(d)(3) defines "action" as "limited to the introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items." The section 4911(e)(3) definition of action, however, although similar to the definition under the section 501(c)(3) and section 4945

73. I.R.C. § 4911(b) (1991).

74. I.R.C. § 4911(c)(2) (1991).

75. I.R.C. § 4911(c)(4) (1991).

76. I.R.C. § 4911(e)(1)(B)(ii) (1991).

77. I.R.C. § 501(h)(1)(A) (1991).

78. See S. REP. NO. 938 (PART 2), 94th Cong., 2d Sess. 81, n.3 (1976).

79. I.R.C. § 4911(c)(1) (1991).

80. I.R.C. § 4911(d)(1) (1991).

81. I.R.C. § 4911(d)(1)(A) (1991).

regulations, has two significant differences. First, this definition is intentionally limiting; only those items listed are included in the definition. The definition of action under the section 501(c)(3) and section 4945 regulations is less restricting by using the word "includes" in the definition. Second, section 4911(d)(3) specifically lists "amendment" as an action; the section 501(c)(3) and the section 4945 regulations do not specifically list "amendment" of legislation as an action. The section 501(c)(3) regulations do not even define "action" of a legislative body. "Amendment" might be interpreted by courts to be included in the "similar procedure" language of the section 501(c)(3) and section 4945 definition of "legislation." The regulations, however, are obviously inconsistent in major respects.⁸² Interpretation of the statutes and the regulations under such circumstances is necessarily more complex and more difficult than if a consistent definition of lobbying applied.⁸³

II. WEAKNESSES OF THE CURRENT STRUCTURE

As stated in the introduction to this article, the current scheme for restricting the political activity of exempt organizations fails to guide charitable organizations in determining the boundaries of acceptable political activity. The rules guiding charitable organizations are far too ineffective, in large part because of their complexity and disorganization. Congress has previously recognized this problem and has established objectives to improve the sanction structures. The boundaries and the sanctions for exceeding those boundaries can be greatly improved by legislation which meets the following Congressional objectives:

82. Treasury has attempted to improve the coordination between the section 4911 definition of lobbying and the section 4945 definition through recently issued final regulations. T.D. 8308, 1990-2 C.B. 112. Treasury regulation section 53.4945-2(a)(1) states:

Under section 4945(d)(1) the term "taxable expenditure" includes any amount paid or incurred by a private foundation to carry on propaganda, or otherwise to attempt, to influence legislation. An expenditure is an attempt to influence legislation if it is for a direct or grass roots lobbying communication, as defined in § 56.4911-2 (without reference to §§ 56.4911-2(b)(3) and 56.4911-2(c) and 56.4911-3.

Treas. Reg. § 53.4945-2(a)(1) (as amended in 1990). For a general discussion of the new proposed regulations, see Troyer and Slocombe, *New Prop. Regs. on Lobbying Ease Many Restrictions*, J. TAX'N, March, 1989, at 146 and McGovern, Accettura, and Skelly, *The Final Lobbying Regulations: A Challenge for Both the IRS and Charities*, 48 TAX NOTES 1305 (September 3, 1990).

83. See Notice 88-76, 1988-2 C.B. 392, as an example of how complexity can mislead the unwary. Here, the Internal Revenue Service attempted to determine the applicability of sections 501(c)(3), 501(h), 4911, 4912, 4945(d)(1) and (2), and 4955 when a section 501(c)(3) organization attempts to influence the Senate confirmation of an individual nominated by the President to serve as a federal judge. The IRS correctly stated that such activity is not campaigning under sections 501(c)(3), 4955 or 4945(d)(2). However, in determining whether or not such activity constitutes lobbying under sections 501(c)(3), 501(h), 4911, 4912 and 4945(d)(1), the IRS completely fails to recognize the differences in the lobbying definitions of the applicable code sections. The IRS decides that "[b]ecause the Senate's action of advice and consent on a judicial nomination is an action with respect to a resolution or similar item," the attempt is an attempt to "influence legislation" under section 4911(e). This interpretation of section 4911(e) is at least plausible. However, the leap made by the IRS from the applicability of section 4911(e) to the applicability of sections 501(c)(3), 501(h), 4912 and 4945(d)(1) is unjustifiable. "Accordingly, these activities are subject to the restrictions on attempting to influence legislation contained in the code sections referred to above [sections 501(c)(3), 501(h), 4911, 4912 and 4945(d)(1)]." Notice 88-76, 1988-2 C.B. 392.

1. Simplification of the law;⁸⁴
 2. Matching the severity of the sanction with the severity of the offence;⁸⁵
- and,
3. Neutral application of the law.⁸⁶

Unfortunately, Congress has not yet transformed these objectives into legislation.

A. Simplicity

A major problem with the current structure of sanctioning political activity of charitable organizations is that there are as many definitions of political activity as there are code sections restricting the activity.⁸⁷ Although all of the code sections dealing with political activity restrictions appear to be addressing similar activities, there is no unified definition of the types of political activity which are restricted. Both subtle and obvious differences in the definitions are a primary source of unnecessary complexity and confusion. Although Congress has perceived a problem with the multiple definitions and has asked the Treasury to study the desirability of a unified standard for the measurement of political activities of all charitable organizations, as yet no study results and no legislative changes have been made.⁸⁸

Not only are the definitions dealing with similar activities inconsistent, the language employed by Congress in labelling the similar activities is confusing. For example, what would be called campaigning in laymen's terms is referred to in the Code as "participating or intervening in a political campaign"⁸⁹ or a "political expenditure."⁹⁰ What would be called lobbying in laymen's terms is referred to as "carrying on propaganda,"⁹¹ "influencing legislation,"⁹² and "lobbying expenditures."⁹³ "Taxable expenditure" is used to describe both campaigning and lobbying,⁹⁴ both considered to be political activities by the layman.

Each code section defining a political activity has its own particular sanction for discouraging the activity. For any one particular activity, therefore, there may be multiple sanctions. Such a scheme of multiple sanctions may be proper if the different code sections attempt to regulate distinct activities. The

84. H.R. REP. NO. 100-391, 100th Cong., 1st Sess. at 1628 (1987).

85. *Id.* at 1623-4.

86. *Id.* at 1625. See also *Hearings*, at 6 and 7 (Summary of statement of Lawrence B. Gibbs, Jr., Commissioner, Internal Revenue Service).

87. Campaigning is defined in sections 501(c)(3), 527(e)(2), 4945(d)(2), 4955(d) and 162(e)(2)(A). Direct lobbying is defined in sections 501(c)(3), 4911(d)(1)(B), 4912(d)(1), 4945(e)(2) and 162(e)(1). Indirect or "grass roots" lobbying is defined in sections 501(c)(3), 4911(d)(1)(A), 4912(d)(1), 4945(e)(1), and 162(e)(2)(B).

88. H.R. REP. NO. 100-391, 100th Cong., 1st Sess. 1628 (1987). Treasury has, however, published final regulations which "ensure that the rules regarding lobbying by private foundations are consistent with the rules regarding lobbying by electing public charities." T.D. 8308, 1990-2 C.B. 112. The regulations, however, fall far short of developing a unified definition of lobbying. See *supra* note 82 and accompanying text.

89. I.R.C. § 501(c)(3) (1991).

90. I.R.C. § 4955(d) (1991).

91. I.R.C. § 501(c)(3) (1991).

92. I.R.C. §§ 501(c)(3), 4911(d)(1)(B) (1991).

93. I.R.C. §§ 501(h) 4911 (1991).

94. I.R.C. § 4945(d)(2), (e)(2) (1991).

sections dealing with the sanctioning of political activity, however, appear only accidentally to regulate distinct activities. The definitions of political activities are different, and therefore the activities regulated are different. Congress could not possibly have intended to create a rational scheme to regulate subtle differences in behavior through subtle differences in definitions. More likely, the differences in definitions of similar political activities are the result of haphazard, piecemeal legislation.

B. Matching Severity of Sanction with Severity of Offense

The severity of sanctions imposed on charitable organizations for their political activities should correlate with the severity of the activity.⁹⁵ A small political expenditure should not be as offensive to Congress as a large expenditure, and should, therefore, be taxed less severely than a large expenditure. A large political expenditure should receive more severe penalties. The imposition of multiple penalties for a single political behavior should be avoided for the same reason. If multiple penalties are imposed, behaviors which are similar in nature may be treated very differently. In effect, multiple penalties create a suddenly higher rate of tax for behaviors that are not radically distinct from behaviors that are subject to only one penalty.

Sanctions for campaign activity under current law include mandatory loss of exempt status. Any campaigning activity, no matter how small, may invoke this sanction.⁹⁶ Obviously, the current rule for sanctioning campaign activity falls far short of the Congressional matching objective. Complicating the sanction structure even more, standards for applying the denial of tax exempt status are ambiguous and subjective.⁹⁷ Charitable organizations may inadvertently exceed boundaries of acceptable behavior with disastrous results.

Taxation of political expenditures, with loss of exempt status only in the case of an objectively defined excessive expenditure, would solve the problem of unfairly enforced, or unenforced, penalties for minor offenses. Sections 501(h) and 4911 already achieve this goal with respect to the lobbying activities of those organizations which elect to fall under the section 501(h) lobbying standards. Expanding this type of expenditure structure to all section 501(c)(3) organizations, and to campaigning as well as lobbying activities, would go far

95. H.R. REP. No. 1210, 94th Cong., 2d Sess. (1976) states:

Except in the case of private foundations, the only sanctions available at present with respect to an organization which exceeds the limits on permitted lobbying are loss of exempt status under section 501(c)(3) and loss of qualification to receive deductible charitable contributions. Some organizations (particularly organizations which have already built up substantial endowments) can split up their activities between a lobbying organization and a charitable organization. For such organizations, these sanctions may have little effect, and this lack of effect may tend to discourage enforcement effort. For other organizations which cannot split up their activities between a lobbying organization and a charitable organization and which must continue to rely upon the receipt of deductible contributions to carry on their exempt purposes, loss of section 501(c)(3) status cannot be so easily compensated for and would constitute a severe blow to the organization.

Id.

96. I.R.C. § 501(c)(3) (1991).

97. See *supra* note 44 and accompanying text.

in accomplishing the goal of matching the severity of the sanction with the severity of the offense. The rates of tax applied to the expenditures and the point at which tax exempt status is revoked can be set to suit Congressional sentiment toward the type of charitable organization engaging in the activity and toward the type of political behavior.

C. Neutral Application

Treasury enforcement discretion is perhaps the most dangerous aspect of the current sanction structure. Congress has repeatedly expressed its concern that the Treasury remain neutral in applying the political activity sanctions against charitable organizations.⁹⁸ The abuse of a subjective measure of political activity by a partisan Treasury could greatly undermine public confidence in the political system. The "substantial" standard now used to evaluate a large portion of the lobbying activity of the nation's exempt organizations has the potential to become just such a partisan tool. The "de minimis" exception to campaigning activity could also severely damage the public's trust in a tax system which is neutrally applied.⁹⁹ The Congressional intent of a neutral application of the law can be accomplished only by an objective political expenditure standard.

III. PROPOSED SANCTION STRUCTURE: REPEALING THE UNDERBRUSH

Improvement of the political activity sanction structure for charitable organizations can be achieved by the enactment of the specific modifications to the current law as set forth in the Appendix to this article. The proposal reduces the number of penalties to two excise taxes, both using an objective measure of political activity. One excise tax would control campaigning. The other excise tax would control lobbying. The proposed taxes improve Treasury neutrality and maintain a match between the severity of political activity and the severity of the sanction. Under the proposal, an organization is subject to the loss of its tax-exempt status only after making large or continuing political expenditures.

98. H.R. REP. NO. 1210, 94th Cong., 2nd Sess. 7-17 (1976) and H.R. REP. NO. 100-391, 100th Cong., 1st Sess. 1625 (1987). T.D. 8308, 1990-2 C.B. 112, states:

Before the passage of the Tax Reform Act of 1976, there was uncertainty about what constituted a "substantial part" of an organization's activities. Congress was aware both of the severity of loss of tax exemption as a sanction and of the belief that the vague standard of the substantial part test tended to create uncertainty and allow subjective and selective enforcement.

Id.

99. The Service has recognized the importance of a neutral appearance in the application of the de minimis exception. Gen. Couns. Mem. 34,267 (Feb. 20, 1970) states:

We are not indicating that the de minimis principle can or should be invoked in every case where a number of organizations have engaged in substantially similar activities. However, we do think that in a case where it is questionable whether more than a de minimis amount of political activity has taken place, and where to revoke an exemption would give the appearance of dissimilar treatment of organizations similarly situated, the principle should be invoked.

Id.

The maximum rate of tax on the expenditures and the level of expenditures which cause a loss of exempt status under the proposal could be adjusted to suit Congressional concerns. For example, in order to discourage large political expenditures, Congress might desire to progressively increase the rates of tax on both the lobbying and the campaigning excise taxes as the level of expenditure increased. Campaigning, historically considered the more undesirable political activity of charitable organizations, could be taxed at a high maximum rate and with a steep rate increase. A relatively small expenditure could also trigger loss of exempt status. Less worrisome lobbying activity could be taxed less severely.

The proposed simplification suggested in this article is itself intentionally kept simple. The proposal uses as much of the existing sanction structure as is possible while meeting the Congressional objectives discussed in Part II of this article. The Code sections which are suggested as the basis of a new sanction structure are chosen because they have to some degree withstood Congressional scrutiny and been tested by the IRS and charitable organizations. To say the least, the sections used in the proposal are familiar.

No doubt there will be objections to the particular code sections chosen to guide charitable organizations in their political activities. Organizations once free to test the murky waters of the "substantial part" restriction may dislike the more objective standards proposed by this article.¹⁰⁰ Congressmen opposed to even a small amount of charitable organization involvement in campaigning activities¹⁰¹ may object to an expenditure test, despite the benefits of greater objectivity created by such a test. Nevertheless, the proposal as a whole better satisfies Congressional objectives than does the status quo.

A. Campaigning Excise Tax

It is difficult to imagine a reasonable justification for the existence of four different sanctions for campaigning activities which are closely similar.

100. Churches, made ineligible for the section 501(h) election at their own request, may especially object to the proposed objective standard of the lobbying rules. The Joint Committee on Taxation, "General Explanation of the Tax Reform Act of 1976," 1976-3 (Vol. 2) C.B. 427 (Vol. 2), at 427, states:

Concerns have been expressed by a number of church groups that both prior law and the rules in the Act might violate their constitutional rights under the First Amendment. Such groups have indicated a concern that if a church were permitted to elect the new rules, then the Internal Revenue Service might be influenced by this legislation even though the church in fact did not elect.

As a result of the concerns expressed by a number of churches and in response to their specific request, the Act does not permit a church or a convention or association of churches (or an integrated auxiliary or a member of an affiliated group which includes a church, etc.), to elect to come under these provisions.

Additionally, because they have been a primary beneficiary of the *de minimis* exception to the prohibition on campaigning activity, churches may also fight the proposed objective standard of the campaigning rules.

Gen. Couns. Men. 34,267 (Feb. 20, 1970); Gen. Couns. Mem. 34,071 (Mar. 11, 1969).

101. For a discussion of the legislative history reflecting Congressional concern over the involvement by charitable organizations in campaigning activities, see *Association of the Bar v. Commissioner*, 858 F.2d 876 (2nd Cir. 1988), *cert. denied*, 490 U.S. 1030 (1989).

The discussion regarding the problems of the current sanction system¹⁰² suggests the need for a unified definition of campaigning activity and a matching of the severity of sanctions with the severity of the offense. An obvious way to accomplish this goal is to repeal the section 527(f) excise tax (as it applies to charitable organizations)¹⁰³, the 4945 excise tax (as it applies to the campaigning activity of private foundations)¹⁰⁴ and the section 501(c)(3) prohibition on campaigning activity.¹⁰⁵ What remains is a modified section 4955 excise tax applicable as the sole sanction to campaigning by all charitable organizations.¹⁰⁶

The proposal retains the sanction of loss of exempt status for large or continuous campaign expenditures by adding a new section 4955(e).¹⁰⁷ Under

102. See *supra* notes 84-99 and accompanying text.

103. Congress may desire to keep the section 527(f) tax for other tax exempt entities. Discussion of this decision is outside the scope of this article.

104. The proposal eliminates the section 4945 excise tax on the campaigning activity of private foundations in order to simplify the definitions of lobbying and campaigning. Under the proposal private foundation activity would be governed by the same sections which govern other section 501(c)(3) organizations, primarily sections 4911 and 4955. If Congress were to decide that private foundations needed more severe sanctions than other section 501(c)(3) organizations, the rates of tax under sections 4911 and 4955 could be increased for private foundations. In this manner, the integrity of the simplified definitions is maintained.

105. The repeal of the section 501(c)(3) prohibition on campaigning would not, of course, relieve a section 501(c)(3) organization from the requirement that it be organized and operated exclusively for religious, charitable, etc. purposes and that no part of the net earnings inures to the benefit of any private shareholder or individual. Organizations operated for the benefit of a particular candidate or a particular party still could not maintain a tax-exempt status. See *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989).

106. Section 6852 (relating to termination assessments in case of flagrant political expenditures) and section 7409 (relating to actions to enjoin flagrant political expenditures) are repealed in the proposal because repeal would not substantially diminish the effectiveness of section 4955 and because repeal would aid the effort to simplify sanctions for political activities of charitable organizations. However, the IRS would likely oppose any reduction in their enforcement powers and Congress may decide these sections are necessary tools to restrict campaigning activity. If Congress were to make all other changes suggested in this proposal, but retain the section 6852 and section 7409 powers, minor modifications to these sections would be required to take into account changes made in section 501(c)(3) and section 4955. For example, to be consistent with the proposed section 4955, "political" expenditures would need to be changed to "campaign" expenditures. Also, because there is not an absolute prohibition against campaigning under the proposal, the enforcement sections would need to be made applicable only in severe cases. This modification could be achieved by defining "flagrant" under sections 6852 and 7409 in terms of dollars expended in campaigning activity.

107. A similar plan was suggested by the Treasury to the Subcommittee on Oversight of the House Ways and Means Committee during the 1987 hearings on lobbying and political activities of tax exempt-organizations:

As previously stated, under current law the only sanction for engaging in political activities is revocation of tax exempt status. Unlike the restriction on lobbying, the prohibition on participation in political activities is absolute and thus does not raise problems of measuring the level of the activity. Further, political activity is somewhat easier to define than lobbying activity. Even though the standards are more precise than with respect to the rules on lobbying, revocation of tax exempt status may still be unduly harsh in some instances. In other cases, such as where an organization has expended all its funds, it may have little or no impact on an organization.

The Treasury Department suggests that, in lieu of automatic revocation of exempt status, the Subcommittee consider the imposition of an excise tax on public charities that engage in political activities. Such a tax should be similar to the excise tax that is imposed on private foundations under section 4945. Thus, a tax should be imposed both on the organization and on the management of the organization if it acted with knowledge that the expenditure was for political activities. Also, the statute should require correction of the prohibited expenditure either by recovery of the money or by

this new provision, the organization loses its exempt status if the average campaign expenditure over any two year period exceeds \$500.¹⁰⁸ The provision is similar to the proposed section 501(h)(1) provision requiring loss of exempt status if the average direct or grass roots lobbying expenditures exceeds the appropriate ceiling amounts.¹⁰⁹ The proposed section 4955(e) sanction is in addition to the tax under the proposed section 4955(a). This two step approach to sanctions improves the matching of the severity of the penalty with the severity of the offence.¹¹⁰ The two year period and the \$500 amount proposed are arbitrary and may be adjusted by Congress to either loosen or tighten the conditions for the loss of exempt status.

In order to discourage campaigning, the proposed section 4955 rate is modified to equal the maximum individual tax rate under section 1. At this maximum individual rate, there would be no net tax advantage to making a deductible charitable contribution which would be used for campaign activity. In other words, an individual taxpayer could buy the same dollars of campaign activity by means of a direct contribution to a political campaign as the taxpayer could buy through a tax-exempt conduit. The tax at the charitable organization level should cause donors to be just as inclined to send the dollars they intended to be used for campaigning activities directly to the political campaigns as they are to send those dollars through a charitable organization.¹¹¹

The proposed sanction for campaigning activity is based on expenditures. It is easier for the IRS to locate an expenditure than it is for them to define an activity; enforcement of an expenditure-based tax is more objective than an activity-based sanction.¹¹² However, the trade-off for increased objectivity in enforcement is that the door would be open for charitable organizations to become more involved in political campaigns than they have in the past. The organizations would incur no campaign activity tax as long as the organization makes no campaign expenditures. Endorsement, not involving expenditures, of political candidates might become common. Unpaid volunteer campaigning could also increase. This change to an expenditure-based standard, however, would ameliorate the politically delicate problem of the challenge to the exempt status of certain organizations which currently endorse candidates.¹¹³

such other means as the Commissioner may prescribe. Absent correction of the expenditure, or in cases of repeated or flagrant violations, the organization should be subject to loss of its exempt status.

Hearings, at 90 (Statement of J. Roger Mentz, Assistant Secretary (Tax Policy), Department of the Treasury).

108. The language of section 504 is modified to take into account the change in how an organization loses its exempt status. The concept of preventing a shift from a section 501(c)(3) organization to a section 501(c)(4) organization is unchanged. Note also that section 504(c) is deleted in the proposal because proposed section 501(h) applies to all section 501(c)(3) organizations.

109. See *supra* note 77 and accompanying text.

110. See *supra* note 95 and accompanying text.

111. The tax at the exempt organization level is simply a way for Congress not to subsidize the campaign activity of exempt organizations. See *Regan v. Taxation With Representation*, 461 U.S. 540, 544 (1983).

112. *Hearings*, at 6 (Summary of statement of Lawrence B. Gibbs, Jr., Commissioner, Internal Revenue Service).

113. See, e.g., *Abortion Rights Mobilization, Inc. v. Treasury Secretary*, 89-2 USTC ¶ 9576 (2nd Cir. 1989). For a discussion of the campaigning activities of religious organizations, see generally

B. Lobbying Excise Tax

Sections 501(h) and 4911 can be modified to accomplish all regulation of charitable organization lobbying activity. These two code sections are already in use on an elective basis.¹¹⁴ The proposal makes the modified sections 501(h) and 4911 mandatory for all charitable organizations.¹¹⁵ Other code sections currently regulating charitable organization lobbying activity are eliminated.¹¹⁶

The proposal requires all charitable organizations to use an objective expenditure standard for evaluating lobbying activities. Section 4912, imposing a tax on disqualifying lobbying expenditures, and section 4945, imposing a tax on private foundations which engage in lobbying activities, would be superfluous and are suggested for repeal under the proposal.¹¹⁷ As a result of the use of the objective standard the problems relating to the definition and enforcement of "substantial" lobbying would disappear. Charitable organizations and the IRS would more easily know when an organization crossed over into unfavorable territory.¹¹⁸

Note, *Religion and Political Campaigns: A Proposal to Revise Section 501(c)(3) of the Internal Revenue Code*, 29 *FORDHAM L. REV.* 536 (1981).

114. See *supra* note 70 and accompanying text for a discussion of how few organizations have made the section 501(h) election.

115. Congress may see fit to raise the rate on the section 4911 tax in order to make substantial lobbying even less desirable. If the rate exceeds the maximum individual tax rate then the Congressional goal of ensuring "that no tax-deductible contributions are used to pay for substantial lobbying" will be met. *Regan v. Taxation With Representation*, 461 U.S. 540, 544, n.6 (1983).

116. The proposal eliminates the section 501(c)(3) lobbying language and all of sections 4912 and 4945.

117. In order to keep the limitations on lobbying by private foundations more restrictive than the limitations on lobbying activity by other charitable organizations, Congress may decide that private foundations need greater tax rates and smaller ceiling amounts than do the other charitable organizations. This further restriction on private foundations could be accomplished within sections 501(h) and 4911. For purposes of simplicity, this change was not incorporated into the proposal.

By the elimination of section 4912 (and section 4945) the proposal removes all sanctions against managers who knowingly exceed lobbying limitations. The proposed section 4911(a)(3), however, remedies the problem by including a sanction against managers similar to that found in section 4955(a)(2).

118. The Treasury endorsed the objective expenditure standard for evaluating lobbying activities in a statement to the Subcommittee on Oversight of the House Ways and Means Committee:

As noted above, if a section 501(c)(3) organization does not elect to be subject to the expenditure test, it is subject to loss of tax exempt status if it engages in substantial lobbying activities. Because of the vagueness of the "substantial part" test, the test provides little guidance to taxpayers and is difficult for the Service to administer. A vague standard is particularly troublesome in this situation because the only available sanction — revocation of the tax exempt status — is sometimes unduly harsh. Moreover, the vagueness of the standard and the harshness of the sanction leave the Service open to accusations of politically motivated enforcement.

The elective expenditure test under section 501(h) represents a significant improvement over the substantial part test. Admittedly, an expenditure test is not necessarily the best measure of the extent of an organization's lobbying activities in all cases. In addition, even though the dollar amount of permissible lobbying is a precise standard, it must be applied to an activity that is difficult to define and that raises difficult allocation issues. However, while the expenditure test is not perfect from a theoretical standpoint and is not entirely precise, on balance it represents a reasonable and objective measure of lobbying activities.

The imposition of excise taxes on organizations that exceed the applicable limits under the expenditure test, with revocation of exempt status reserved as a sanction for those organizations that exceed the limits by a significant amount over the substantial part

The proposal makes a minor change in section 501(h) by replacing "normally" with "on the average over four consecutive years." The phrase "for each taxable year" is deleted in sections 501(h)(1)(A) and (B) in order to clarify that the average of four years is the proper test and that any single year in isolation is not significant in the computation of the four-year average. These changes make a measurable standard for the denial of exempt status when an organization consistently exceeds the lobbying or grass roots ceiling amounts. The four-year standard has been informally applied by IRS in the past¹¹⁹; the proposal merely codifies the standard so that IRS enforcement discretion is minimized.¹²⁰

IV. CONCLUSION

The current system for controlling the political behavior of charitable organizations does not work. The boundaries of acceptable political activity are unclear. The penalties for exceeding the boundaries are complex and inappropriate. Treasury enforcement of the laws is overly discretionary, allowing for the perception, at least, of politically motivated discrimination. In such a climate of uncertainty, regulation of political activity becomes ineffective and unfair.

Congress can improve the current law by enacting the changes suggested in this article. The proposed changes simplify the definitions of proscribed lobbying and campaigning activity so that charitable organizations will know which behavior is permitted and which behavior is penalized. The definitions are made more objective in order to reduce the possibility of discrimination in enforcement. The proposal modifies the penalty calculation so that the penalties correspond to the severity of the sanctioned behavior. In this way, the more egregious behavior is taxed more severely than the less egregious behavior (i.e., larger political expenditures receive larger penalties). In summary, the proposal allows Congress to restrict the political activity of charitable organizations in a way that achieves the Congressional goals of simplifying the law, matching sanctions with offenses and improving Treasury neutrality.

APPENDIX

PROPOSED AMENDMENTS

501(c)(3)

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public

test. The imposition of an excise tax is a more appropriate sanction for initial violations and provides fair warning, prior to revocation of exempt status, to organizations that are engaging in impermissible levels of lobbying activities.

Hearings, at 90 (Statement of J. Roger Mentz, Assistant Secretary (Tax Policy), Department of the Treasury).

119. See *supra* note 78 and accompanying text.

120. Proposed regulation section 1.501(h)-3 handles the "normally" standard more severely than the legislative history of section 501(h) suggests was intended by Congress. The proposal in this article adheres to the four year standard discussed in H.R. REP. 1210, 94th Cong., 2d Sess. 7-17 (1976) and S. REP. No. 938 (PART 2), 94th Cong., 2d Sess. 81, n.3 (1976).

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 (or in opposition to) any candidate for public office.~~¹²¹

501(h)

(1) GENERAL RULE.-In the case of [any organization which is described in subsection (c)(3)]~~an organization to which this subsection applies,~~¹²² exemption from taxation under subsection (a) shall be denied because a substantial part of the activities of such organization consists of carrying on propaganda, or otherwise attempting, to influence legislation, but only if such organization [on the average over four consecutive years]~~normally~~¹²³

(A) makes lobbying expenditures in excess of the lobbying ceiling amount for such organization for ~~each taxable year,~~¹²⁴ or

(B) makes grass roots expenditures in excess of the grass roots ceiling amount for such organization ~~for each taxable year.~~¹²⁵

(2) DEFINITIONS.-For purposes of this subsection-

(A) LOBBYING EXPENDITURES.-The term "lobbying expenditures" means expenditures for the purpose of influencing legislation (as defined in section 4911(d)).

(B) LOBBYING CEILING AMOUNT.-The lobbying ceiling amount for any organization for any taxable year is 150 percent of the lobbying nontaxable amount for such organization for such taxable year, determined under section 4911.

(C) GRASS ROOTS EXPENDITURES.-The term "grass roots expenditures" means expenditures for the purpose of influencing legislation (as defined in section 4911(d) without regard to paragraph (1)(B) thereof).

(D) GRASS ROOTS CEILING AMOUNT.-The grass roots ceiling amount for any organization for any taxable year is 150 percent of the grass roots nontaxable amount for such organization for such taxable year, determined under section 4911.

~~(3) ORGANIZATIONS TO WHICH THIS SUBSECTION APPLIES.-This subsection shall apply to any organization which has elected (in such manner and at such time as the Secretary may prescribe) to have the provisions of this subsection apply to such organization and which, for the taxable year which includes the date the election is made, is described in subsection (c)(3) and -~~

~~(A) is described in paragraph (4), and~~

121. See *supra* notes 105, 116 and accompanying text.

122. See *supra* note 115 and accompanying text.

123. See *supra* note 120 and accompanying text.

124. *Id.*

125. *Id.*

(B) is not a disqualified organization under paragraph (5).

(4) ORGANIZATIONS PERMITTED TO ELECT TO HAVE THIS SUBSECTION APPLY.—An organization is described in this paragraph if it is described in—

(A) section 170(b)(1)(A)(ii) (relating to educational institutions),

(B) section 170(b)(1)(A)(iii) (relating to hospitals and medical research organizations),

(C) section 170(b)(1)(A)(iv) (relating to organizations supporting government schools),

(D) section 170(b)(1)(A)(vi) (relating to organizations publicly supported by charitable contributions),

(E) section 509(a)(2) (relating to organizations publicly supported by admissions, sales, etc.) or

(F) section 509(a)(3) (relating to organizations supporting certain types of public charities) except that for purposes of this subparagraph, section 509(a)(3) shall be applied without regard to the last sentence of section 509(a).

(5) DISQUALIFIED ORGANIZATIONS.—For purposes of paragraph (3) an organization is a disqualified organization if it is—

(A) described in section 170(b)(1)(A)(i) (relating to churches),

(B) an integrated auxiliary of a church or of a convention or association of churches, or

(C) a member of an affiliated group of organizations (within the meaning of section 4911(f)(2)) if one or more members of such group is described in subparagraph (A) or (B).

(6) YEARS FOR WHICH ELECTION IS EFFECTIVE.—An election by an organization under this subsection shall be effective for all taxable years of such organization which—

(A) end after the date the election is made, and

(B) begin before the date the election is revoked by such organization (under regulations prescribed by the Secretary).

(7) NO EFFECT ON CERTAIN ORGANIZATIONS.—With respect to any organization for a taxable year for which—

(A) such organization is a disqualified organization (within the meaning of paragraph (5)), or

(B) an election under this subsection is not in effect for such organization, nothing in this subsection or in section 4911 shall be construed to affect the interpretation of the phrase, “no substantial part of the activities of which is carrying of propaganda, or otherwise attempting, to influence legislation,”²² under subsection (c)(3).

(8) AFFILIATED ORGANIZATIONS.—

For rules regarding affiliated organizations, see section 4911(f).¹²⁶

504

(a) GENERAL RULE. — An organization which —

(1) was exempt (or was determined by the Secretary to be exempt) from taxation under section 501(a) by reason of being an organization described in section 501(c)(3), and

126. See *supra* note 115 and accompanying text.

(2) is not an organization described in section 501(c)(3) —

(A) by reason of [section 501(h)] ~~carrying on propaganda, or otherwise attempting, to influence legislation,~~¹²⁷ or

(B) by reason of [section 4955(e)] ~~participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for public office,~~¹²⁸ shall not at any time thereafter be treated as an organization described in section 501(c)(4).

(b) REGULATIONS TO PREVENT AVOIDANCE. — The Secretary shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of subsection (a), including regulations relating to a direct or indirect transfer of all or part of the assets of an organization to an organization controlled (directly or indirectly) by the same person or persons who control the transfer or organization.

(c) CHURCHES, ETC. — ~~Subsection (a) shall not apply to any organization which is a disqualified organization within the meaning of section 501(h)(5) (relating to churches, etc.) for the taxable year immediately preceding the first taxable year for which such organization is described in paragraph (2) of subsection (a).~~¹²⁹

527(f)(1)

IN GENERAL.—If an organization described in section 501(c) [(except an organization described in section 501(c)(3))¹³⁰] which is exempt from tax under section 501(a) expends any amount during the taxable year directly (or through another organization) for an exempt function (within the meaning of subsection (e)(2)), then, notwithstanding any other provision of law, there shall be included in the gross income of such organization for the taxable year, and shall be subject to tax under subsection (b) as if it constituted political organization taxable income, an amount equal to the lesser of—

(A) the net investment income of such organization for the taxable year, or

(B) the aggregate amount so expended during the taxable year for such an exempt function.

4911(a)(2)

ORGANIZATIONS TO WHICH THIS SECTION APPLIES.—This section applies to any organization [described in section 501(c)(3) which is exempt from tax under section 501(a)] ~~with respect to which an election under section 501(h)(i) (relating to lobbying expenditures by public charities) is in effect for the taxable year~~¹³¹.

4911(a)(3)

[ON THE MANAGEMENT.—There is hereby imposed on the agreement of any organization manager to the making of any expenditure, knowing that it is an excess lobbying expenditure, a tax equal to 5 percent of the amount

127. See *supra* note 108 and accompanying text.

128. *Id.*

129. *Id.*

130. See *supra* note 103 and accompanying text.

131. See *supra* note 115 and accompanying text.

thereof, unless such agreement is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any organization manager who agreed to the making of the expenditure.^{132]}

4911(e)(2)

[ORGANIZATION MANAGER.-The term "organization manager" has the meaning given to such term by section 4955(e)(2).^{133]}

4912

[REPEAL]¹³⁴

4945

[REPEAL]¹³⁵

4955

(a) INITIAL TAXES.-

(1) ON THE ORGANIZATION.-There is hereby imposed on each [campaign] ~~political~~¹³⁶ expenditure by a section 501(c)(3) organization a tax equal to [the highest rate of tax imposed on individuals under section 1] ~~40 percent~~¹³⁷ of the amount thereof. The tax imposed by this paragraph shall be paid by the organization.

(2) ON THE MANAGEMENT.-There is hereby imposed on the agreement of any organization manager to the making of any expenditure, knowing that it is a [campaign] ~~political~~ expenditure, a tax equal to 2 1/2 percent of the amount thereof, unless such agreement is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any organization manager who agreed to the making of the expenditure.

(b) ADDITIONAL TAXES.-

(1) ON THE ORGANIZATION.-In any case in which an initial tax is imposed by subsection (a)(1) on a [campaign] ~~political~~ expenditure and such expenditure is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount of the expenditure. The tax imposed by this paragraph shall be paid by the organization.

(2) ON THE MANAGEMENT.-In any case in which an additional tax is imposed by paragraph (1), if an organization manager refused to agree to part or all of the correction, there is hereby imposed a tax equal to 50 percent of the amount of the [campaign] ~~political~~ expenditure. The tax imposed by this paragraph shall be paid by any organization manager who refused to agree to part or all of the correction.

(c) SPECIAL RULES.-For purposes of subsections (a) and (b)-

(1) JOINT AND SEVERAL LIABILITY.-If more than 1 person is liable under subsection (a)(2) or (b)(2) with respect to the making of a [campaign]

132. See *supra* note 117 and accompanying text.

133. *Id.*

134. See *supra* note 116 and accompanying text.

135. See *supra* notes 104, 116 and accompanying text.

136. A change in terminology is proposed because of the current confusion as discussed in *supra* notes 89-94 and accompanying text.

137. See *supra* note 111 and accompanying text.

political expenditure, all such persons shall be jointly and severally liable under such subsection with respect to such expenditure.

(2) LIMIT FOR MANAGEMENT.-With respect to any 1 [campaign] political expenditure, the maximum amount of the tax imposed by subsection (a)(2) shall not exceed \$5,000, and the maximum amount of the tax imposed by subsection (b)(2) shall not exceed \$10,000.

(d) [CAMPAIGN] POLITICAL EXPENDITURE.-For purposes of this section-

(1) IN GENERAL.-The term "[campaign] political expenditure" means any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

(2) CERTAIN OTHER EXPENDITURES INCLUDED.-In the case of an organization which is formed primarily for purposes of promoting the candidacy (or prospective candidacy) of an individual for public office (or which is effectively controlled by a candidate or prospective candidate and which is availed of primarily for such purposes), the term "[campaign] political expenditure" includes any of the following amounts paid or incurred by the organization;

(A) Amounts paid or incurred to such individual for speeches or other services.

(B) Travel expenses of such individual.

(C) Expenses of conducting polls, surveys, or other studies, or preparing papers or other materials, for use by such individual.

(D) Expenses of advertising, publicity, and fundraising for such individual.

(E) Any other expense which has the primary effect of promoting public recognition, or otherwise primarily accruing to the benefit, of such individual.

(e) [LOSS OF EXEMPT STATUS.— Exemption from taxation under section 501(a) shall be denied any organization described in section 501(c)(3) if such organization on the average over two consecutive years makes campaign expenditures in excess of \$500.]¹³⁸

COORDINATION WITH SECTION 4945.— If tax is imposed under this section with respect to any political expenditure, such expenditure shall not be treated as a taxable expenditure for purposes of section 4945.¹³⁹

(f) OTHER DEFINITIONS.-For purposes of this section-

(1) SECTION 501(C)(3) ORGANIZATION.-The term "section 501(c)(3) organization" means any organization which (without regard to any [campaign] political expenditure) would be described in section 501(c)(3) and exempt from taxation under 501(a).

(2) ORGANIZATION MANAGER.-The term "organization manager" means-

(A) any officer, director, or trustee of the organization (or individual having powers or responsibilities similar to those of officers, directors, or trustees of the organization), and

138. See *supra* note 108 and accompanying text.

139. Section 4945 is repealed under the proposal. See *supra* notes 104, 116 and accompanying text.

(B) with respect to any expenditure, any employee of the organization having authority or responsibility with respect to such expenditure.

(3) CORRECTION.-The terms "correction" and "correct" mean, with respect to any [campaign] ~~political~~ expenditure, recovering part or all of the expenditure to the extent recovery is possible, establishment of safeguards to prevent future [campaign] ~~political~~ expenditures, and where full recovery is not possible, such additional corrective action as is prescribed by the Secretary by regulations.

(4) TAXABLE PERIOD.-The term "taxable period" means, with respect to any [campaign] ~~political~~ expenditure, the period beginning with the date on which the [campaign] ~~political~~ expenditure occurs and ending on the earlier of-

(A) the date of mailing a notice of deficiency under section 6212 with respect to the tax imposed by subsection (a)(1), or

(B) the date on which tax imposed by subsection (a)(1) is assessed.

6852

[REPEAL]¹⁴⁰

7409

[REPEAL]¹⁴¹

140. See *supra* note 106 and accompanying text.

141. *Id.*