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An Essay on Federal Income Taxation and Campaign Finance Reform

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AN ESSAY ON FEDERAL INCOME TAXATION AND CAMPAIGN FINANCE REFORM

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This Article explores the structure of campaign finance reform, the role of political organizations under that system, and the federal tax policy that affects the income taxation of this form of entrepreneurial activity. Decades of campaign finance reform have had little impact on the influence of money in the electoral process. Reform efforts instead have re-routed the pathways of campaign finance. In part that occurs because of the evolution of campaign professionals, organized through large entities, who receive payments from interested contributors in exchange for influence in the political decisionmaking arena.[1] While substantial in

1. *See* MICHAEL J. MALBIN & THOMAS L. GAIS, THE DAY AFTER REFORM: SOBERING CAMPAIGN FINANCE LESSONS FROM THE AMERICAN STATES (1998). In the context of state attempts to regulate campaign finance, Malbin and Gais state,

> People who would like to change campaign finance law . . . are trying to change the behavior of political professionals, whose need to survive amidst ever-changing technologies of communications and campaigning teaches them to adapt as they pursue their own interests. Any proposal that fails to come to grips, over the long term, with the way these professionals "exist in reality" will be more likely to bring about the destruction of the ends the proposal seeks to achieve than

scope, these large scale organized economic activities are free from federal income taxation. The trade or business of collecting revenue and expending it in the acquisition of political influence is favorably treated for income tax purposes and is treated differently than other forms of business activity.

This examination of federal income taxation of political campaign finance and legislative activity begins with a search for overriding policy objectives. The United States Supreme Court established limitations on regulatory activity with respect to campaign finance in *Buckley v. Valeo*.[2] The first part of the Article reviews the Constitutional litigation and the statutory regulation scheme affecting election campaign finance. Readers who work in this area will recognize this part as familiar territory. The Supreme Court also has spoken in *Cammarano v. United States*[3] with respect to the relationship between federal income tax provisions and the First Amendment in the context of political activity. Part II examines the role of federal income taxation in campaign finance. Analysis of both lines of authorities provide a policy framework from which to explore application of federal income tax rules in the campaign realm.

I. FIRST AMENDMENT LIMITATIONS AND PUBLIC POLICY REGARDING POLITICAL FINANCE

A. *Constitutional Limitations on Campaign Finance Regulation*

The starting point of any review of campaign finance must be the First Amendment limitations on regulatory activity imposed by the Supreme Court in *Buckley*.[4] *Buckley* is well-known, much discussed, and highly vilified by scholars and practitioners of campaign finance reform.[5] The

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their fulfillment.

Id. at 2; *see also* Carroll J. Doherty, *Overhaul Gridlock on the Hill Contrasts With Action in States*, CONG. Q., Feb. 28, 1998, at 465 (suggesting that "despite the spate of new state laws, the effort to drastically change the way elections are financed has run into some formidable obstacles. Indeed, the lesson from the states is that it is easier to pass tough campaign laws than it is to actually make them work.").

2. 424 U.S. 1 (1976).

3. 358 U.S. 498 (1959).

4. *Buckley*, 424 U.S. at 1.

5. *See, e.g.*, Frances R. Hill, *Corporate Philanthropy and Campaign Finance: Exempt Organizations as Corporate-Candidate Conduits*, 41 N.Y.L. SCH. L. REV. 881, 895 (1997) (describing the Court's rationale for distinguishing between the corrupting influence of contributions and expenditures on behalf of candidates as "conceptual incoherence"); Bradley A. Smith, *Money Talks: Speech, Corruption, Equality and Campaign Finance*, 86 GEO. L.J. 45, 46-47,

case, which is the seminal authority with respect to the regulation of campaign finance,[6] outlines the constitutional parameters of legal limitation on campaign finance activities.[7] Organizations engaged in political activity are formed to act within or without the strictures of the Federal Election Campaign Act as interpreted through the *Buckley* analysis.

Buckley considers the Federal Election Campaign Act of 1971 (FECA),[8] as amended in 1974.[9] The 1974 amendment enhanced the FECA in response to campaign abuses that were disclosed as a result of the Watergate break-ins during the 1972 presidential campaign.[10] As described by the Court in *Buckley*, the Act had several components: individual campaign contributions to a candidate were limited to $1,000 for a single election, with an overall limitation of $25,000 by any contributor; independent expenditures "relative to a clearly identified candidate" were limited to $1,000 per year; and spending by candidates and political parties was subject to proscribed limits.[11] In addition, FECA contained reporting requirements and provisions for public disclosure and created a system in the Internal Revenue Code[12] for public funding of presidential candidates.[13] The Court upheld the constitutional validity of limits on contributions to individual candidates, the reporting and disclosure requirements, and public financing of presidential campaigns.[14] The Court declared unconstitutional, as an infringement on First Amendment rights

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nn. 9 & 10 (1997); Cass R. Sunstein, *Political Equality and Unintended Consequences*, 94 COLUM. L. REV. 1390, 1394 (1994).

6. The opinion is more of a law review article than a judicial opinion. The 139 page *per curiam* opinion, plus an appendix reprinting the FECA, plus the concurring and dissenting opinions of Chief Justice Burger and Justices White, Marshall, Blackman, and Rehnquist total 294 pages in the official report. Justice Stevens did not participate in the case. The *per curiam* opinion represents the unqualified views of only Justices Brennan, Stewart, and Powell.

7. *See generally Buckley*, 424 U.S. at 1.

8. Pub. L. No. 92-225, 86 Stat. 3 (1988) (as amended in Pub. L. No. 93-433, 88 Stat. 1263 (1974)).

9. *Buckley*, 424 U.S. at 6.

10. For a history of campaign finance reform efforts, see generally R. GOIDEL ET AL., MONEY MATTERS: CONSEQUENCES OF CAMPAIGN FINANCE REFORM IN THE U.S. HOUSE ELECTIONS, ch. 2 (1999).

11. *Buckley*, 424 U.S. at 7. The FECA is reprinted in an appendix to the *Buckley* opinion. *Id.* at 144-99.

12. Title 26 of the United States Code is referred to as the "Internal Revenue Code" or the "Code."

13. *Buckley*, 424 U.S. at 7.

14. *Id.* at 143.

of free speech, limitations on independent expenditures by individuals and groups[15] and expenditure limits on candidates and political organizations.[16]

The first principle of the *Buckley* opinion seems to be the Court's conclusion that, "[a] restriction on the amount of money a person or group can spend on political communication during a campaign necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of the audience reached."[17] Thus, "expenditure limitations . . . represent substantial rather than merely theoretical restraints on the quantity and diversity of political speech."[18] As a consequence, expenditure limitations on political speech are tantamount to restraint on political expression, which is afforded the "broadest protection" of the First Amendment "in order 'to assure [the] unfettered interchange of ideas for the bringing about of political and social changes desired by the people.'"[19] In the words of Justice White's dissenting opinion, "money talks" and is, therefore, protected speech.[20] The Court also rejected arguments that regulation of campaign money affected non-speech conduct that is subject to a lower level of

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15. *Id.* at 51.

16. *Id.* at 58-59.

17. *Id.* at 19. For better or worse, this principle is withstanding the test of time. *See, e.g.*, Fed. Election Comm'n v. Colo. Republican Fed. Campaign Comm., 121 S. Ct. 2351, 2371 (2001).

18. *Buckley*, 424 U.S. at 19.

19. *Id.* at 14 (alteration in original) (quoting Roth v. United States, 354 U.S. 476, 484 (1957)). The *per curiam* opinion also concludes that FECA's contribution and expenditure limitations impinge on the First Amendment freedom of association. *Id.* at 22. Contributions serve to affiliate a person with a candidate or party and further permit like-minded associates to pool their resources in furtherance of common political goals. *See id.* at 25.

20. *Id.* at 262 (White, J., dissenting in part and concurring in part). Justice White wrote, "Proceeding from the maxim that 'money talks,' the Court finds that the expenditure limitations will seriously curtail political expression by candidates and interfere substantially with their chances for election." *Id.* Justice White concludes that, "As an initial matter, the argument that money is speech and that limiting the flow of money to the speaker violates the First Amendment proves entirely too much." *Id.* Justice White further argues that,

> The record before us no more supports the conclusion that the communicative efforts of congressional and Presidential candidates will be crippled by the expenditure limitations than it supports the contrary. The judgment of Congress was that reasonably effective campaigns could be conducted within the limits established by the Act and that the communicative efforts of these campaigns would not seriously suffer.

Id. at 262-63 (White, J., dissenting in part and concurring in part); *see also* Frances R. Hill, *Softer Money: Exempt Organizations and Campaign Finance*, 32 EXEMPT ORG. L. REV. 27, 29 (2001) (asserting that "[t]he Supreme Court's position that money is speech has been distorted by rent-seeking officeholders into the proposition that payment should be the precondition for the right to speech in the policy process, a right that should carry no price tag").

constitutional scrutiny.[21] The consequence of this holding is that any regulation of campaign money is subject to strict scrutiny and requires a compelling governmental interest.[22]

While the Court in *Buckley* found that the FECA limitations on campaign *expenditures* imposed a substantial restraint on the quantity and diversity of political speech,[23] "a limitation upon the amount that any one person or group may contribute to a candidate or political committee entails only a marginal restriction upon the contributor's ability to engage in free communication."[24] In addition, the *per curiam* opinion concludes that a compelling governmental interest in preventing corruption and the appearance of corruption in elected officials justifies restrictions on the amount of campaign contributions from individual sources that a candidate may accept.[25] The opinion states that, "[t]o the extent that large contributions are given to secure political *quid pro quo's* from current and potential office holders, the integrity of our system of representative democracy is undermined."[26] The Court thereby upheld the validity of FECA's $1,000 contribution limit to a single candidate by separate

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21. *Buckley*, 424 U.S. at 16.

22. *See id.* at 25. In the context of restrictions on the First Amendment protected freedom of association, which is restrained by limitations on campaign contributions, the Court states that, "Even a significant interference with protected rights of political association may be sustained if the State demonstrates a sufficiently important interest and employs means closely drawn to avoid unnecessary abridgement of associational freedoms." *Id.* (quoting Cousins v. Wigoda, 419 U.S. 477, 488 (1975)) (internal quotation marks omitted).

23. *Id.* at 19.

24. *Id.* at 20-21. Ironically the Court also observes that,

> There is no indication . . . that the contribution limitations imposed by the Act would have any dramatic adverse effect on the funding of campaigns and political associations. The overall effect of the Act's contribution ceilings is merely to require candidates and political committees to raise funds from a greater number of persons and to compel people who would otherwise contribute amounts greater than the statutory limits to expend such funds on direct political expression, rather than to reduce the total amount of money potentially available to promote political expression.

Id. at 21-22. The comment illustrates the Court's naivety about the mainsprings of human conduct. As discussed below, FECA changed the face of campaign funding.

25. *Id.* at 25-29. Finding this purpose sufficient to justify the contribution limit, the Court found it unnecessary to address two additional justifications; the Act was said to limit the voices of affluent persons and groups thereby equalizing the ability of all citizens to affect the outcome of elections, and the Act was said to limit the increasing costs of political campaigns. *Id. See generally* Nixon v. Shrink Mo. Gov't PAC, 528 U.S. 377 (2000) (upholding state limits on contributions to candidates for state offices).

26. *Buckley*, 424 U.S. at 26-27 (emphasis added). The Court added here that the appearance of corruption arising from public awareness of the opportunities for abuse is "of almost equal concern." *Id.* at 27.

persons[27] and the $5,000 contribution limit imposed on political committees that are registered with the Federal Election Commission.[28] The Court also upheld FECA's overall $25,000 limitation on the amount that a person may contribute within a single calendar year.[29]

FECA's limitations on direct expenditures by candidates and groups as well as expenditures by others to benefit an identified candidate did not fare as well. FECA had attempted to limit expenditures made from personal funds by an individual who is running for federal office (and his or her family),[30] limit the overall level of expenditures by a candidate for federal office,[31] and limit the expenditures of any person on behalf of a clearly identified candidate to $1,000 per calendar year.[32] The Court concluded that restrictions on expenditures constituted a direct restraint on the quantity and diversity of political speech.[33] In order to avoid a challenge that the limit on expenditures "relative to a clearly identified candidate" was unconstitutionally vague, the Court held that the limitation must be interpreted as only applying to "expenditures for communications that in *express terms* advocate the election or defeat of a clearly identified candidate for federal office."[34] The Court then concluded that FECA, as narrowly construed, did not limit independent expenditures promoting a candidate or the candidate's views as long as the communication did not

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27. *Id.* at 30, 35. The limitation is applied to persons; the term "persons" is defined in 18 U.S.C. § 591(g) to include "an individual, partnership, committee, association, corporation or any other organization or group of persons." *Id.* at 23 (quoting 18 U.S.C. § 591(g) (1976)).

28. *Id.* at 35-36. To qualify for the $5,000 limit, the FECA requires a group to be registered with the Federal Election Commission as a political committee for at least six months and to have received contributions from more than 50 persons. *Id.* at 13 n.12, 35. Additionally, the political committee must have contributed to five or more candidates for federal office. *Id.* Significantly, although not relevant to the thesis of this Article, the Court rejected arguments that the contribution limit is overbroad because the perceived harm could be limited by more narrowly focused provisions, the $1,000 limit is unrealistically low, and the limitation works an invidious discrimination between incumbents and challengers in federal elections. *Id.* at 29-35.

29. *Id.* at 38. The *per curiam* opinion refers to this overall limitation as a "moderate restraint" that "serves to prevent evasion of the $1,000 contribution limitation by a person who might otherwise contribute massive amounts of money to a particular candidate through the use of unearmarked contributions to political committees likely to contribute to that candidate, or huge contributions to the candidate's political party." *Id.* The Court also upheld FECA limitations on certain expenses incurred by individuals providing volunteer services. *Id.* at 36.

30. *Id.* at 51 (quoting 18 U.S.C. § 608(a)(1) (1970)).

31. *Id.* at 54 n.60 and accompanying text.

32. *Id.* at 39 (citing 18 U.S.C. § 608(e)(1) (1970)).

33. *Id.* at 19-20, 39. "It is clear that a primary effect of these expenditure limitations is to restrict the quantity of campaign speech by individuals, groups, and candidates. The restrictions, while neutral as to the ideas expressed, limit political expression 'at the core of our electoral process and of the First Amendment freedoms.'" *Id.* at 39 (quoting Williams v. Rhodes, 393 U.S. 23, 32 (1968)).

34. *Id.* at 23, 44 (emphasis added).

expressly advocate the election or defeat of a clearly identified candidate.[35] As a consequence, the Court held that the limit on independent expenditures would not function as a "loophole-closing provision designed to check corruption."[36] In addition, the Court concluded that independent expenditures favoring a candidate which are not coordinated with the candidate[37] do not pose the same danger of corruption in the form of the *quid pro quo* that justified limitations on campaign contributions.[38] Thus, the direct restriction on political speech imposed by expenditure limitations was not justified by the requisite compelling governmental interest.[39] Similarly, a restriction on a candidate's expenditure of his or her personal funds directly restricts the candidate's freedom to be an advocate for the candidate's personal views and does not serve to protect FECA's primary governmental interest in preventing the actual and apparent corruption of the political process that is possible when others obtain undue influence over the candidate through monetary contributions.[40] In addition, FECA's attempt to limit overall campaign expenditures, which again directly restricted the quantity of political expression, was not, in the Court's view, justified by a governmental interest in restraining increasing campaign expenditures.[41]

The distinction in *Buckley* between contributions to a candidate, which may be restricted, and expenditures for political activity not coordinated with a candidate, which are considered unregulated speech, has framed the subsequent development of campaign organizations. The *per curiam* opinion recognized the difficulty inherent in this dichotomy where, in assessing the claim that the FECA expenditure limitation was vague,[42] the opinion states that

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35. *Id.* at 45.

36. *Id.*

37. Expenditures that are coordinated with the candidate are considered to be campaign contributions to the candidate. *Id.* at 46 n.53.

38. *Id.* at 47. "The absence of prearrangement and coordination of an expenditure with the candidate or his agent not only undermines the value of the expenditure to the candidate, but also alleviates the danger that expenditures will be given as a *quid pro quo* for improper commitments from the candidate." *Id.*

39. *See id.* at 47-48.

40. *Id.* at 53.

41. *Id.* at 55. "The interest in alleviating the corrupting influence of large contributions is served by the Act's contribution limitations and disclosure provisions rather than by section 608 (c)'s campaign expenditure ceilings." *Id.* The Court also said that, "In the free society ordained by our Constitution it is not the government, but the people—individually as citizens and candidates and collectively as associations and political committees—who must retain control over the quantity and range of debate on public issues in a political campaign." *Id.* at 57.

42. *Id.* at 41-42. The limitation was contained in 18 U.S.C. § 608(e)(1) (1970), which limited expenditures relative to a clearly identified candidate to $1,000. *Id.*

> the distinction between discussion of issues and candidates and advocacy of election or defeat of candidates may often dissolve in practical application. Candidates, especially incumbents, are intimately tied to public issues involving legislative proposals and governmental actions. Not only do candidates campaign on the basis of their positions on various public issues, but campaigns themselves generate issues of public interest.[43]

Justice White, in his concurring and dissenting opinion in *Buckley*, acknowledged the conclusion of the *per curiam* opinion[44] and stated,

> It would make little sense to me, and apparently made none to Congress, to limit the amounts an individual may give to a candidate or spend with his approval but fail to limit the amounts that could be spent on his behalf. . . . [A]pparently, a contributor is to be constitutionally protected in spending unlimited amounts of money in support of his chosen candidate or candidates.[45]

Contrasting a $1 million expenditure urging election of a named candidate in identical words with and without the approval of the candidate, Justice White observed that "[f]or constitutional purposes it is difficult to see the difference between the two situations. I would take the word of those who know—that limiting independent expenditures is essential to prevent transparent and widespread evasion of the contribution limit."[46] As Justice White seems to predict, the distinctions between campaign activity that expressly advocates the election or defeat of a candidate or that is controlled by the candidate, and independent campaign activity not subject to contribution limits defines the contemporary nature of campaign organizations and the tax regime under which they operate. The Court badly underestimated the role that independent expenditures on behalf of a candidate would come to play in the electoral system. Perhaps the Court majority was somewhat naïve in its belief that large independent expenditures on behalf of a candidate have less of a corrupting influence than direct campaign contributions.

The *per curiam* opinion of *Buckley v. Valeo* addressed a second justification for limiting campaign expenditures that is of some interest in considering the permissible extent of the tax regime applicable to the

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43. *Id.* at 42.

44. *Id.* at 260 (White, J., concurring in part and dissenting in part).

45. *Id.* at 261 (White, J., concurring in part and dissenting in part).

46. *Id.* at 261-62 (White, J., concurring in part and dissenting in part). Justice Blackmun agreed with this assessment. *Id.* at 290. (Blackmun, J., concurring in part and dissenting in part).

business of political influence. The Court considered and rejected an "ancillary" justification for spending limits that is described as a "governmental interest in equalizing the relative ability of individuals and groups to influence the outcome of elections."[47] The Court asserted that

> the concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment, which was designed to secure the widest possible dissemination of information from diverse and antagonistic sources, and to assure unfettered interchange of ideas for the bringing about of political and social changes desired by the people. The First Amendment's protection against governmental abridgment of free expression cannot properly be made to depend on a person's financial ability to engage in public discussion.[48]

While government may not restrain the speech of some persons to equalize the voice of others, the discussion in Part II argues that likewise the government is not required to favorably subsidize the speech of some groups over others.

Buckley upheld FECA requirements for disclosure of campaign contributions and expenditures by candidates, political groups and independent expenditures.[49] Disclosure and reporting requirements were attacked as infringing freedom of association under *NAACP v. Alabama*.[50] The *Buckley* Court recognized the deterrent effect of disclosure on the

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47. *Id.* at 48. Justice Marshall characterized this interest as "promoting the reality and appearance of equal access to the political arena." *Id.* at 287 (Marshall, J., concurring in part and dissenting in part); *see also* ROBERT MUTCH, CAMPAIGNS, CONGRESS AND COURTS: THE MAKING OF FEDERAL CAMPAIGN FINANCE LAW 53 (1988) (asserting that the two sides in *Buckley* raised as a constitutional matter one of the oldest conflicts in Anglo-American political thought, that between liberty and equality, that between those who want no restrictions on the political use of wealth and those who want to retard the tendency of unequally distributed wealth to become the basis for a similarly unequal distribution of political influence); Lillian R. BeVier, *Campaign Finance Reform: Specious Arguments, Intractable Dilemmas*, 94 COLUM. L. REV. 1258, 1267 (1994) ("[R]egulating campaign expenditures as a means of achieving political equality is . . . a simplistic if not a deliberately misleading strategy for removing disparities of political influence. Regulating expenditures isolates wealth as the critical variable and controls only for differences in immediately available financial resources.").

48. *Buckley*, 424 U.S. at 48-49 (citations and internal quotation marks omitted). This language is in response to an argument that equalizing the voice of individuals and groups justified expenditure limits on individual political activity. *Id.* at 48. The *per curiam* opinion contains similar expressions regarding this argument with respect to limitations on candidates' expenditures from personal resources and overall limitations on campaign expenditures. *Id.* at 54, 56.

49. *Id.* at 60-61.

50. 337 U.S. 449 (1958); *Buckley*, 424 U.S. at 65.

exercise of First Amendment rights[51] but concluded that the possible infringement on First Amendment freedoms was outweighed by governmental interests in providing the electorate with information on the source of candidates' money, in deterring actual corruption by exposing large contributions to public scrutiny, and by providing records essential to enforcing FECA's campaign contribution limits.[52] With respect to the disclosure requirement applicable to independent expenditures advocating the election or defeat of a candidate, the Court held that the requirement was justified by a strong governmental interest in "shed[ding] the light of publicity on spending that is unambiguously campaign related but would not otherwise be reported because it takes the form of independent expenditures or of contributions to an individual or group not itself required to report the names of its contributors."[53] However, in order to avoid a perceived overbreadth problem with respect to disclosure of independent expenditures, the Court narrowly interpreted the language of the disclosure requirement to apply to expenditures by individuals or groups that are not candidates or political committees only, "(1) when they make contributions earmarked for political purposes or authorized or requested by a candidate or his agent, to some person other than a candidate or political committee, [or] (2) when they make expenditures for communications that expressly advocate the election or defeat of a clearly identified candidate."[54] In contrast, independent expenditures that may influence the outcome of an election, but which do not "expressly advocate the election or defeat of a clearly identified candidate" are not subject to reporting or disclosure.[55] The distinction between these two categories of advocacy further frames the structure of campaign finance activities by forcing much campaign advocacy into the realm of independent expenditures. *Buckley* also limits disclosure of contributors to a minor political party that can show a "reasonable probability" that compelled disclosure will subject the contributors to "threats, harassment, or reprisals."[56]

Finally, *Buckley* sustains FECA's establishment of a voluntary system of public finance for presidential campaigns, which includes expenditure

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51. *Buckley*, 424 U.S. at 65.
52. *Id.* at 66-68.
53. *Id.* at 81.
54. *Id.* at 80.
55. *See id.*
56. *Id.* at 68-74. The Court indicates that the governmental interest in disclosure is diminished in the case of a minor party with little chance of winning. *Id.* at 70; *see also* Brown v. Socialist Workers, 74 Campaign Comm., 459 U.S. 87, 88 (1982) (holding that the First Amendment requires an exemption for the Socialist Workers Party from requirements of an Ohio statute for disclosure of campaign contributors and expenditures).

limitations for candidates who elect to accept public funding for the campaign.[57]

B. Statutory Regulation of Campaign Finance

The regulation of campaign finance under FECA is significantly restrained as a result of its compliance with the First Amendment limitations of *Buckley*. The scheme is fraught with difficult interpretative issues that make the system complex.[58] As is described in Part III of this Article, entrepreneurial marketers of political influence have been able to exploit the lacunae in the regulatory scheme using various forms of tax-exempt entities to facilitate large investment in political decision making outside of the regulatory scheme.

FECA limits individual contributions to a candidate for federal office,[59] or to a candidate's authorized political committee, to $1,000 with respect to any election.[60] The term "election" separately includes both the primary and general election, thereby permitting $1,000 contributions to the same candidate for each part of the election cycle, a total of $2,000 per candidate.[61] Overall contributions to FECA regulated activities during a

57. *Buckley*, 424 U.S. at 85-86.

58. MALBIN & GAIS, *supra* note 1, at 101. The complexity itself makes it more difficult to trace the flow of money, makes enforcement more difficult, and favors the use of diverse tactics by the most sophisticated political entrepreneurs. *Id.*

59. A candidate is a person who seeks nomination or election to the United States offices of President, Vice President, Senator, or Representative to Congress and who has received or spent in excess of $5,000 with respect to the candidacy. 2 U.S.C. § 431(2)-(3) (2001); 11 C.F.R. § 100.3 (a) (2001); *see also* 2 U.S.C. § 431(8)-(9) (2001) (defining, contributions and expenditures that are discussed *infra* note 78 and accompanying text).

60. 2 U.S.C. § 441a(a)(1)(A) (2001). Many commentators assert that the $1,000 limit set in 1971 is too low in terms of current dollars, and further, that increasing the limit to a more reasonable amount might mitigate abuse. *See, e.g.*, Craig M. Engle et al., Buckley *Over Time: A New Problem with Old Contribution Limits*, 24 J. LEGIS. 207-09, 214-16 (1998); Joel Fleischman & Pope McCorkle, *Level-Up Rather Than Level-Down: Toward a New Theory of Campaign Finance Reform*, 1 J.L. & POL. 211, 215 (1984); Frank J. Sorauf, *Politics, Experience, and the First Amendment: The Case of American Campaign Finance*, 94 COLUM. L. REV. 1348, 1365 (1994). The McCain-Feingold Bill would have increased the limit for contributions to candidates to $2,000, and the overall contribution limit to $37,500. S. 27, 107th Cong. § 308(a)-(b) (as passed by the Senate Apr. 2, 2001).

61. 2 U.S.C. §§ 431(1), 441a(a)(6) (2001). The contributor may designate in writing to which election a contribution relates. 11 C.F.R. § 110.1(b)(2)(i) (2001). Otherwise the contribution is deemed to be made for the next election. 11 C.F.R. § 110.1(b)(2)(ii) (2001). A contribution made after an election may be designated as a contribution for the preceding election, but only to the extent that the contribution does not exceed debts outstanding from the particular election. 11 C.F.R. § 110.1(b)(3)(i) (2001).

calendar year by an individual may not exceed $25,000.[62] Contributions in the name of another person, which would permit the contributor to evade the limitations, are expressly prohibited.[63]

Subject to the $25,000 overall limitation[64] applicable to individuals, a person[65] may contribute up to $20,000 to political committees established and maintained by a national political party.[66] Individual contributions to a political committee other than a candidate committee (i.e., multicandidate political committees, which are referred to as political action committees, or PACs) are limited to $5,000 in a calendar year.[67] A political committee is an entity that has received contributions in excess of $1,000 or has incurred expenditures in excess of $1,000 with respect to a candidate for federal office, or a local committee of a political party that has received contributions or incurred expenditures in excess of $5,000 with respect to a candidate.[68] A multicandidate political committee is in turn limited to contributing $5,000 to any single candidate or the candidate's authorized political committees with respect to an election, $15,000 in the aggregate during a calendar year to a political committee established by a national party and the House and Senate campaign committees, and $5,000 during the calendar year to any other political committee.[69] Political committees are required to file reports with the

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62. 2 U.S.C. § 441a(a)(3) (2001). For purposes of the $25,000 limitation, contributions to a candidate with respect to an election in a calendar year other than the election year are treated as having been made in the calendar year of the election. *Id.* The McCain-Feingold Bill would increase the overall contribution limit to $37,500. S. 27, 107th Cong. §§ 102(b), 308(b) (2001).

63. 2 U.S.C. § 441f (2001).

64. 2 U.S.C. § 441a(a)(3) (2001).

65. 2 U.S.C. § 431(11) (2001) defines a "person" to include individuals and entities such as partnerships, corporations, associations, and committees.

66. 2 U.S.C. § 441a(a)(1)(B) (2001). The McCain-Feingold Bill would increase the contribution limit to a national political party to $25,000. S. 27, 107th Cong. § 308(a)(2)(2001).

67. 2 U.S.C. § 441a(a)(1)(C) (2001). The McCain-Feingold Bill would increase the contribution limit to $10,000 for contributions to a political committee of a state committee of a political party. S. 27, 107th Cong. § 102(a)(3) (2001) (adding 2 U.S.C. § 441a(a)(1)(d)); *See also* Cal. Med. Ass'n v. Fed. Election Comm'n, 453 U.S. 182, 184 (1981) (upholding the $5,000 contribution limit as applied to an unincorporated association).

68. 2 U.S.C. § 431(4)(A), 4(c) (2001); *see also* 11 C.F.R. § 100.5(a), (c) (2001). A political committee is also a committee that has made certain other political expenditures in excess of $5,000 or received in excess of $5,000 of benefits that are outside of the definition of contributions. 2 U.S.C. § 431(4)(c) (2001). A political committee may incorporate for the purpose of securing limited liability. 11 C.F.R. § 114.12(a) (2001).

69. 2 U.S.C. § 441a(a)(2) (2001); *see also* 11 C.F.R. § 110.2 (2001). A multicandidate political committee is a political committee which is registered with the Federal Election Commission or the Secretary of the Senate and which has received contributions from more than 50 persons and which has made contributions to five or more federal candidates. 11 C.F.R. § 100.5(e)(3) (2001).

Federal Election Commission,[70] which, among other matters, disclose the identity of individuals who contribute in excess of $200 during a calendar year and political committees that make contributions to the reporting committee.[71]

FECA imposes expenditure limitations on candidates for President and Vice-President of the United States who accept federal campaign funds.[72] The national and state political parties also are limited in the amounts they can expend on behalf of candidates for President, the House of Representatives, and the Senate.[73] The expenditure limitations on parties only apply, however, to expenditures that are directly coordinated with candidates.[74] Independent expenditures by a state or local political party as constitutionally protected speech are not subject to limitation.[75]

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70. 2 U.S.C. § 434(a)(1) (2001).

71. 2 U.S.C. § 434(b)(3)(A)-(B) (2001). "Identification" of contributors includes the name, address, occupation, and employer of an individual, and the name and address of any other person. 2 U.S.C. § 431(13)(A)-(B) (2001). The reporting requirement applies to contributions to the federal accounts of the reporting committee. 11 C.F.R. § 104.8(a) (2001).

72. 2 U.S.C. § 441a(b) (2001). Candidates are limited to expenditures of $10,000,000 to secure nomination and $20,000,000 for the general campaign. *Id.* These amounts are adjusted for increases in the consumer price index beginning in 1976. 2 U.S.C. § 441a(c) (2001). Contributions to candidates running for Vice President are treated as contributions to the candidate for President. 2 U.S.C. § 441a(a)(7)(C) (2001).

73. 2 U.S.C. § 441a(d) (2001). The national committee of a political party is limited to expenditures of two cents multiplied by the voting age population of the United States. *Id.* For senatorial campaigns and campaigns for representatives in single representative states the two cents limit is applied to the voting population of the state, with a minimum permissible expenditure of $20,000. *Id.* Expenditures on behalf of other candidates for the House of Representatives are limited to $10,000. *Id.* These limitations free the political parties from the $5,000 limitation that is otherwise imposed on multicandidate political committees. *Id.*

74. 2 U.S.C. § 441a(a)(7) (2001). Expenditures coordinated with the candidate are treated as contributions and are subject to expenditure limitations under the First Amendment standards of *Buckley v. Valeo* because coordinated expenditures might otherwise be used to avoid the constitutionally valid limits on campaign contributions. Buckley v. Valeo, 424 U.S. 1, 47 (1975); *see also* 11 C.F.R. § 109.1(c) (2001). Limitations on political party coordinated expenditures were upheld against constitutional attack in *Federal Election Commission v. Colorado Republican Federal Campaign Committee*, 121 S. Ct. 2351 (2001), *reversing* 213 F.3d 1221 (10th Cir. 2000) (holding that the limitation on national political parties' coordinated expenditures is itself an infringement of the parties' First Amendment rights).

75. Colo. Republican Fed. Campaign Comm. v. Fed. Election Comm'n, 518 U.S. 604, 608 (1996). However, even though overall campaign strategy may be coordinated between the party and the candidate, expenditures for advertising that attacks the party candidate's opponent that is undertaken by the party independent of the candidate are treated as independent expenditures that may not be limited. *Id.* at 613-14. The Colorado party chairman coordinated campaign strategy with the candidate, but the particular advertising campaign was developed and reviewed independently. *Id.*

Identifying coordinated expenditures is, at best, difficult. *See, e.g.*, James Dao, *Bush Approves New Attack Ad Mocking Gore*, N.Y. TIMES, Sept. 1, 2000, at A1 (reporting that the George W. Bush campaign approved of one Republican National Committee television advertisement attacking Al

However, since these funds are spent with the purpose of influencing a federal election, contributions to the party for this purpose are subject to the $20,000 limit on contributions to a political party.[76] Thus, money for this type of activity must be raised the "hard" way, in FECA limited increments.

The FECA limitations and the identity of "political committees" to which limited contributions are made are dependent in part on the definitions of "contributions" and "expenditures" contained in the Act.[77] These restricted definitions and narrow interpretation of their scope permit extensive funding of political activity outside of the FECA limitations.

Contributions initially are defined to include "any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office."[78] Compensation to another for personal services rendered to a political committee is also treated as a contribution to the political committee.[79] The definition of a contribution is restricted, however, by fifteen specific exclusions.[80] For example, voluntary personal service and the use of property for the benefit of a candidate or political committee are not contributions.[81] An individual's efforts expended in collecting individual contributions from several other persons is not itself treated as a contribution.[82] This exclusion permits an individual or organization to

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Gore but blocked another Party-sponsored commercial).

76. 2 U.S.C. §§ 431(8)(A)(i), 441a(a)(1)(B), 441a(a)(7) (2001).

77. 2 U.S.C. § 431 (2001).

78. 2 U.S.C. § 431(8)(A)(i) (2001); *see also* 11 C.F.R. § 100.7 (2001). The McCain-Feingold Bill would revise the definition of "contribution" to include any expenditure that is coordinated with a candidate or the candidate's agents, broadly defined. S. 27, 107th Cong. § 214(a)-(b) (as passed by the Senate Apr. 2, 2001) (amending 2 U.S.C. § 431(8)); *see also* S. 27, 107th Cong. § 202 (2001) (adding a new subsection (C) to 2 U.S.C. § 441a(a)(7)).

79. 2 U.S.C. § 431(8)(A)(ii) (2001).

80. 2 U.S.C. § 431(8)(B) (2001); *see also* 11 C.F.R. § 100.7(b) (2001).

81. 2 U.S.C. § 431(8)(B)(i)-(ii) (2001). The exemption includes the cost of invitations, food, and beverages provided by an individual in rendering voluntary personal services that does not exceed $1,000 per election with respect to a single candidate in a single election, and up to $2,000 on behalf of all political committees in a single calendar year. 2 U.S.C. § 431(8)(B)(ii) (2001) Likewise, § 431(8)(B)(iii) (2001) excludes the sale of food at cost to the extent that the value provided by a vendor does not exceed the same $1,000 and $2,000 limits. 2 U.S.C. § 431(8)(B)(iii) (2001); *see also* 11 C.F.R. § 100.7(b)(4)-(7) (2001). In addition, payments by state and local party committees for campaign materials used by the committee in connection with volunteer activities are not treated as contributions or expenditures, except that amounts allocable to candidates in federal elections must be paid from FECA regulated contributions. 2 U.S.C. §§ 431(8)(B)(xi), (9)(B)(viii)(2) (2001); *see also* 11 C.F.R. §§ 100.7(b)(15)(ii), 100.8(b)(16)(ii) (2001). This exclusion does not cover expenditures for broadcast or newspaper advertising. 2 U.S.C. §§ 431(8)(B), (9)(B)(i) (2001); *see also* 11 C.F.R. §§ 100.7(b)(15)(i), 100.8(b)(16)(i) (2001).

82. *See* KENNETH WEINE, THE FLOW OF MONEY IN CONGRESSIONAL ELECTIONS 12-13 (1998) (describing "bundling").

incur expenditures "bundling" numerous FECA limited contributions from others into a single package for presentation to a candidate.[83] The large combined contribution is thereby attributed by the candidate to the person who collects the bundle.[84] The exemption for personal services extends to legal and accounting services rendered by a regular employee of the person paying for the services to a political committee of a political party or to the authorized committee of a candidate for the purpose of complying with the election law.[85]

Expenditures are described as "any purchase, payment, distribution loan, advance, deposit, or gift of money or anything of value, made by any person for the purpose of influencing any election for Federal office."[86] As is the case with the definition of contributions, identification of an expenditure is restricted by multiple exclusions,[87] some of which permit campaign activities of political parties outside of the FECA limitations.[88] The most significant provisions are exceptions that distinguish "party building" activities from regulated political expenditures. Neither contributions nor expenditures include the costs incurred for, or any benefit provided by, the preparation of "slate cards" or sample ballots by a state or local committee of a political party as long as the slate endorses three or more candidates for any public office.[89] Contributions and expenditures allocable to federal candidates must be made from funds subject to FECA limitations, but the remainder of these party activities may be financed without limitation by contributions not subject to FECA limits, "soft money."[90] Expenditures by a state or local committee for general party broadcast and newspaper advertising are not subject to

83. *Id.*

84. *Id.*

85. 2 U.S.C. § 431(8)(B)(ix) (2001); *see also* 11 C.F.R. § 100.7(b)(13)-(14) (2001). The amounts must be disclosed in the reports required of the political committee. 2 U.S.C. § 431(8)(B)(ix) (2001); *see also* 11 C.F.R. § 100.7(b)(13)-(14) (2001). Expenses incurred for such activities also are not treated as "expenditures" for political activity. 2 U.S.C. § 431(9)(B)(vii) (2001).

86. 2 U.S.C. § 431(9)(A)(i) (2001). Expenditures also include "a written contract, promise, or agreement to make an expenditure." 2 U.S.C. § 431(9)(A)(ii) (2001).

87. 2 U.S.C. § 431(9)(B) (2001). Subdivision (i) excludes the publication of news stories and commentary unless the broadcast station or publication is owned by a political party, committee or candidate. 2 U.S.C. § 431(9)(B)(i) (2001).

88. *See, e.g.*, 2 U.S.C. § 431(9)(B)(viii) (2001).

89. 2 U.S.C. § 431(8)(B)(v), (9)(B)(iv) (2001).

90. 11 C.F.R. §§ 100.7(b)(9), 100.8(b)(10) (2001). The McCain-Feingold Bill would eliminate political party soft money in federal election campaigns by requiring that national, state, and local party solicitations and expenditures for federal candidates involve funds that are subject to the FECA's limitations, prohibitions, and reporting requirements. S. 27, 107th Cong. § 101(a) (as passed by the Senate Apr. 2, 2001).

FECA regulation.[91] Party activities that are not related to the support of candidates for federal office are completely outside of the FECA regulatory scheme, although such activity may be subject to individual state campaign finance regulations.[92] Contributions to a national or state political party for the acquisition of office facilities that are not acquired for the election of a candidate in a particular election for federal office are not subject to FECA regulation.[93] These party activities are, therefore, also financed outside of the hard money restrictions on contributions. Contributions and expenditures also do not include state and local party voter registration or get-out-the-vote drives,[94] including operation of voluntary phone banks.[95] Amounts allocable to federal candidates, however, must be paid from FECA regulated funds.[96]

Although FECA does not impose expenditure limits on committees that are not coordinated with a candidate for federal office,[97] independent expenditures by political committees and individuals are subject to reporting to the Federal Election Commission.[98] Consistent with the language used in the *Buckley* opinion,[99] independent expenditures are defined as expenditures by a person "expressly advocating the election or defeat of a clearly identified candidate which are made without the cooperation or consultation with any candidate" or the candidate's political

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91. 11 C.F.R. §§ 100.7(b)(9), 100.8(b)(10) (2001).

92. For an analysis of state campaign finance legislation, see MALBIN & GAIS, *supra* note 1.

93. 2 U.S.C. § 431(8)(B)(viii) (2001); *see also* 11 C.F.R. § 100.7(b)(12) (2001).

94. 2 U.S.C. § 431(8)(B)(xii), (9)(B)(ix) (2001). The excluded payments do not include payments for political advertising and cannot be made from funds earmarked by a contributor for the benefit of specific candidates. There is an argument that the soft money loophole is important to increasing the role of parties in national elections and that the party building activities that are funded with these soft money contributions enhance voter participation. *See generally* Stephen Ansolabehere & James M. Snyder, Jr., *Soft Money, Hard Money, Strong Parties*, 100 COLUM. L. REV. 598 (2000). A contrary view, that parties may be corrupting, is found in Richard Briffault, *The Political Parties and Campaign Finance Reform*, 100 COLUM. L. REV. 620 (2000).

95. 11 C.F.R. §§ 100.7(b)(17)(v), 100.8(b)(18)(v) (2001). All of these activities would become subject to the FECA rules under the McCain-Feingold Bill. S. 27, 107th Cong. § 101(b) (as passed by the Senate Apr. 2, 2001). There is a possibility that the McCain-Feingold Bill's ban on soft money, if enacted, would increase the flow of money to political action committees. *Goodbye, Soft Money*, ECONOMIST, Apr. 7, 2001, at 22. The McCain-Feingold Bill might also increase the role of nonprofit groups. *Brave New World (perhaps)*, ECONOMIST, Apr. 7, 2001, at 30.

96. *See* 2 U.S.C. § 431(8)(B)(xii), (9)(B)(ix) (2001). 11 C.F.R. § 100.8(b)(18)(iv) (2001) provides that costs are treated as expenditures related to a candidate for the House or Senate if the materials include references to the candidate. The regulation retracts classification as an "expenditure" if "the mention of such candidate(s) is merely incidental to the overall activity." *Id.*

97. Colo. Republican Fed. Campaign Comm. v. Fed. Election Comm'n, 518 U.S. 604, 608 (1996).

98. 2 U.S.C. § 434(c) (2001); *see also* 11 C.F.R. §§ 104.4(a), 109.2(a) (2001).

99. Buckley v. Valeo, 424 U.S. 1, 80 (1976).

committees.[100] Expenditures by any person that do not "expressly advocate" the election or defeat of a candidate are outside of the FECA provisions.[101]

The definitional focus on contributions and expenditures that expressly advocate the election or defeat of a candidate for federal office leaves a vast expanse of political advocacy beyond the regulatory pale.[102] Before it declared the original FECA independent expenditure limitation unconstitutional, the Court in *Buckley* distinguished communications that address political "issues" from communications that might be subject to limitation as campaign expenditures.[103] The Court opined that in order to preserve the expenditure limitation on vagueness grounds, the limitation "must be construed to apply only to expenditures for communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office."[104] The Court added in a footnote that, "This construction would restrict the application of [the expenditure limitation] to communications containing express words of advocacy of election or defeat, such as 'vote for,' 'elect,' 'support,' 'cast your ballot for,' 'Smith for Congress,' 'vote against,' 'defeat,' 'reject.'"[105] The Court similarly interpreted the FECA requirement of disclosure of independent expenditures only as applicable to expenditures that advocate the election

100. 2 U.S.C. § 431(17) (2001); *see also* 2 U.S.C. § 431(18) (2001) (defining "clearly identified candidate").

101. *See* 2 U.S.C. § 431(17) (2001).

102. Issue advocacy is the route by which money unregulated by the FECA enters into the campaign process. The problem of issue advocacy is the subject of much scholarly writing. For some good examples, see generally DEBORAH BECK ET AL., ISSUE ADVOCACY DURING THE 1996 CAMPAIGN 3 (Annenberg Pub. Policy. Ctr. Report Series No. 16, 1997) (providing statistics of issue advocacy advertisement); MALBIN & GAIS, *supra* note 1, at 11; GLENN MORAMARCO, REGULATING ELECTIONEERING: DISTINGUISHING BETWEEN "EXPRESS ADVOCACY" & "ISSUE ADVOCACY," (1998); Lillian R. BeVier, *Mandatory Disclosure, "Sham Issue Advocacy," and* Buckley v. Valeo: *A Response to Professor Hasen*, 48 UCLA L. REV. 285 (2000); Richard Briffault, *Issue Advocacy: Redrawing the Elections/Politics Line*, 77 TEX. L. REV. 1751 (1999); Richard L. Hasen, *Measuring Overbreadth: Using Empirical Evidence to Determine the Constitutionality of Campaign Finance Laws Targeting Sham Issue Advocacy*, 85 MINN. L. REV. 1773 (2001); Richard L. Hasen, *The Suprisingly Complex Case for Disclosure of Contributions and Expenditures Funding Sham Issue Advocacy*, 48 UCLA L. REV. 265 (2000); Allison R. Hayward, *When Does an Advertisement About Issues Become an "Issues Ad"?*, CATH. U. L. REV. 63 (1999).

103. *Buckley*, 424 U.S. at 41-43; *see supra* note 34 and accompanying text. 18 U.S.C. § 608(e)(2) (1970) would have limited independent expenditures relative to a clearly identified candidate to $1,000. *Buckley*, 424 U.S. at 19. As narrowly construed to apply only to communications advocating election or defeat of a candidate, the provision was held unconstitutional under the First Amendment on the ground that the asserted governmental interest in preventing corruption was inadequate to justify a ceiling on independent expenditures. *Id.* at 45.

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

105. *Id.* at 44 n.52.

or defeat of a clearly identified candidate.[106] Several courts have interpreted *Buckley* to mean that advocacy is election advocacy within the FECA only if the "magic words" of the *Buckley* footnote are used in the communication.[107] This means, for example, that the Organization for Country, Motherhood, and Apple Pie can collect unlimited contributions and make unlimited expenditures, without disclosure, in an election eve campaign advertising that Congress member X opposes a tax credit for apple pie and this activity should be stopped, as long as the advertisements do not recommend that the recipient of the communication vote for Congress Member X's opponent or vote against Congress Member X. The advertising campaign only comments on the issue of tax credits for apple pie. On the other hand, in *Federal Election Commission v. Furgatch*[108] the Ninth Circuit Court of Appeals took the position that express advocacy may be identified from the substance of the communication rather than the form of its magic words.[109] The court concluded that speech may be express advocacy "when read as a whole, and with limited reference to external events, [it is] susceptible of no other reasonable interpretation but as an exhortation to vote for or against a specific candidate."[110] Nonetheless, advocacy that purports to inform on issues, even when the communication clearly identifies individuals who are candidates for

106. *Id.* at 80; *see also* Fed. Election Comm'n v. Mass. Citizens for Life, Inc., 479 U.S. 238, 243-44 (1986) (holding that a newsletter urging voters to vote for pro-life candidates and identifying specific candidates is express advocacy, even though the newsletter did not expressly direct the reader to vote for a particular candidate).

107. *See, e.g.*, Fed. Election Comm'n v. Christian Action Network, Inc., 110 F.3d 1049 (4th Cir. 1997); Faucher v. Fed. Election Comm'n, 928 F.2d 468, 470 (1st Cir. 1991) (finding that a pro-life voter guide was not express advocacy); Fed. Election Comm'n v. Cent. Long Island Tax Reform Immediately Comm., 616 F.2d 45, 52-53 (2d Cir. 1980) (finding that a bulletin criticizing the voting record of a local congressman was not express advocacy); Fed. Election Comm'n v. Nat'l Org. of Women, 713 F. Supp. 428, 433-34 (D.D.C. 1989) (holding that to be express advocacy a communication must contain an explicit, unambiguous reference to a candidate and a clear exhortation to vote for or against that candidate); *see also* 11 C.F.R. § 100.22 (2001) (defining express advocacy in similar terms). The issue was before the Supreme Court in *Fed. Election Comm'n v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238, 249 (1986) in which the Court held that an organization's newsletter that urged readers to vote for pro-life candidates and that identified candidates with pro-life voting records, but did not recommend a vote for specific candidates, constituted express advocacy.

108. 807 F.2d 857 (9th Cir. 1987).

109. *Id.* at 863-64.

110. *Id.* at 864. The court's opinion lists three components of this standard: (i) the speech is express if its message is unmistakable and unambiguous, suggestive of only one plausible meaning; (ii) the speech is advocacy if it presents a clear plea for action, as opposed to speech that is merely informative; and (iii) it must be clear that the contemplated action is a vote for or against a candidate. *Id.*

federal office in an upcoming election as being in support or opposition to the advocate's point of view, is not subject to regulation under FECA.[111]

The McCain-Fiengold Bill that passed the Senate in April 2001 would reduce the scope of permissible issue advocacy on two fronts. Federal election activity of political parties would be defined to include "a public communication that refers to a clearly identified candidate for federal office . . . and that promotes or supports a candidate for that office, or attacks or opposes a candidate for that office (regardless of whether the communication expressly advocates a vote for or against a candidate)."[112] "Electioneering communications" subject to disclosure under FECA would be defined to include any

> broadcast, cable, or satellite communication which (I) refers to a clearly identified candidate for Federal office; (II) is made within . . . (aa) 60 days before a general, special or run off election for such Federal office; or (bb) 30 days before a primary or preference election, or a convention or caucus of a political party that has authority to nominate a candidate, for such Federal office; and (III) is made to an audience that includes members of the electorate for such election, convention, or caucus. . . .[113]

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111. *See, e.g.*, Fed. Election Comm'n v. Christian Action Network, Inc., 110 F.3d 1049, 1050 (4th Cir. 1997). In this case the court found the following was not express advocacy:

> Bill Clinton's vision for America includes job quotas for homosexuals, giving homosexuals special civil rights, allowing homosexuals in the armed forces. Al Gore supports homosexual couples adopting children and becoming foster parents. Is this your vision for a better America? For more information on traditional family values, contact the Christian Action Network.

Id. See generally; MORAMARCO, *supra* note 102; Hayward, *supra* note 102; Glenn J. Moramarco, *Beyond "Magic Words": Using Self-Disclosure to Regulate Electioneering*, 49 CATH. U. L. REV. 107 (1999).

112. S. 27, 107th Cong. § 101(b) (as passed by the Senate Apr. 2, 2001) (adding 2 U.S.C. § 431(20)(A)(iii)).

113. *Id.* § 201(f)(3)(A)(i) (adding 2 U.S.C. § 434(f)(3)). In the event the primary definition is declared unconstitutional, the Bill would define an electioneering communication as

> any broadcast, cable, or satellite communication which promotes or supports a candidate for that office, or attaches or opposes a candidate for that office (regardless of whether the communication expressly advocates a vote for or against a candidate) and which also is suggestive of no plausible meaning other than an exhortation to vote for or against a specific candidate.

Id. § 201(f)(3)(A)(ii).

Corporations and labor unions are prohibited by FECA from making contributions or expenditures with respect to a candidate in a federal election.[114] The prohibition on corporate campaign activity survived scrutiny under the First Amendment on the basis of Congress's compelling interest in ensuring "that substantial aggregations of wealth amassed by the special advantages which go with the corporate form of organization . . . not be converted into political 'war chests' which could be used to incur political debts from legislators who are aided by the contributions."[115] In *First National Bank of Boston v. Bellotti,*[116] however, the Court limited this rationale to corporate contributions to political candidates.[117] The Court was not willing to find the same compelling interest in broadly protecting the election process and struck down a Massachusetts statute that restricted corporate expenditures in an initiative campaign.[118]

The FECA limitation on corporate campaign expenditures does not prevent corporations and unions from participating in elections as active players. None of the FECA limitations reaches speech that is not "express advocacy."[119] Corporations and labor unions are thus unrestrained in their ability to inform on issues, whether or not the issue is identified with a

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114. 2 U.S.C. § 441b(a) (2001). National banks and corporations organized under the authority of a law of Congress are prohibited from making contributions or expenditures in any election for any political office, including state and local elections. 11 C.F.R. § 114.2(a) (2001). Other corporations and labor unions are prohibited from making contributions and expenditures in connection with elections of candidates for federal office. *Id.* § 114.2(b). A labor organization is an organization, committee, or plan in which employees participate for the purpose of dealing with employers concerning work conditions. 2 U.S.C. § 441b(b)(1); 11 C.F.R. § 114.1(d). An incorporated association of volunteer members is not subject to these limitations. Fed. Election Comm'n v. Mass. Citizens for Life, Inc., 479 U.S. 238, 252-55 (1986).

115. Fed. Election Comm'n v. Nat'l Right to Work Comm., 459 U.S. 197, 207 (1982). For the Court's description of the early history of restrictions on corporate political contributions, see *United States v. Int'l Union United Automobile, Aircraft & Agric. Implement Workers of Am.*, 352 U.S. 567, 570-584 (1957); see also *Mass. Citizens for Life*, 479 U.S. at 257; *Fed. Election Comm'n v. Nat'l Conservative Political Action Comm.*, 470 U.S. 480, 500-01 (1985); *Pipefitters Local Union No. 562 v. United States*, 407 U.S. 385, 416 (1972). For a discussion of these cases, see Thomas Joo, *The Modern Corporation and Campaign Finance: Incorporating Corporate Governance Analysis Into First Amendment Jurisprudence*, 79 WASH. U. L. Q. 1, 7-24 (2001).

116. 435 U.S. 765 (1977).

117. *See generally id.*

118. *Id.* at 789-90.

119. *See id.* at 784.

> We thus find no support in the First or Fourteenth Amendment, or in the decisions of this Court, for the proposition that speech that otherwise would be within the protection of the First Amendment loses that protection simply because its source is a corporation that cannot prove, to the satisfaction of a court, a material effect on its business property.

Id.

candidate. In addition, the FECA itself expressly provides additional outlets for corporate and labor union participation in elections.[120]

Corporate and labor union contributions and expenditures subject to FECA are broadly defined to include any direct or indirect transfers of money, services, or anything of value to any candidate, campaign committee, political party or organization in connection with an election.[121] The definition is substantially modified with exceptions. Forbidden contributions or expenditures do not include "communications by a corporation to its stockholders and executive or administrative personnel and their families" (the "restricted class") on any subject, including express advocacy for a candidate and election related coordination with candidates and political committees.[122] Similarly, labor unions are permitted communications to members and their families on any subject.[123] These communications are subject to reporting to the Federal Election Commission.[124] Regulations permit communications by corporations and labor unions to their restricted classes to include candidate endorsements that may be accompanied by a public announcement of the endorsement with a press release and press conference.[125] Corporations and labor unions also are permitted to arrange for meetings at which a candidate may address stockholders, executive administrative personnel and/or members.[126] In addition, corporations may undertake "nonpartisan" get-

120. 2 U.S.C. § 441b (2001); *see also* 11 C.F.R. § 114 (2001).

121. 2 U.S.C. § 441b(b)(2) (2001); *see also* 11 C.F.R. § 114.1(a)(1).

122. 11 C.F.R. §§ 114.1(a)(2)(i), 114.3(a)(1). These communications may be made to a "restricted class" consisting of the stockholders and executive administrative personnel, and their families, of a corporation and its subsidiaries, branches and divisions. *Id.* § 114.1(j). Executive and administrative personnel are salaried employees who have policymaking, managerial, professional, or supervisory responsibilities. *Id.* § 114.1(c). A stockholder is a person with a present beneficial interest in stock who has the power to vote the stock if it is voting stock, and has the right to receive dividends. *Id.* § 114.1(h). The communication must reflect the views of the corporation or labor union and cannot be a re-publication of materials prepared by candidates. *Id.* § 114.3(c)(1)(ii). The permitted communications include operation of phone banks to encourage members of the restricted class to register to vote, to vote for particular candidates, and to register for a particular party. *Id.* § 114.3(c)(3).

123. *Id.* §§ 114.1(a)(2)(i), 114.3(a)(1). The restricted class of a labor union to whom unlimited communication is permissible includes members, executive and administrative personnel, and their families. *Id.* § 114.1(j). A member is a person who has satisfied requirements for membership in an organization, who has accepted the organization's invitation to become a member, and who has some significant connection with the organization such as a financial commitment, paying dues, or who has a significant organizational commitment. *Id.* § 114.1(e)(2).

124. *Id.* §§ 100.8(b)(4), 114.3(c).

125. *Id.* § 114.4(c)(6). Expenditures for the press release and press conference must be "de minimis" and may not be coordinated with a candidate. *Id.*

126. *Id.* § 114.3(c)(2)(i). The corporation or labor organization is not required to offer the same opportunity to other candidates in the election. *Id.* However, if a corporation arranges for a meeting with employees beyond the restricted class, other candidates for the same office must be

out-the-vote campaigns aimed at stockholders and executive administrative personnel, and their families.[127] Labor unions also may undertake nonpartisan get-out-the-vote campaigns focused on members, executive and administrative personnel, and their families.[128]

The most significant corporate and labor union political activity falls under the provision allowing corporations and labor unions to maintain a "separate segregated fund to be utilized for political purposes."[129] These funds are also referred to as political action committees (PACs).[130] The corporation or labor union solicits voluntary contributions from stockholders, employees, and/or members.[131] Amounts expended by a corporation or labor union in the establishment and administration of a separate segregated fund, and amounts expended in soliciting contributions to a fund, are not treated as contributions or political expenditures.[132] The separate segregated fund may be controlled by the establishing corporation or labor union.[133] A separate segregated fund is a multicandidate political committee subject to FECA contribution limitations and disclosure

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given a similar opportunity if requested. *Id.* § 114.4(b)(1)(i)-(iii). In addition, the corporation or labor union must refrain from express advocacy at a meeting that includes persons other than members of the restricted class. *Id.* § 114.4(b)(1)(v), (2)(ii).

127. *Id.* § 114.1(a)(2)(ii). This activity may also include express advocacy. *Id.* § 114.3(c)(4).

128. 2 U.S.C. § 441b(b)(2)(B) (2001). The regulations permit express advocacy for particular candidates or parties as part of a get-out-the-vote campaign. 11 C.F.R. § 114.3(c)(4) (2001). Get-out-the-vote drives that are aimed at the general public can neither include express advocacy nor be coordinated with a candidate. *Id.* § 114.4(d)(1)-(2).

Contributions and expenditures by corporations and labor unions also do not include sales of food and beverages by a corporate vendor at cost if the value provided to a candidate for an election does not exceed $1,000, or to a party or political committee $2,000 in a calendar year. *Id.* § 114.1(a)(2)(v). Payments for legal and accounting services for a political committee or party are not treated as expenditures as long as the services are not attributable to activities that directly further the election of a designated candidate. *Id.* § 114.1(a)(2)(vi)–(vii). Corporations and labor unions may also make unlimited contributions to a national or state political party for the purpose of defraying the costs of construction or purchase of an office facility that is not acquired for the purpose of influencing the election of any candidate for federal office. *Id.* § 114.1(a)(2)(ix). These contributions are subject to reporting requirements. *Id.* § 114.1(a)(2)(ix).

129. 2 U.S.C. § 441b(b)(2).

130. For an analysis of the development of PACs and their growing influence, see generally ANTHONY CORRADO, CREATIVE CAMPAIGNING: PACS AND THE PRESIDENTIAL SELECTION PROCESS (1992); THOMAS GAIS, IMPROPER INFLUENCE: CAMPAIGN FINANCE LAW, POLITICAL INTEREST GROUPS, AND THE PROBLEM OF EQUALITY (1996); FRANK J. SORAUF, INSIDE CAMPAIGN FINANCE: MYTHS AND REALITIES (1992).

131. See 11 C.F.R. § 114.5(a)(1) for regulations prohibiting reprisals, negative actions, or threats to induce contributions. No more than two solicitations per year may be made from persons other than stockholders, executive administrative personnel, and members. 2 U.S.C. § 441b(b)(4)(B); 11 C.F.R. § 114.6.

132. 2 U.S.C. § 441b(b)(2)(c); 11 C.F.R. § 114.1(a)(2)(iii).

133. 11 C.F.R. § 114.5(d).

requirements.[134] Such a fund is limited to contributions of $5,000 per election to a candidate for federal office, $15,000 during the calendar year in the aggregate to a national party political committee and the House and Senate campaign committees, and $5,000 during the calendar year to any other political committee.[135] Individual contributions to a PAC are limited to $5,000 in a calendar year.[136] Trade associations also are permitted to establish a separate segregated fund based on contributions from the stockholders and executive administrative personnel of corporations that are members of the trade association and their families.[137]

By its terms, the prohibition on corporate political activity applies to incorporated nonprofit organizations. However, in *Federal Election Commission v. Massachusetts Citizens for Life, Inc.*,[138] the Supreme Court held that the prohibition could not be imposed on a voluntary nonprofit political organization.[139] The Court noted that the limitation on corporate political expenditure was justified as a restriction on the "corrosive influence of concentrated corporate wealth" that can be aggregated as a result of special advantages which go with the corporate form of organization.[140] In the Court's view, the potential unfair deployment of accumulated corporate capital was not present in the case of a voluntary nonprofit advocacy organization for which the availability of resources is dependent upon the popularity of its ideas.[141] The Court stressed the voluntary nature of the association that permits any individual who disagrees with its positions to withdraw support without suffering collateral consequences.[142] At the conclusion of its majority opinion, the Court identified three features that distinguish a nonprofit advocacy organization from a corporation that is constitutionally subject to FECA's prohibition on political expenditures: (1) the organization is formed for the purpose of promoting political ideas and cannot engage in business

134. *Id.* § 114.5(e)-(f).

135. 2 U.S.C. § 441a(a)(2).

136. *Id.* § 441a(a)(1)(C).

137. *Id.* § 441b(b)(4)(D). A trade association may solicit contributions from the stockholders and executives of a member corporation only if the corporation approves the solicitation. *Id.* A corporation is permitted to approve solicitation by only one trade association in any calendar year. *See* 11 C.F.R. § 114.8(c).

138. 479 U.S. 238 (1986).

139. *Id.* at 239.

140. *Id.* at 257. The Court indicates that the availability of corporate resources for political activity are a reflection of the corporation's economic success, rather than a reflection of the power of its advocacy, and reflects the economically motivated decisions of investors and customers. *Id.* at 258.

141. *Id.* at 259.

142. *Id.* at 260-61. This is distinguishable from the case of a for-profit corporation or labor union in which withdrawal from the organization has consequences beyond disassociation with the organization's political advocacy. *Id.* at 260.

activities,[143] (2) the organization has no shareholders or other persons who would have a claim on its earnings or assets, and (3) the organization is not established by a corporation or labor union and cannot, therefore, be used as a conduit for the type of direct spending that is constitutionally prohibited.[144]

The three features of a nonprofit political organization enumerated in *Federal Election Commission v. Massachusetts Citizens for Life, Inc.* were pivotal in *Austin v. Michigan Chamber of Commerce*[145] in which the Court upheld a State of Michigan prohibition on direct campaign expenditure by an incorporated chamber of commerce.[146] Unlike the organization involved in *Massachusetts Citizens for Life*, the Michigan Chamber of Commerce was organized for a variety of purposes in addition to its political goals.[147] Because the members of the Chamber derived benefits from the association beyond its political goals, withdrawal from the organization in disagreement with the Chamber's political positions would entail the loss of non-political benefits.[148] The Court concluded that the Chamber's members were thus more similar to corporate shareholders than to the members of Massachusetts Citizens for Life, Inc.[149] Finally, the Chamber largely was financed by corporate contributions.[150] Thus, the Chamber could serve as a conduit for the political expenditures of corporations that were otherwise constitutionally subject to limitation.[151] As a consequence, unlike incorporated political associations, broader based incorporated associations such as trade organizations, chambers of commerce, and others, are limited by FECA in their ability to make direct contributions.[152]

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143. *Id.* at 264. The opinion states that, "If political fundraising events are expressly denominated as requests for contributions that will be used for political purposes, including direct expenditures, these events cannot be considered business activities." *Id.*

144. *Id.*

145. 494 U.S. 652 (1990).

146. *Id.* at 657-58. The Michigan statute permitted corporations to make political expenditures through a separate segregated fund. *Id.* at 655 (citing MICH. COMP. LAWS § 169.255(1) (1979)).

147. *Id.* at 662.

148. *Id.* at 663.

149. *Id.*

150. *Id.* at 664.

151. *Id.*

152. *See generally id. But see* Jill E. Fisch, *Frankenstein's Monster Hits the Campaign Trail: An Approach to Regulation of Corporate Political Expenditures*, 32 WM. & MARY L. REV. 587, 589 (1991) (asserting that *Austin v. Michigan Chamber of Commerce* is an "unjustified departure" from case law holding that individual and corporate campaign expenditures are protected speech). The McCain-Feingold Bill would exclude from the definition of campaign expenditures subject to the prohibition any communication by an organization exempt from tax under sections 501(c)(4) or 527(e)(1) of the Internal Revenue Code if the communication is paid for from funds provided by individuals who are United States citizens or lawful permanent residents. S. 27, 107th Cong. § 203(b) (as passed by the Senate Apr. 2, 2001) (adding 2 U.S.C. § 441(c)(2)).

In summary, the restrictions on the regulation of campaign finance reflect the Supreme Court's rejection under the First Amendment of governmental intrusion into the campaign process. *Buckley* treats restrictions on expenditures as an unconstitutional restraint on the quantity of speech that is protected by the First Amendment. Only limitations on contributions to a candidate or candidate organization may be restricted under a compelling state interest to prevent corruption or the appearance of corruption in the electoral process. Independent expenditures of individuals advocating the election or defeat of a candidate that are not coordinated with the candidate are not subject to governmental regulation, although they are subject to disclosure. No public disclosure requirements apply to communications that do not "expressly" advocate the election or defeat of an identified candidate.

II. TAX SUBSIDIES AND REGULATION OF POLITICAL ACTIVITY

A. *Permissible Limitations on Federal Income Tax Subsidies for Political Advocacy*

The principal cases addressing the role of income taxes in campaign activity reflect a restraint on governmental participation in election advocacy that is consistent with limitations on the regulation of campaign finance, but broader in scope. *Cammarano v. United States*[153] is the seminal authority in this area. *Cammarano* involved the consolidated cases of taxpayers who claimed business expense deductions[154] for contributions to funds maintained by trade associations for the purpose of defeating proposed state initiatives.[155] The taxpayers in both cases were in the business of selling alcoholic beverages and faced state-wide initiatives that would have terminated their businesses.[156] In *Cammarano,* the taxpayers were partners engaged in the wholesale distribution of beer in the state of Washington.[157] The partnership contributed money to the Washington Beer Wholesalers Association, which maintained a trust fund for the defeat of an initiative measure that would have placed the retail sale of wine and beer in the hands of the State.[158]

153. 358 U.S. 498 (1959).

154. I.R.C. § 162(a) (2001) allows a deduction for ordinary and necessary expenses incurred in the conduct of a trade or business. The deductions in *Cammarano* were claimed under the predecessor to section 162 in the 1939 Code, 26 U.S.C. § 23(a)(1)(A). *Id.* at 501.

155. *Id.*

156. *Id.* at 501-02.

157. *Id.* at 500.

158. Cammarano v. United States, 246 F.2d 751, 751 (9th Cir. 1957).

In *F. Strauss & Son, Inc. v. Commissioner*,[159] the companion case, the taxpayer was a corporation engaged in the wholesale liquor business in Arkansas.[160] The taxpayer contributed money to the Arkansas Legal Control Associates, which was formed for the purpose of defeating an initiative that would have imposed statewide prohibition of alcoholic beverages.[161] Both taxpayers claimed the contributions as ordinary and necessary business expenses incurred to preserve their respective businesses, which would have been lost had the proposed initiatives been enacted.[162]

Treasury regulations in effect for the taxable years at issue in *Cammarano* prohibited business expense deductions for expenditures incurred "for lobbying purposes, the promotion or defeat of legislation, [or] the exploitation of propaganda."[163] The Court in *Cammarano* first concluded that the regulations applied to deny deductions for expenses incurred for the purpose of influencing an initiative plan,[164] then addressed the taxpayers' principal argument that the regulations were invalid because they contradicted statutory language that allowed deductions for all of the ordinary and necessary expenses incurred in the course of a trade or business.[165] The Court noted that the words "ordinary and necessary" suffer from sufficient ambiguity to warrant an interpretive regulation.[166] The Court pointed to the regulations as constituting a "sharply defined national policy" that had acquired the "force of law" by virtue of Congress's continued re-enactment of the statutory language with the interpretative gloss of the regulations.[167] The Court described the public policy goal of the regulations by quoting Justice Learned Hand, who wrote in *Slee v. Commissioner*[168] that "political agitation as such is outside the

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159. 251 F.2d 724 (8th Cir. 1958).

160. *Id.*

161. *Id.* at 724-25.

162. *Id.* at 725, 727.

163. *Cammarano*, 358 U.S.at 499-500 (quoting Treas. Reg. §§ 29.23(o)-1, .23 (q)-1 (1954) (applicable to individuals and corporations respectively)). The same rules currently are found in section 162(e) of the Code. Regulations similar to the Treasury Regulations at issue in *Cammarano* had been in place since 1918. *Id.* at 502-03, 504 n.6.

164. *Id.* at 504-07.

165. *Id.* at 507-08.

166. *Id.* at 508.

167. *Id.* at 508-12. Several commentators question the existence of a clearly defined public policy at the time. *See, e.g.*, Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities*, 71 TEX. L. REV. 1269, 1285 (1993); Dean E. Sharp, *Reflection on the Disallowance of Income Tax Deductions for Lobbying Expenditures*, 39 B.U. L. REV. 365, 379 (1959); George Cooper, *The Tax Treatment of Business Grassroots Lobbying: Defining and Attaining the Public Policy Objectives*, 68 COLUM. L. REV. 801, 808-10 (1968).

168. 42 F.2d 184 (2d Cir. 1930).

statute, however innocent the aim. . . . Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them."[169] The Court elaborated its view of that clearly defined policy in its discussion of the taxpayers' argument that denial of the deduction for their initiative campaign expenditures violated their First Amendment rights by restricting their ability to advocate their opinions.[170] The Court's brief analysis of this assertion speaks volumes about the proper role of federal income tax rules in the context of campaign finance.

> 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 under the provisions of the Internal Revenue Code. Nondiscriminatory denial of deduction from gross income to sums expended to promote or defeat legislation is plainly not "aimed at the suppression of dangerous ideas." Rather it appears to us to express a determination by Congress that since purchased publicity can influence the fate of legislation which will affect, directly or indirectly, all in the community, everyone in the community should stand on the same footing as regards its purchase so far as the Treasury of the United States is concerned.[171]

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169. *Cammarano*, 358 U.S. at 512 (quoting *Slee*, 42 F.2d at 185).

170. *Id.* at 512-13.

171. *Id.* at 513 (citation omitted). Justice Douglas's concurring opinion is interesting in this regard. *Id.* (Douglas, J., concurring). Justice Douglas asserted that the First Amendment was equally applicable to business speech. *Id.* at 514 (Douglas, J., concurring). "A protest against government action that affects a business occupies as high a place." *Id.* Justice Douglas added that,

> Deductions are a matter of grace, not of right. To hold that this item of expense must be allowed as a deduction would be to give impetus to the view favored in some quarters that First Amendment rights must be protected by tax exemptions. But that proposition savors of the notion that First Amendment rights are somehow not fully realized unless they are subsidized by the State. Such a notion runs counter to our decisions, and may indeed conflict with the underlying premise that a complete hands-off policy on the part of government is at times the only course consistent with First Amendment rights.

Id. at 515 (Douglas, J., concurring) (citations omitted). In *Haswell v. United States*, 500 F.2d 1133, 1148 (Ct. Cl. 1974), the court commented on the holding of *Cammarano* by pointing out that "[t]he exercise of the freedom of speech is not free from taxation. Writers, speakers, newspapers, and similar individuals and organizations whose principal activities frequently directly involve first amendment rights are all subject to nondiscriminatory taxation on their incomes."

In *Regan v. Taxation with Representation*,[172] a post-*Buckley* Supreme Court addressed the idea expressed in *Cammarano* that public policy justifies restrictions on tax benefits that provide a government subsidy to political activity.[173] Taxation with Representation (TWR) was a charitable organization exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code.[174] Exemption under section 501(c)(3) meant not only that TWR was exempt from tax on its own income, but also that contributions to the organization were deductible from the contributor's income.[175] Part of the price for exemption under section 501(c)(3) is compliance with the statutory prohibition that no substantial part of the activities of the organization involve "carrying on propaganda, or otherwise attempting, to influence legislation."[176] TWR, as a tax-exempt charity, claimed that the statutory limitation on its lobbying activities violated its rights to free speech under the First Amendment.[177]

The Court's rejection of TWR's First Amendment claim began with the explicit proposition that, "[b]oth tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system."[178] The Court explained that a tax exemption is equivalent to a cash grant to the organization in the amount of tax that the organization would otherwise pay on its income.[179] A tax deduction is the equivalent of a cash grant of a portion of the contributor's contributions.[180] The Court noted the distinction applied in the application of these subsidies between politically active public welfare organizations and charitable organizations.[181] Public welfare organizations that are exempt from tax under section 501(c)(4) of the Internal Revenue Code are permitted to lobby.[182] Contributions to these organizations are not deductible by the contributor.[183] To claim the

172. 461 U.S. 540 (1983).

173. *Id.* at 546-47.

174. *Id.* at 543.

175. I.R.C. § 170(c)(2) (2001); *see also Regan*, 461 U.S. at 543.

176. I.R.C. § 501(h) (2001). This language prohibits activities proposing, supporting, or opposing legislation. Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) (2001). Section 501(h) permits a limited amount of lobbying and other political activity, but subject to the excise tax of section 4911. *See infra* note 320 and accompanying text.

177. *Regan*, 461 U.S. at 545.

178. *Id.* at 544.

179. *Id.*

180. *Id.* Some would argue that these tax benefits are not subsidies because tax exemption or disallowance of deductions may be provided for reasons of simplicity or because the measurement of income would otherwise be difficult. *See, e.g.*, Galston, *supra* note 167, at 1288. However, whether Congress intends a subsidy or not, eliminating the cost of tax liability on income reduces the cost of doing business for the exempt taxpayer and thereby provides an important tax benefit.

181. *Regan*, 461 U.S. at 543.

182. *Id.*

183. *Id.*

additional subsidy provided by allowing a deduction of contributions, the organization must forego participation in political activities, including lobbying.[184] The Court thus states, "In short, Congress chose not to subsidize lobbying as extensively as it chose to subsidize other activities that nonprofit organizations undertake to promote the public welfare."[185]

Having identified both the tax-exemption and deduction for charitable contributions as subsidies, the Court in *Regan* rejected TWR's claim that denial of the subsidy to contributions because of TWR's exercise of its right to political advocacy infringed TWR's First Amendment rights.[186] The Court recognized that the government cannot deny a benefit to a person because of the exercise of a constitutional right.[187] However, the Court concluded,

> The Code does not deny TWR the right to receive deductible contributions to support its nonlobbying activity, nor does it deny TWR any independent benefit on account of its intention to lobby. Congress has merely refused to pay for the lobbying out of public moneys. This Court has never held that Congress must grant a benefit such as TWR claims here to a person who wishes to exercise a constitutional right.[188]

Referring to *Cammarano,* the Court expressly rejected the "notion that First Amendment rights are somehow not fully realized unless they are subsidized by the State."[189]

Identification of the tax provisions as a subsidy also framed the Court's rejection of TWR's assertion that allowing lobbying by veterans'

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184. The term "political activities" is used broadly here. The distinctions between activities permitted to a tax-exempt charity and prohibited political activity is not clear. *See infra* note 297 and accompanying text.

185. *Regan*, 461 U.S. at 544.

186. *Id.* at 545.

187. *Id.*; *see also* Perry v. Sindermann, 408 U.S. 593, 597 (1972) (finding that the refusal to renew a teacher's contract because of speech critical of the college governing board may have violated a contractual expectation interest in re-employment and may require a hearing); Speiser v. Randall, 357 U.S. 513, 529 (1958) (holding that denying a property tax exemption to a person who refused to sign a declaration that he did not advocate the forcible overthrow of the Government of the United States was an unconstitutional penalty for certain forms of speech).

188. *Regan*, 461 U.S. at 545.

189. *Id.* at 546 (quoting Cammarano v. United States, 358 U.S. 498, 515 (1959) (Douglas, J., concurring)); *see also supra* note 171. Many commentators disagree and suggest that the statutory restraint on lobbying and intervention in political campaigns denies First Amendment guarantees. *See, e.g.*, Anne Berrill Carroll, *Religion, Politics, and the IRS: Defining the Limits of Tax Law Controls on Political Expression by Churches*, 76 MARQ. L. REV. 217, 218-19 (1992); Laura Brown Chisolm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 GEO. WASH. L. REV. 308, 327 (1989); Joseph S. Klapach, Note, *Thou Shalt Not Politic: A Principled Approach to Section 501(c)(3)'S Prohibition of Political Campaign Activity*, 84 CORNELL L. REV. 504, 542 (1999).

organizations, which are tax-exempt charitable organizations to which deductible contributions may be made,[190] while denying the ability to lobby to other tax-exempt charities, is an unreasonable classification that violates Due Process Clause of the Fifth Amendment.[191] The Court noted the general proposition that statutory classifications are subject to strict scrutiny if they interfere with the exercise of a fundamental right.[192] The Court added, however, that "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes."[193] The Court rejected the view that strict scrutiny is required "whenever Congress subsidizes some speech, but not all speech."[194] Analogizing tax subsidies to appropriations,[195] the Court noted that "Congressional selection of particular entities or persons for entitlement to this sort of largesse 'is obviously a matter of policy and discretion not open to judicial review unless in circumstances which here we are not able to find.'"[196]

The majority opinion in *Regan* does not distinguish between the tax subsidy provided by tax exemption and the tax subsidy provided by the contributors' claim to deduction of contributions to a section 501(c)(3) organization.[197] The majority did note, however, that TWR could obtain tax-deductible contributions for its non-lobbying activity by separating its

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190. I.R.C. § 501(c)(19) (2001).

191. *Regan*, 461 U.S. at 546-47.

192. *Id.* at 547 (citing Harris v. McRae, 448 U.S. 297, 322 (1980)).

193. *Id.* The Court quoted at length from *Madden v. Kentucky*, 309 U.S. 83, 87-88 (1940), which said in part that "in taxation, even more than in other fields, legislatures possess the greatest freedom in classification. . . . [T]he presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes." *Id.*

194. *Id.* at 548. The Court explains that,

> Congress could, for example, grant funds to an organization dedicated to combating teenage drug abuse, but condition the grant by providing that none of the money received from Congress should be used to lobby state legislatures. Under *Cammarano*, such a statute would be valid. Congress might also enact a statute providing public money for an organization dedicated to combating teenage alcohol abuse, and impose no condition against using funds obtained from Congress for lobbying. The existence of the second statute would not make the first statute subject to strict scrutiny.

Id. at 548-49.

195. *Id.* at 549. "For purposes of these cases appropriations are comparable to tax exemptions and deductions, which are also 'a matter of grace [that] Congress can, of course, disallow . . . as it chooses.'" *Id.* (quoting Comm'r v. Sullivan, 356 U.S. 27, 28 (1958)).

196. *Id.* at 549 (quoting United States v. Realty Co., 163 U.S. 427, 444 (1896)).

197. *Id.* at 544.

political activity into a separate section 501(c)(4) public welfare organization that is not funded by tax-deductible contributions.[198]

The opportunity to create a tax-exempt entity under section 501(c)(4) to undertake political activity was pivotal to the Justices who signed the concurring opinion.[199] The concurring opinion interprets section 501(c)(3) as a denial of a benefit to a person who exercises a constitutional right to lobby, adding that the provision deprives an otherwise eligible organization of both its tax exemption and its ability to receive tax-deductible contributions for all of its activities whenever one of its activities involves lobbying.[200] The concurring opinion finds that the defect is remedied by the presence of section 501(c)(4) which permits the exempt organization to form a separate tax-exempt entity for its lobbying activities.[201] The concurring Justices find a congressional purpose to ensure that tax-deductible contributions are not used for lobbying which is satisfied by the separate accounting required of separate section 501(c)(3) and section 501(c)(4) organizations.[202]

The distinction drawn in the concurring opinion is anomalous. As described in the majority opinion, both the tax exemption and the contributors' deductions are tax subsidies to a qualified organization.[203] The concurring opinion does not identify any distinction between the two subsidies that would support different treatment, but suggests that Congress has the power to withhold one of the subsidies, but not both.[204] The concurring opinion confuses the benefit of tax subsidies to political activity with a prohibition on the ability of an organization to exercise its First Amendment entitlement to free speech. The ability to speak through a tax-exempt section 501(c)(4) organization, thereby obtaining some tax subsidy for political activities, ought not to be considered an entitlement under the First Amendment. There is no prohibition on speech as long as the tax system does not deprive an exempt organization of an outlet for its political expression. But, as the majority states in *Regan,* "[t]his Court has never held that the court must grant a benefit . . . to a person who wishes to exercise a constitutional right."[205] The view of the concurring opinion

198. *Id.*

199. *Id.* at 551 (Blackmun, J., concurring). This opinion was joined by Justices Brennan and Marshall.

200. *Id.* at 552 (Blackmun, J., concurring).

201. *Id.* at 552-53 (Blackmun, J., concurring).

202. *Id.* at 553 (Blackmun, J., concurring). The concurring opinion here cites a footnote of the majority opinion out of context to assert that the majority opinion reflects this sentiment. *Id.* at 545 n.6. The text of the majority opinion asserts the broader proposition that "Congress has merely refused to pay for the lobbying out of public moneys." *Id.* at 545.

203. *Id.* at 544.

204. *Id.* at 553 (Blackmun, J., concurring).

205. *Id.* at 545.

can be accommodated with recognition of the ability of a tax-exempt section 501(c)(3) charitable organization to establish a separate entity, whether taxable or not, outside of section 501 to separate its political advocacy from tax subsidized activities.[206] In that event, the charitable organization would not lose its First Amendment entitlement to unrestricted speech, it simply would be required to undertake its political activity without a public subsidy in the form of tax exemptions. As discussed in the next part, however, the Internal Revenue Code provides for a good deal of tax subsidy to political speech.

B. *Campaign Finance Organizations Under the Internal Revenue Code*

One of the facts of life in the commercial world is that the tax law regulates virtually all forms of doing business. That is no less true with respect to campaign finance, in which the Internal Revenue Code and Treasury Regulations influence the organizational structure and activities of political organizations. The scope of the Internal Revenue Code's involvement with political expenditure is striking.

This part explores the parameters of various applicable sections of the Internal Revenue Code, particularly the provisions of section 501 that contain rules for tax-exempt entities. Part III of the Article explores the application of these provisions in combination with FECA in the operation of campaign expenditures.

1. Income and Deductions with Respect to Political Activity

Gross income generally includes all economic benefits clearly realized over which the taxpayer has dominion and control.[207] This broad definition

206. *See* Fed. Communications Comm'n v. League of Women Voters of Cal., 468 U.S. 364, 399-400 (1984). The Court held, under the authority of the concurring opinion in *Regan*, that First Amendment rights are abridged by a condition on a government subsidy (e.g., support for the Corporation on Public Broadcasting) that barred speech in the absence of an alternative outlet for the speech. *Id.* The statute at issue barred all editorial commentary by radio stations receiving funds from the federally funded Corporation for Public Broadcasting. *Id.* at 400. The Court indicated that under *Regan*, Congress could enact a valid scheme that would permit the noncommercial radio stations to create non-subsidized affiliates to make known their views. *Id.; see also Fed. Election Comm'n v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238, 252-53 (1986), in which the Court held that the ability to establish a separate segregated fund did not mitigate the Constitutional infirmity of 2 U.S.C. § 441b(a) as it applied to restrict campaign expenditures of an incorporated nonprofit organization. Even with a separate, segregated fund, the organization would have been precluded from using its treasury funds for campaign expenditures. *Mass. Citizens for Life*, 479 U.S. at 253. The Court added that the FECA requirements for a separate segregated fund were burdensome to an organization that made only occasional campaign expenditures. *Id.* at 252.

207. Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 433 n.11 (1955). I.R.C. § 61(a) defines gross income as "all income from whatever source derived." *Id.* (quoting I.R.C. § 62(a) (1955)).

would seem to include the economic benefit of a campaign contribution received by a candidate or political organization that it may direct to its own benefit to enhance the candidate's or organization's political aspirations. Clearly there is a benefit, measurable in monetary value, that the recipient may control to its advantage. The Internal Revenue Service ruled in Revenue Ruling 68-512,[208] however, that political campaign contributions are not income to the benefited candidate except to the extent that the candidate diverts contributions to personal use.[209] Likewise, in Revenue Ruling 74-21[210] the Service concluded that an unincorporated campaign organization, which was treated as a taxable corporation under rules prevailing at the time,[211] was not required to include campaign contributions in gross income.[212] These administrative pronouncements lack any indication of the reasons for the exclusion from income except citation to prior administrative positions.[213] However, the Internal Revenue

208. Rev. Rul. 68-512, 1968-2 C.B. 41.

209. *Id.*; *see also* Rev. Rul. 71-449, 1971-2 C.B. 77.

210. Rev. Rul. 74-21, 1974-1 C.B. 14.

211. The ruling cited regulations under section 7701 of the Code, which distinguished corporations from partnerships and trusts on the basis of specific criteria that attempted to determine whether the organization more nearly resembles a corporation. Treas. Reg.§§ 301.7701-1, 301.7701-2 (2001). Current Treasury Regulation § 301.7701-1 and § 301.7701-2 provides for classification of a "business entity" as a partnership or corporation. A "business entity" is recognized as a separate entity if there is a "joint venture or other contractual arrangement" under which "the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom." *Id.* § 301.7701-1(a)(2). Revenue Ruling 74-21, under similar language in the old regulations, stated that the criteria "do not definitively cover" unincorporated not-for-profit organizations but concluded nonetheless that the organization was to be treated as a separate entity. Rev. Rul. 74-21, 1974-1 C.B. 14. In lieu of the joint profit motive language of the regulations, the Ruling described the campaign organization as having "associates and an objective to carry on jointly, activities in furtherance of the purposes for which the organization was organized." *Id.*; *see also* Madison Gas & Elec. Co. v. Comm'r, 633 F.2d 512, 516-17 (7th Cir. 1980) (holding that joint production of goods in-kind for division among the participants met the joint profit motive test). This finding continues to be significant with respect to the current regulations. Under Treasury Regulation § 301.7701-3(a)-(b) (1967), an unincorporated separate business entity that does not elect corporate status is treated as a partnership.

212. Rev. Rul. 74-21, 1974-1 C.B. 14.

213. The first published position is I.T. 3276, 1939-1 C.B. 108, which simply states that, "it is held that a political gift received by an individual or a political organization is not taxable income to the recipient." One plausible theory is that the funds are received subject to restrictions on their use as campaign expenditures that benefit the interest of the contributor. The receipts may be viewed as trust funds not includible in the income of the candidate or recipient organization, which is merely a conduit for the funds. *See* Ford Dealers Adver. Fund, Inc. v. Comm'r, 55 T.C. 761, 773 (1971), *aff'd per curiam*, 456 F.2d 255 (5th Cir. 1972); Dri-Powr Distribs. Ass'n Trust v. Comm'r, 54 T.C. 460, 480 (1970); Angelus Funeral Home v. Comm'r, 47 T.C. 391, 397 (1967), *aff'd* 407 F.2d 210 (9th Cir. 1969). The Internal Revenue Service does not follow this line of cases. Rev. Rul. 74-318, 1974-2 C.B. 14. Legislative history to Public Law 93-625, which enacted section 527 of the Code, states that the practice presumably "resulted from the belief that virtually all of the

Service position treats as includible in income campaign contributions that have been "diverted from the channel of campaign activities and used by a [political] candidate . . . for [any] personal use."[214] Diversions requiring inclusion in income include accepting payment for specific services,[215] failure to demonstrate that contributed funds were in fact used for campaign expenditures,[216] use of funds for personal expenses,[217] use of funds for non-campaign political activities,[218] use of funds for political office expenses,[219] or the direction of campaign funds to a charitable organization.[220] Contribution of excess campaign funds to the federal government does not trigger inclusion in gross income.[221] These rules are now incorporated in section 527 of the Internal Revenue Code which exempts a political organization from tax on contributions used to support the nomination or election of persons to political office.[222]

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receipts of political organizations were from gifts." S. REP. NO. 93-1357, at 25 (1974), *reprinted in* 1975-1 C.B. 517, 531. *But see* Rev. Rul. 75-146, 1975-1 C.B. 23 (stating that contributions from constituents to a member of Congress to support the member's internship program are not treated as gifts because the contributors donated the money to obtain a "more efficient public servant"); Rev. Rul. 76-276, 1976-2 C.B. 14 (stating that contributions to a Congress member's travel fund are not gifts because the payments were made by constituents for the purpose of obtaining more effective representation). Presumably campaign contributions, at best, are motivated by a desire for more effective representation, and, at worst, the expectation of a specific quid-pro-quo.

214. Rev. Rul. 54-80, 1954-1 C.B. 11 (modifying I.T. 3276, 1939-1 C.B. 108 by adding the caveat that "any amount diverted from the channel of campaign activities and used by a candidate or other individual for personal use constitutes taxable income to such candidate or other individual for the year in which the funds are so diverted"). The inclusion rule of Rev. Rul. 54-80 found judicial support. *See, e.g.*, United States v. Jett, 352 F.2d 179, 182 (6th Cir. 1965); O'Dwyer v. Comm'r, 266 F.2d 575, 586 (4th Cir. 1959); Stratton v. Comm'r, 54 T.C. 255, 286 (1970). I.T. 3276 and Revenue Ruling 54-80 were superseded and restated in Revenue Ruling 71-449, 1971-2 C.B. 77, which similarly contained no analysis of the basis for exclusion from income. Revenue Procedure 68-19, 1968-1 C.B. 810, listed factors to be considered by the Internal Revenue Service in determining the taxability of political funds based on the rules of I.T. 3276 and Revenue Ruling 54-80. Rev. Proc. 68-19, 1968-1 C.B. 810. In essence, the Internal Revenue Service announced an administrative rule and then developed a body of internal administrative law interpreting the rule. *See, e.g.*, Gen. Couns. Mem. 35,809 (May 7, 1974); Gen. Couns. Mem. 35,914 (July 22, 1974); Gen. Couns. Mem. 36,856 (Sept. 21, 1976).

215. Reichert v. Comm'r, 19 T.C. 1027, 1039 (1953), *aff'd* 214 F.2d 19 (7th Cir. 1954).

216. *O'Dwyer*, 266 F.2d at 588.

217. *Jett*, 352 F.2d at 183.

218. Gen. Couns. Mem. 35,914 (July 22, 1974).

219. Gen. Couns. Mem. 35,809 (May 7, 1974).

220. Gen. Couns. Mem. 36,856 (Sept. 21, 1976). The income inclusion may be accompanied by a deduction for the charitable contribution. *Id.*

221. Rev. Rul. 74-22, 1974-1 C.B. 16.

222. I.R.C. § 527(e)(2) (2001).

Section 527 of the Internal Revenue Code, enacted in 1974,[223] is a multifaceted provision that both exempts certain receipts from gross income and provides tax-exempt status to political organizations and political funds of taxable and tax-exempt organizations.[224] On the income side, section 527 imposes the income tax at the highest corporate rate on the taxable income of a political organization.[225] Income, however, is determined by excluding the organization's "exempt function income,"[226] which includes contributions, membership dues, and the proceeds from political entertainment events and sales of campaign materials that are used for the purpose 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."[227] As a consequence, only the organization's investment income and capital gains are subject to tax with an allowance for the expenses incurred to produce these sources of income.[228] An individual candidate's campaign fund is treated as a political organization as long as the fund is segregated from the individual's other assets.[229] Section 527 also clarifies the prior administrative law by providing that income treated as diverted to a candidate, and thereby includible in the candidate's gross income, does not include amounts contributed to another section 527 political organization,[230] a public charity, or the United States or state or local government.[231] Expenditures that personally benefit the candidate remain includible in the candidate's gross income.[232] However, the

223. H.R. 421, 93d Cong. § 10 (1975). The provision was inserted by the Senate Finance Committee into an act to amend Tariff Schedules of the United States to permit the importation free of duty of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins. H.R. 421, 93d Cong. (1975).

224. *See generally* I.R.C. § 527 (2001).

225. *Id.* § 527(b)(1). A political organization designated by a candidate for Congress as the candidate's principal campaign committee is subject to tax at regular rates instead of the highest corporate rate. *Id.* § 527(h)(1).

226. *Id.* § 527(c)(1)(B); *see supra* text accompanying notes 213-21 (discussing the tax-exempt status of political organizations).

227. I.R.C. § 527(e)(2).

228. *See* Treas. Reg. § 1.527-4 (1980); S. REP. NO. 93-1357, at 28 (1974), *reprinted in* 1975-1 C.B. 517, 533. Similarly, section 527(f) imposes a tax on tax-exempt organizations that derive their exemption from section 501(a) to the extent of expenditures for "exempt function" activities out of net investment income. I.R.C. § 527(f). The provision is intended to put political expenditures of other tax-exempt organizations on an equal footing with § 527 organizations. S. REP. NO. 93-1357, at 29.

229. Treas. Reg. § 1.527-2(a), (b)(1) (1980).

230. I.R.C. § 527(g)(1). This provision allows an incumbent to share his or her fund-raising success with other politicians thereby enhancing the political power of the incumbent. *See id.*

231. *Id.* § 527(d); *see also* Treas. Reg. § 1.527-5(b) (1980).

232. Treas. Reg. § 1.527-5(a). The Internal Revenue Service also ruled that wages paid to the candidate are exempt function income under section 527 as long as the compensation is reasonable

legislative history indicates that incidental expenses, such as self improvement courses "for the primary purpose of benefiting the candidate directly in connection with his campaign are not to be treated as amounts diverted for the personal benefit of the candidate."[233] The legislative history also indicates that payment of the candidate's "transition" expenses is not gross income to the candidate.[234] In addition, section 527(g) treats a newsletter fund maintained by an office holder or candidate as a political organization.[235] This provision permits the office holder or candidate to maintain a separate vehicle for raising tax-exempt contributions to communicate to voters and constituents.[236] The stated purpose of the provision is to avoid distortions in an office holder's income that would increase the person's adjusted gross income for various percentage limits that affect such things as deductions for medical expenses, casualty losses, and various phase-out provisions, and to prevent the office holder from recognizing income in years in which the receipts exceed the cost of producing the newsletter.[237] Finally, a 1988 amendment to section 527(e)(2) adds that payment by a section 527 political organization of an office holder's ordinary and necessary expenses incurred in the course of the office holder's political employment is not includible in the office holder's gross income.[238] Thus, an exempt political organization may be used to support the office holder's political operations.[239]

While section 527 frees the income of political organizations from the burden of tax, limitations on deductions for political expenditures by others insure that money flowing into the political system is derived from

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and reported as wages. Priv. Ltr. Rul. 95-16-006 (Jan. 10, 1995).

233. S. REP. NO. 93-1357, at 31; *see also* Treas. Reg. § 1.527-2(c)(5)(ii)-(iv).

234. S. REP. NO. 93-1357, at 31.

235. I.R.C. § 527(g)(1).

236. *See id.*

237. S. REP. NO. 93-1357, at 31-32.

238. H.R. 4333, 100th Cong. § 1001(b)(3)(B) (1988). The last sentence of section 527(e)(2) provides that exempt function income "includes the making of expenditures relating to [a political] office . . . which, if incurred by the individual, would be allowable as a deduction under section 162(a)." I.R.C. § 527(e)(2). The purpose of this provision is to conform the treatment of political office holders with respect to reimbursements from a political organization with provisions that allow an employee to disregard business expenses reimbursed by an employer. The provision does permit a section 527 political organization to make substantial contributions to an office holder for the maintenance of staff, travel, and other office expenses limited only by the requirement that the expenses would be deemed to be ordinary and necessary business expenses of the office holder. *See* I.R.C. § 527(e)(2).

239. Rev. Rul. 87-119, 1987-2 C.B. 151 (permitting the use of contributions to give an election night party for campaign workers and to provide reasonable cash awards to campaign workers). However, before the 1988 amendment to section 527(e)(2), excludible exempt function expenditures did not include the cost of sandwiches for office staff working on legislative issues. *Id.*

after-tax funds.[240] Section 162(e) of the Internal Revenue Code bars deduction of any expense incurred in connection with influencing legislation (lobbying), involvement in political campaigns, attempts to influence the general public with respect to elections, legislation or political matters, and communications with certain senior officials in the executive branch.[241] Deductions are permitted for expenses incurred in legislative activities addressed to local governmental entities in the ordinary course of the taxpayer's trade or business.[242] Although the current version of section 162(e) generally is as comprehensive in its limitations as the regulations at issue in *Cammarano*,[243] section 162(e) originally was added to the Code in the Revenue Act of 1962 to expand allowable deductions by permitting a business expense deduction for legislative lobbying on matters of interest to the taxpayer's trade or business.[244] The initial legislative history indicates that Congress was concerned with an anomaly in the regulations that permitted deductions for appearances before executive and administrative agencies while denying deductions for appearances before legislative bodies.[245] The congressional reports add that "it also is desirable that taxpayers who have information bearing on the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making this information available to the Members of Congress or legislators at other levels of Government."[246] The legislative history also states that expenses incurred by persons who bring information to Congress for personal reasons are not deductible.[247] Congress thereby registered little concern for the balance cited by the Court in *Cammarano* between tax-deductible business lobbying and legislative activities by individuals with a personal interest funded with after-tax dollars.[248] However, the Omnibus Budget Reconciliation Act of 1993 restricted deductions for lobbying both legislative and executive

240. *See* I.R.C. § 527.

241. *Id.* § 162(e)(1). Covered executive branch members include the President, Vice President, officers and employees of the White House Office of the Executive Office of the President, the two most senior level officers of the agencies in the White House Executive Office of the President, senior executives in level I of the executive schedule, individuals with Cabinet level status, and the immediate deputies of such persons. *Id.* § 162(e)(6).

242. *Id.* § 162(e)(2)(B).

243. 358 U.S. 498, 503 n.6 (1959). The regulations denied deductions for expenses incurred for "lobbying purposes, the promotion or defeat of legislation, [and] the exploitation of propaganda." *Id.*

244. S. REP. NO. 87-1881, at 21 (1967). Regulations promulgated in 1959, following the government's victory in *Cammarano*, explicitly disallowed deductions for expenses incurred with respect to legislative matters and deductions for dues to lobbying organizations. *Id.* at 21-22.

245. *Id.* at 22.

246. *Id.*

247. *Id.* at 23.

248. *See id.*; *see also* Cammarano v. United States, 358 U.S. 498, 513 (1959).

branches of government with respect to legislation with the current version of section 162(e).[249] The legislative history gives no reason for the change except for a reference to deficit reduction.[250]

Section 162(e) restricts deductions for political campaign activity and lobbying, including grassroots attempts to influence the public with respect to legislative matters.[251] Thus expenditures incurred by an elected office holder in campaigning for either the first election or re-election are not deductible.[252] However, at least one case has drawn a distinction between expenses incurred by an elected official to preserve his business reputation, which were allowed as deductions, and expenses incurred to protect the official's reputation as an elected politician.[253]

Corporate expenditures incurred to educate shareholders and the public regarding legislation affecting corporate interests are not deductible.[254] On the other hand, Treasury Regulations permit deductions for "'good will' advertising" that "keeps the taxpayer's name before the [general] public" and advertising that encourages contributions to organizations such as the Red Cross.[255] The regulations also provide for deductible advertising that "presents views on economic, financial, social, or other subjects of a

249. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13222(a), 83 Stat. 312.

250. H.R. REP. NO. 103-11, at 659 (1993). As the reason for change the House Report states in full: "The committee has determined that, in the context of deficit reduction legislation, it is appropriate to limit the business deduction for lobbying expenses." *Id.* It is not clear whether the deficit reduction is achieved with the disallowance of deductions for lobbying or by the fact that less lobbying may result in lower expenditures for favored lobbyists.

251. I.R.C. § 162(e)(1)(c) (2001); *see also* Treas. Reg. § 1.162-20(c)(4) (1965) (denying a deduction for expenditures incurred "in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums").

252. Treas. Reg. § 1.162-20(c)(1).

253. Conti v. Comm'r, T.C.M. 1972-89 (predating enactment of section 162(e)). In *Conti* the taxpayer held various elected local and state legislative offices in Illinois. *Id.* The taxpayer also was an officer and employee of a savings and loan association. *Id.* In a transaction that involved some dubious actions, the taxpayer arranged for transfer of control of the savings and loan association to a group of buyers who impaired the organizations financial position with questionable loans. *Id.* The taxpayer incurred expenses to rehabilitate the savings and loan, which he claimed were deductible business expenses necessary to protect his business reputation. *Id.* There is also an indication in the record that the taxpayer recognized that the circumstance of the failed savings and loan would adversely affect his political career. *Id.* The Tax Court allowed the deduction, indicating in part, that the expenditures "were not campaign expenses," the taxpayer was not running for office at the time of the expenditure, and that there were no "overriding considerations of public policy involved." *Id.* The Tax Court opinion also noted that the Commissioner made no claim that the taxpayer's elective position was "inextricably interwoven with his other business activities." *Id.*

254. Rev. Rul. 74-407, 1974-2 C.B. 45; Rev. Rul. 78-111, 1978-1 C.B. 41.

255. Treas. Reg. § 1.162-20(a)(2). Presumably this includes non-partial get-out-the-vote and registration advertising that has been allowed as a deductible expense. *See* Rev. Rul. 62-156, 1962-2 C.B. 47.

general nature" as long as the advertising does not advocate the election of a candidate or promotion of legislation, including initiatives.[256] Thus, issue advertising intended to educate the public on topics of political interest not related to the election of a specific candidate nor specific legislation may survive the limitation of section 162(e). Although not expressly required by the regulations, qualification under the ordinary and necessary requirement of section 162(a) should, at a minimum, require prominent inclusion of the name of the entity funding educational advertising.[257]

The reported cases draw a broad line in identifying grassroots lobbying that is claimed as business oriented public education. In *Consumers Power Co. v. United States,*[258] the Sixth Circuit Court of Appeals denied deductions under section 162(e) for contributions by an electric power company for a national negative advertising campaign against public power, even though there was no pending legislation involved.[259] The advertisements broadly criticized federal ownership of electric power production.[260] Several of the advertisements directed the public to let their congressional representatives members know how they felt about governmental ownership.[261] There was no mention of specific legislation, but the advertisements did criticize a specific use of governmental funds.[262] The appellate court observed that several of the advertisements were "border line cases for deductibility" but felt compelled to defer to the judgment of the trial court.[263] The trial judge indicated that, "A fair reading of these [advertisements], both individually and collectively, compels the

256. Treas. Reg. § 1.162-20(a)(2).

257. *See* I.R.C. § 162(a) (2001).

258. 427 F.2d 78 (6th Cir. 1970).

259. *Id.* at 79.

260. *Id.*

261. *Id.*; *see also* Rev. Rul. 78-111, 1978-1 C.B. 41 (stating that the expenses of producing a pamphlet for shareholders containing the corporate president's remarks in legislative hearings opposing specific legislation is not deductible even if the material did not include a suggestion that the shareholders contact their legislators).

262. Consumers Power Co. v. United States, 299 F. Supp. 1180, 1214-16 (S.D.N.Y. 1967). Three of the advertisements are reproduced in the trial court opinion. *Id.* One television advertisement concludes, "With your help, congress can–and will–resist those who want a federal monopoly of electricity. You don't want extravagance. And you don't want the threat of socialism. Let your congressman know what *you* think." *Id.* at 1214. A print add stated, "Since America's Electric Light and Power Companies are ready, willing and able to provide plenty of power, isn't it wasteful of tax dollars for government to try to do the same job? The government way leads straight downhill to a federal electric power monopoly . . . and socialism." *Id.* at 1215. The third advertisement contains the statement that, "a strange twist in federal law exempts several million American families and businesses from paying all the taxes in their electric bills that you pay in yours." *Id.* at 1216. This last advertisement comes close to advocating specific legislative change.

263. Consumers Power Co. v. United States, 427 F.2d 78, 79 (6th Cir. 1970).

conclusion that they belong to the nondeductible category within the purview of 1.162-20."[264] The court of appeals raised a concern, however, that an overly broad application of the regulations' denial of deductions could be used to bar a deduction for a competitive message directed against a publicly owned competitor.[265] Nonetheless, *Consumers Power* recognizes the basic notion that political advertisement intended to influence legislation can do so without direct reference to specific elected officials, candidates, or pending legislation.[266] In other words, issue advertisement directed at the political decisionmaking process falls within the scope of political speech that is not entitled to federal tax subsidy through the deduction of its cost.

The 1993 legislation strengthened the prohibition on deducting lobbying expenses with a further limitation on the deduction of dues to trade associations or other tax-exempt entities that lobby on behalf of their members.[267] In lieu of denying the deduction to members for its dues, an exempt entity may elect to pay a proxy tax on its lobbying expenditures at the highest corporate rate.[268] This scheme was attacked as violating the First Amendment rights of lobbying groups in *American Society of Association Executives v. United States*.[269] The taxpayer was a business league, exempt from tax under section 501(c)(6) of the Internal Revenue Code, that had elected to pay the excise tax of section 6033(e)(2) of the Code on its lobbying activities.[270] The Association sued for a refund of the tax, claiming in part that the tax conditioned an otherwise available benefit on the taxpayer's refraining from the exercise of constitutional rights.[271] The taxpayer agreed with the Commissioner that the government has no obligation to subsidize speech, but argued that the flow-through nature of the proxy tax placed a burden on lobbying.[272] The taxpayer asserted that the application of section 162(e) denied deductions to members for

264. *Consumers Power Co.*, 299 F. Supp. at 1183.

265. *Consumers Power Co.*, 427 F.2d at 79-80.

266. *See generally id.*

267. I.R.C. § 162(e)(3) (2001). The exempt entity is required to determine the proportion of its expenditures that are subject to limitation and report the figure to its members. Rules for making this allocation are found in Treasury Regulation § 1.162-28 (1995).

268. *See* I.R.C. § 162(e)(3) (denying a deduction for dues paid to a tax-exempt organization to the extent the organization notifies the payer that dues are attributable to non-deductible political expenditures, which include lobbying and participation or intervention in a political campaign under § 162(e)(1)). Under section 6033(e)(2) an organization may elect not to notify (or fail to notify) members of an allocation of non-deductible political expenditures, in which case the organization becomes taxable at the highest rate of section 11 (currently 35%) on the aggregate amount of its political expenditures. *Id.* §§ 11, 6033 (2001).

269. 195 F.3d 47 (D.C. Cir. 1999).

270. *Id.* at 48.

271. *Id.*

272. *Id.* at 49.

business expenses that would be deductible if the business league did not engage in lobbying activities.[273] The court found that the taxpayer's members could avoid any loss of deduction with respect to the portion of dues attributable to non-political activities, or the association could avoid the proxy tax on its regular business expenditures, by segregating the lobbying activity from other activities in separate tax-exempt entities.[274] The court noted that deductible (or partially deductible) dues could be paid to the trade association and lobbying activities could be confined to a separately incorporated affiliate for which no deduction would be allowed to members for dues paid.[275] The court observed, "This system achieves precisely what the [taxpayer] says the Constitution demands: a generally applicable tax system that, although it does not subsidize lobbying, imposes no burden on it by comparison with other activities."[276] Given that possibility, the court concluded that restrictions on the deductibility of dues with respect to lobbying activity need satisfy only a rational basis test under *Regan.*[277] With that, the court was satisfied that the denial of

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273. *Id.* at 49-50. The taxpayer argued that subjecting its lobbying expenditures to the 35% rate imposed a direct burden on its exercise of a right to lobby because the tax rate is higher than the rate that would be imposed on direct lobbying by its members at regular graduated corporate rates. *Id.* at 49. The government countered with its calculation that even at the maximum rate, the tax on expenditures by the trade association was less than the tax that would be imposed directly on income diverted to lobbying, [(1 + (0.35 X 1))< (1/1-0.35)] at least for taxpayers in tax brackets greater than 26%. *Id.* at 49 & n.1. The association also argued that under § 6033(e)(1), if the taxpayer overestimates its lobbying expense for the year, members lose deductions for otherwise deductible expenditures. *Id.* at 49. The association further argued that if the association underestimates lobbying expenses it becomes subject to the proxy tax, thereby imposing an extra burden on its exercise of speech in the form of lobbying activities. *Id.* In addition, the association asserted that the requirement that lobbying expenses be treated as paid out of dues income before investment income unduly burdens the exercise of political speech. *Id.* at 49-50; I.R.C. § 6033(e)(1)(C)(i) (2001).

274. *Am. Soc'y of Ass'n Execs,* 195 F.3d at 50.

275. *Id.*

276. *Id.*

277. *Id.*; *see also* Regan v. Taxation with Representation, 461 U.S. 540, 547-48 (1983). The D.C. Circuit seems to misread *Regan* on this point. In the latter case, the Court concluded that Congress's decision to deny subsidies to organizations engaged in political activity did not impede the organization's right to exercise a constitutional right. *Id.* at 548. Given that conclusion, the Court had no need to consider whether a restriction on constitutional prerogatives survived either strict scrutiny or rational basis analysis. *See id.* at 545-46. In a separate part of its opinion, the majority in *Regan* addressed the taxpayer's claim that a provisions permitting tax-exempt veteran's organizations to lobby with tax-deductible contributions discriminated against the taxpayer's exercise of the right to lobby. *Id.* at 546-47. Here the Court pointed out that strict scrutiny is required for classifications that interfere with the exercise of a fundamental right such as free speech, but otherwise classifications are valid if they bear a rational relation to a legitimate governmental purpose. *Id.* at 547. The Court added that "legislatures have especially broad latitude in creating classifications and distinctions in tax statutes." *Id.* The Court further noted its conclusion that "Congress has not violated TWR's First Amendment rights by declining to subsidize its First

deductions and the proxy tax bear a rational relation to the governmental purpose of withholding the tax benefits of a deduction for lobbying expenses, which the parties agreed was a legitimate governmental purpose.[278]

Regardless of whether the availability of a separate form of exempt entity for non-tax subsidized political activity is a requirement for withholding tax subsidies, the court's assumption in *American Society of Association Executives* that the option of separating political from non-political activity in separate entities is necessary to avoid constitutional infirmities raises interesting possibilities. As is described in the next subsection, under the current structure for exempt entities there is a mixture of tax-exempt forms of organization that permit differing approaches and opportunities in the political arena. Consolidating political activity into a single form of organization is suggested in Part V of this Article.

Section 170(f)(9) prevents avoidance of the section 162(e) limitation on deductions by denying a deduction as a charitable contribution of a payment to a tax-exempt charity that conducts activities that would otherwise not be deductible under section 162(e) and which are of direct financial interest to the contributor's trade or business.[279] The disallowance of deductions under section 162(e) also is fortified by limitations in sections 271 and 276 of the Code.[280] Section 271 disallows any deduction for bad debts or worthless securities issued by a political party.[281] This provision blocks any attempt to disguise a nondeductible contribution as a loan that later might be deducted as a bad debt.[282] There is an exception

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Amendment activities," and added that "[t]he case would be different if Congress were to discriminate invidiously in its subsidies in such a way as to aim[] at the suppression of dangerous ideas." *Id.* at 548 (quoting Cammarano v. United States, 358 U.S. 498, 513 (1959)) (internal quotation marks omitted). The circuit court in *American Society of Association Executives* also confuses the majority opinion with the view of the concurring justices in *Regan*, for whom the availability of a separate tax-exempt form of entity was pivotal to their conclusion that the restrictions on the political activity of a charitable organization were constitutionally permissible. *Am. Soc'y of Ass'n Execs.*, 195 F.3d at 51 (stating that the Court in *Regan* "evidently regards the dual incorporation option as obviating the need for heightened scrutiny"); *see also supra* text accompanying note 163.

278. *Am. Soc'y of Ass'n Execs.*, 195 F.3d at 51.

279. I.R.C. § 170(f)(9) (2001).

280. *See id.* §§ 271(a), 276(a).

281. *Id.* § 271(a). Technically section 271(a) bars deductions under sections 166 relating to bad debts and 165(g) relating to worthless securities. *Id.* A political party includes a national, state or local committee of a political party and any committee or other organization that accepts contributions or makes expenditures for the purpose of influencing the election of a person to federal, state or local office. *Id.* § 271(b)(1). For a discussion of this definition, see Hill, *supra* note 5, at 912-14.

282. *See* S. REP. NO. 94-938, at 402 (1976).

to the proscription of section 271 for receivables accrued into income from the "sale of goods or services in the ordinary course of . . . business" by a taxpayer who accrues more than thirty percent of its receivables in the taxable year from political parties and who has made continuing efforts to collect the debt.[283] The exception was enacted to prevent hardship to political consultants and other businesses who provide goods and services to political campaigns.[284] Section 276 bars deductions for expenditures for advertising in a political party's convention program, expenditures for admission to a dinner or program the proceeds of which inure to the benefit of a political party or candidate, or expenses incurred to attend an inaugural event.[285] The restriction on deductions for advertising in a political convention program was enacted as part of 1974 amendments to the FECA after the majority of funds for the 1968 and 1972 presidential nominating conventions of the major parties were derived from such advertising funds.[286]

In a further attempt to limit the transfer of before-tax value to a political organization, section 84 of the Code treats a transfer of appreciated property to a political organization as a sale.[287] Political organizations covered by this provision are limited to campaign organizations described in section 527(e)(1), which includes only organizations that are engaged in the nomination or election of an individual for public office.[288] The transferor recognizes gain to the extent of the difference between the transferor's basis in the property and its fair market value at the time of the transfer.[289] The political organization's basis is the same as the transferor's basis increased by the gain recognized by the transferor.[290] Section 84 does not provide for recognition of loss on the transfer of depreciated property to a political organization.[291]

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283. I.R.C. § 271(c). The exception only applies to an accrual basis taxpayer. *Id.* This language is somewhat redundant because the impact of the section 271 limitation only falls on an accrual basis taxpayer who has accrued a receivable as income. *Id.* A cash basis taxpayer with a bad debt receivable that has not been taken into income has no basis to deduct if the debt should become worthless. *See Id.* §§ 165(b), 166(b).

284. *See* S. REP. NO. 93-938, at 401.

285. I.R.C. § 276(a).

286. Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, § 102(c)(1) 88 Stat. 1263, 1269.

287. I.R.C. § 84(a) (2001).

288. *Id.* §§ 84(c), 527(e)(1)-(2).

289. *Id.* § 84(a).

290. *Id.* § 84(b).

291. *See id.* § 84. Section 84(a) only applies to property where the fair market value exceeds basis.

2. Tax-Exempt Entities Engaged in the Political Process

Section 501 of the Internal Revenue Code provides an exemption from tax for twenty-seven specifically described organizations, ranging from trade associations and employee benefit organizations, to publicly financed charitable organizations.[292] Section 527 of the Code provides an exemption for contributions to a political organization that incurs expenditures to influence the election of political candidates, an additional form of tax-exempt organization.[293] Contributions to tax-exempt organizations are deductible from the income of the contributor only with respect to governmental entities and certain non-governmental organizations; generally organizations with a religious or "charitable" purpose that fulfill the requirements of section 501(c)(3) of the Code.[294] A number of these tax-exempt organizations, including charitable organizations, are utilized for political advocacy.[295] In addition, contributions by business to trade associations or other organizations may be deductible as ordinary and necessary business expenses, except to the extent limited by section 162(e)(3) with respect to the portion of the organization's expenditures for political activities.[296]

i. Charitable Organizations

a. Political Activities

An organization is exempt from tax under section 501(c)(3) if it is "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 . . . or for the

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292. *Id.* § 501.

293. *Id.* § 527(c)(3).

294. *See id.* §§ 170(c)(2)(D), 501(c)(3). Deductible contributions may be made to governmental entities, to domestic organizations organized for religious, charitable, scientific, literary, or educational purposes, to foster national or international amateur sports competition, or to prevent cruelty to children or animals, as long as the organization is not disqualified from tax exemption under section 501(c)(3) because of political activity. *Id.* Deductible contributions are allowed to veterans organizations and to fraternal societies if the contribution is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. *Id.* § 170(c)(3)-(4).

295. Senator Joseph Lieberman wrote in an introduction to a Catholic University Election Law symposium that in the 1996 presidential election, "[t]ax-exempt groups paid for millions of dollars of television ads that clearly endorsed or attached particular candidates although the law barred the groups from engaging in such extensive partisan electoral activity." Joseph Lieberman, *Campaign Finance*, 49 CATHOLIC L. REV. 5, 6 (1999).

296. *See supra* text accompanying notes 241 and 267.

prevention of cruelty to children or animals."[297] Although the statutory provision requires that the organization be operated *exclusively* for one or more of the enumerated purposes, the requirement is interpreted to mean that the organization must "primarily" engage in activities that promote one or more exempt purposes.[298] Although activities unrelated to an exempt purpose are allowable, the presence of a substantial non-exempt purpose will defeat qualification under section 501(c)(3).[299] "Secondary benefits which advance a substantial purpose cannot be construed as incidental to the organization's exempt . . . purpose."[300] Section 501(c)(3) also permits an organization to qualify for its tax exemption only if "no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . .," and the organization "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."[301] Section 170(c)(2)(D) bolsters the prohibition by allowing a charitable contribution deduction for a contribution to an organization only if the organization "is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, 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."[302] Legislative history indicates that,

> [t]he prohibition on political campaign activities and the restrictions on lobbying activities by charities reflect Congressional policies that the U.S. Treasury should be neutral in political affairs, and that substantial activities

297. I.R.C. § 501(c)(3) (2001); *see also* Treas. Reg. § 1.501(c)(3)-1(d)(1) (1960) (enumerating purposes which allow organizations to claim exempt status under § 501(c)(3)).

298. Treas. Reg. § 1.501(c)(3)-1(c)(1); *see also id.* § 1.501(c)(3)-1(b)(1)(b) (providing that the articles of incorporation may not empower an organization to engage in other activities "otherwise than as an insubstantial part of its activities").

299. *See* Better Bus. Bureau v. United States, 326 U.S. 279, 283 (1945). The Court looked to the primary activities of an organization to determine that an organization was not exempt from the social security tax under 42 U.S.C. section 1011(b)(8), which contained language virtually identical to the present I.R.C. section 501(c)(3), where a substantial part of its activities were directed towards a non-exempt purpose. *Id.* at 280; *see also* Housing Pioneers, Inc. v. Comm'r, T.C.M. (RIA) 1993-120, *aff'd* 58 F.3d 401, 404 (9th Cir. 1995); Nationalist Movement v. Comm'r, 37 F.3d 216, 219 (5th Cir. 1994).

300. Am. Campaign Acad. v. Comm'r, 92 T.C. 1053, 1078 (1989). The taxpayer was formed to train campaign workers who participated in campaigns for Republican candidates. *Id.* at 1055. The court held that the taxpayer was operated for the private benefit of the non-charitable private interests of members and candidates of the Republican Party. *Id.* at 1079.

301. I.R.C. § 501(c)(3) (2001).

302. *Id.* § 170(c)(2)(D).

> directed to attempts to influence legislation should not be subsidized through the tax benefits accorded to charitable organizations and their contributors.[303]

The Treasury Regulations provide that "[a]n organization is not operated exclusively for one or more exempt purposes if it is an 'action' organization."[304] The regulations classify an organization as an "'action' organization if a substantial part of its activities [are] attempting to influence legislation by propaganda or otherwise."[305] Attempting to influence legislation includes both advocacy for the adoption or rejection of specific legislation and grassroots lobbying that urges the public to contact members of a legislative body for the purpose of supporting or opposing legislation.[306] An organization that participates, directly or indirectly, in a political campaign in support of or opposition to a candidate for public office is also classified as an action organization.[307] For this purpose, a "candidate for public office" is broadly defined to include "an individual who offers himself, or is proposed by others, as a contestant for an elective public office."[308] Finally, an action organization includes an organization whose primary objective may be attained only by enactment or defeat of legislation and which advocates or campaigns for the attainment of its primary objective.[309] Campaigning for legislation to meet such an organization's objective is distinguished in the regulations from engaging in "nonpartisan analysis, study, or research and making the results thereof available to the public."[310]

There is an important distinction in these provisions between direct or grassroots lobbying and intervention in a political campaign. Intervention in a political campaign is absolutely forbidden.[311] In contrast, the restriction on lobbying prohibits the use of a "substantial" part of the

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303. Omnibus Budget Reconciliation Act of 1987, H.R. REP. NO. 100-391, at 1625, *reprinted in* 1987 U.S.C.C.A.N. 2313-1205. The Omnibus Budget Reconciliation Act of 1987 added provisions affecting political campaign activities and lobbying of section 501(c)(3) organizations, including statutory clarification that the prohibition on intervention in political campaigns included activities both in support of and in opposition to a political candidate. *Id.* at 1621.

304. Treas. Reg. § 1.501(c)(3)-1(c)(3)(i).

305. *Id.* § 1.501(c)(3)-1(c)(3)(ii).

306. *Id.* § 1.501(c)(3)-1(c)(3)(ii)(a)-(b).

307. *Id.* § 1.501(c)(3)-1(c)(3)(iii).

308. *Id.*

309. *Id.* § 1.501(c)(3)-1(c)(3)(iv).

310. *Id.*

311. Ass'n of the Bar of N. Y. v. Comm'r, 858 F.2d 876, 881 (2d Cir. 1988); *see also* discussion *infra* note 334; Rev. Rul. 67-71, 1967-1 C.B. 125. An organization that seeks to promote quality education by endorsing qualified candidates for a school board is not entitled to exemption under section 501(c)(3). I.R.C. § 501(c)(3) (2001).

organization's resources in attempting to influence legislation.[312] Some lobbying activity is permissible as long as it does not represent a "substantial part" of the organization's activities.[313] Thus, in *Seasongood v. Commissioner*[314] the Sixth Circuit Court of Appeals held that devotion of less than five percent of the organization's resources to lobbying is not "substantial" and thereby permitted to the tax-exempt charity.[315] On the other hand, in *Haswell v. United States*,[316] while noting that a quantitative test is not determinative,[317] the Court of Claims concluded that sixteen to seventeen percent of resources devoted to lobbying is substantial.[318]

The strict prohibitions of sections 501(c)(3) and 170(c)(2)(D) are mitigated by section 501(h), which allows an electing organization to incur a defined amount of expenditures for lobbying and grassroots activities to influence legislation.[319] Lobbying and grassroots activities in support of legislation do not include participation in the election of a candidate.[320] Organizations are allowed to spend up to 150% of a "lobbying ceiling," which varies from five to twenty percent of the organization's expenditures for exempt purposes, without jeopardizing their status as an exempt charity under section 501(c)(3).[321] The price of the election is a

312. I.R.C. §§ 501(a), 502 (2001).

313. *Id.* § 501(c)(3).

314. 227 F.2d 907 (6th Cir. 1955).

315. *Id.* at 912. The organization involved was a civic league formed "to provide an opportunity for discussion of matters of civic importance and to advance good government." *Id.* at 909. On occasion the league endorsed legislation or candidates (the case predated the current language of section 501(c)(3) prohibiting intervention in a campaign) as recommended by its study committees. *Id.* The Internal Revenue Service has ruled that indirect, substantial efforts to promote legislation for the common good (protecting animals) preclude tax exemption under section 501(c)(3). Rev. Rul. 67-293, 1967-2 C.B. 185.

316. 500 F.2d 1133 (Ct. Cl. 1974).

317. *Id.* at 1145; *see also* Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849, 855 (10th Cir. 1972) ("The political activities of an organization must be balanced in the context of the objectives and circumstances of the organization to determine whether a *substantial* part of its activities was to influence or attempt to influence legislation.").

318. *Haswell*, 500 F.2d at 1146. The court added that although the dollar amounts involved were miniscule when compared to the legislative budgets of other organizations, "[f]or an organization that operates on as small a total budget as NARP to devote so much of its total resources to legislative activities, it fairly can be concluded that its purposes no longer accord with conceptions traditionally associated with a common-law charity." *Id.* at 1146-47. On a qualitative basis, the court also noted that "[t]he legislative program was a primary objective in NARP's total operations for preservation of railroad passenger service and is on an equal footing with its educational and litigative efforts." *Id.* at 1147.

319. I.R.C. § 501(h) (2001).

320. *Id.* § 4911(c)(1)-(4), (d) (defining lobbying and grassroots activities); Treas. Reg. § 56.4911-1(b)(1)(ii), (2)(ii) (1990) (requiring that direct lobbying and grassroots lobbying refer to specific legislation and reflect a view on the legislation).

321. I.R.C. § 4911(c). If the exempt organization's expenditures for its exempt purposes are

twenty-five percent excise tax under section 4911 for lobbying expenditures in excess of the lobbying ceiling.[322] Thus, although tax-exempt charities are permitted some engagement in the legislative process, the activity comes with the partial loss of the dual subsidy of tax deductible contributions and organizational tax-exemption provided to section 501(c)(3) organizations.

Blatant disregard of the restrictions of section 501(c)(3) and the Treasury Regulations can result in revocation of tax exempt status. In 1992, Branch Ministries, a tax exempt church, published full page advertisements in two newspapers that urged Christians not to vote for then presidential candidate Bill Clinton.[323] At the bottom the advertisements stated, "Tax-deductible donations for this advertisement gladly accepted" with a mailing address for contributions.[324] The advertisements produced "hundreds of contributions to the Church from across the country."[325] The Internal Revenue Service revoked the Church's tax exemption indicating that the advertisements were prohibited intervention in a political campaign.[326] The revocation was upheld in an action for declaratory judgment filed in the D.C. District Court by the Church to overrule the Commissioner's revocation.[327] Affirming the

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not over $500,000, it may spend up to 20% of its exempt purpose expenditures for lobbying. *Id.* Exempt purpose expenditures between $500,000 and $1 million permit lobbying expenditures of $100,000 plus 15% of exempt purpose expenditures over $100,000. *Id.* Exempt purpose expenditures between $1 million and $1.5 million permit lobbying expenditures of $175,000 plus 10% of exempt purpose expenditures over $1 million. *Id.* Exempt purpose expenditures over $1.5 million permit lobbying expenditures of $225,000 plus 5% of the excess of exempt purpose expenditures over $1.5 million. *Id.* The maximum allowed expenditures before the excise tax is imposed is $1 million. *Id.*

322. *Id.* § 4911(a)(1).

323. Branch Ministries v. Rossotti, 211 F.3d 137, 139 (D.C. Cir. 2000).

324. *Id.* at 140.

325. *Id.*

326. *Id.*; *see* Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) (1960). *But see* Gen. Couns. Mem. 34,267 (Feb. 20, 1970) (concluding that editorials in a magazine published by an exempt organization that questioned whether John F. Kennedy's adherence to the Catholic religion would affect his fitness to be President of the United States were intervention in a political campaign but of such a de minimis nature that the activity did not require revocation of the organization's charitable status, although suggesting that the activity came next to the "absolute limit permissible of activity in the political area").

327. Branch Ministries v. Rossotti, 40 F. Supp. 2d 15, 27 (D.D.C. 1999). Section 7428 of the Internal Revenue Code provides for a declaratory action in the Tax Court, Claims Court, or the District Court for the District of Columbia. I.R.C. § 7428(c) (2001). Under section 7428(c), contributions to a charitable organization described in section 170(c)(2) continue to be deductible until judgment is entered by the court. *Id.* The Internal Revenue Service began its investigation of Branch Ministries in November 1992. *Branch Ministries*, 40 F. Supp. at 17-18. The district court judgment was filed on March 30, 1999. *Id.* at 15. Thus, contributions to the Branch Ministries remained deductible for almost seven years following the Church's political advertising.

district court, the District of Columbia Circuit rejected the Church's argument that the Commissioner lacked authority to revoke a church's tax exemption under section 501(c)(3) because a church is independently exempt under the Code which does not specifically impose tax on the income of a church.[328] More importantly, the court held that neither the First Amendment nor the Religious Freedom Restoration Act of 1993[329] prevent the Commissioner from revoking the tax exemption of a church in appropriate circumstances.[330] The court pointed out that Branch Ministries did not argue that withdrawal from political activity would violate its religious beliefs.[331] The court added, "The sole effect of the loss of the tax exemption will be to decrease the amount of money available to the Church for its religious practices," noting that the Supreme Court has described such a result as "not constitutionally significant."[332] This conclusion is consistent with the holding of *Taxation With Representation v. Regan*[333] that Congress's refusal to provide a tax subsidy to particular forms of speech is not a denial of First Amendment protections.

In *Association of the Bar of New York v. Commissioner*[334] a more subtle form of political intervention than the political advertisements in Branch Ministries also was held to preclude tax exemption under section 501(c)(3).[335] The New York City Bar Association rated judicial candidates as qualified or not qualified for appointed and elected positions.[336] The

328. Branch Ministries v. Rossotti, 211 F.3d 137, 141 (D.C. Cir. 2000) ("We find this argument more creative than persuasive.").

329. 42 U.S.C. § 2000bb-1 (2001).

330. *Branch Ministries*, 211 F.3d at 139.

331. *Id.* at 142.

332. *Id.* (quoting Jimmy Swaggart Ministries v. Bd. of Equalization of Cal., 493 U.S. 378, 391 (1990) (internal citations omitted); *see also Jimmy Swaggart Ministries*, 493 U.S. at 391 ("As the Court made clear in *Hernandez*, however, to the extent that imposition of a generally applicable tax merely decreases the amount of money [a church] has to spend on its religious activities, any such burden is not constitutionally significant."); Hernandez v. Comm'r, 490 U.S. 680, 700 (1989).

The result in *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030 (D.C. Cir. 1980) illustrates the impotence of revocation as a sanction for political intervention by a section 501(c)(3) organization. The *Branch Ministries* court described revocation as "more symbolic than substantial." *Branch Ministries*, 211 F.3d at 142. The court noted that the Church could hold itself out as a section 501(c)(3) organization and receive all the benefits of that status, losing only advance assurance to contributors that their contributions would be deductible. *Id.* at 142-43. The court also pointed out that there is nothing to prevent the Church from reapplying for section 501(c)(3) status. *Id.; see also* Frances R. Hill, *Newt Gringrich and Oliver Twist: Charitable Contributions and Campaign Finance*, 66 TAXNOTES 237, 246 (1995) (asserting that if a charitable organization loses its status under section 501(c)(3), the organizers can dissolve and transfer the assets to a new section 501(c)(3) organization).

333. 461 U.S. 540 (1983).

334. 858 F.2d 876 (2d Cir. 1988).

335. *Id.* at 877.

336. *Id.*

Commissioner denied tax exempt status to the Bar Association under section 501(c)(3) because the ratings of judicial candidates for elective office constituted participation in a political campaign.[337] The Tax Court overruled the Commissioner's determination, finding that the Bar Association's "ratings do not support or oppose the candidacy of any particular individual or recommend that the public vote for or against a specific candidate."[338] The court of appeals reversed.[339] The Tax Court found that the judicial ratings were intended to, and did in fact, influence the voter,[340] and the Bar Association conceded that the purpose of the judicial ratings was to attempt to ensure that unqualified persons were not elected to the bench.[341] Noting those findings, the court of appeals took a broad view of the prohibition against indirect participation in a campaign to conclude that the Bar Association's activities represented intervention in a campaign on behalf of or in opposition to a candidate for public office as described in the Treasury Regulations.[342] The court of appeals pointed out that "expressions of 'professional opinion' concerning the candidates' qualifications" represented more than the mere collection and dissemination of objective data.[343] The court also indicated that,

> one may be a candidate without running an organized political campaign. "[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."[344]

In General Counsel Memorandum (GCM) 39,811,[345] the Internal Revenue Service concluded that an exempt organization may be intervening in a political campaign even if no actual candidate is specifically identified.[346] Under the facts of the GCM, a section 501(c)(3) organization with a distinct political agenda urged its members to run for

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337. *Id.* at 878. The organization already qualified for exempt status under section 501(c)(6) but wanted the additional benefit of tax deductible contributions. *Id.* at 877.

338. Ass'n of the Bar of N.Y. v. Comm'r, 89 T.C. 599, 609-10 (1987).

339. *Ass'n of the Bar of N.Y.*, 858 F.2d at 877.

340. *Id.* at 879.

341. *Id.* at 881.

342. *Id.*; *see* Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii) (1960); *see also* Rev. Rul. 67-71, 1967-1 C.B. 125 (stating that a nonprofit organization, dedicated to improving education, that endorsed candidates in a school board election in order to improve the quality of local education engaged in prohibited intervention in a campaign).

343. *Ass'n of the Bar of N.Y.*, 858 F.2d at 880.

344. *Id.* (quoting Norris v. United States, 86 F.2d 379, 382 (8th Cir. 1936), *rev'd on other grounds*, 300 U.S. 564 (1937)).

345. Gen. Couns. Mem. 39,811 (Feb. 9, 1990).

346. *Id.* at 15.

office as precinct committeemen, a partisan political office, for both national political parties.[347] Citing *Association of the Bar of New York v. Commissioner*, the GCM states,

> The effort, and not the effect, constituted intervention in a political campaign. Therefore, whether anyone heeded the call to run for precinct committeeman, whether that individual was elected, and if so, what he or she subsequently did, are all immaterial. To require the identification of particular candidates would undermine the clear prohibition against "any" participation contained in the regulations.[348]

The prohibitions on intervention in a campaign of sections 170(c)(2)(D) and 501(c)(3) are enforced by section 4955,[349] which imposes a ten percent excise tax on "political expenditures" by any organization that is described in section 501(c)(3).[350] A separate two percent excise tax separately applies to an organization manager who knowingly and willfully authorizes a political expenditure.[351] There is an additional excise tax of 100% of the amount of a political expenditure imposed on the organization, and 50% on the managers, if the expenditure is not corrected within a specified period by the establishment of safeguards to prevent future political expenditures and recovery of the political expenditure, to the extent possible.[352] Political expenditures that trigger the excise tax

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347. *Id.*

348. *Id.* at 15-16.

349. Section 4955 was enacted with the Omnibus Budget Reconciliation Act of 1987. Omnibus Budget Reconciliation Act of 1987, § 10712, Pub. L. No. 100-203, 100 Stat. 1330-465. For a detailed legislative history, see Laura Brown Chisholm, *Sinking the Think Tanks Upstream: The Use and Misuse of Tax Exemption Law to Address the Use and Misuse of Tax-Exempt Organizations by Politicians*, 51 U. PITT L. REV. 577, 611 nn. 133-34 (1990).

350. I.R.C. § 4955(a)(1) (2001). Section 4955(f)(1) applies the excise tax to any organization that is described in section 501(c)(3) without regard to its political expenditures. *Id.* § 4955(f)(1). Thus disqualification as a section 501(c)(3) organization because of political expenditures does not avoid application of section 4955. *See id.* Before 1987 the excise tax was only imposed on private foundations. *See id.*

351. *Id.* § 4955(a)(2). A manager for this purpose is an officer or director of the organization, or similar position, who has authority or responsibility with respect to the political expenditure. Id. § 4955(f)(2); *see also* Treas. Reg. § 53.4955-1(b)(2) (1995). The excise tax on managers is limited to $5,000 with respect to each political expenditure. I.R.C. § 4955(c)(2). The excise tax on managers may not be paid by the organization. Managers are jointly and severally liable for the excise tax imposed on managers. *Id.* § 4955(c)(1).

352. I.R.C. § 4955(b), (f)(3). This second level tax is imposed on managers who refuse to agree to the correction and is limited to $10,000. *Id.* § 4955(b)(2), (c)(2). The period for correction begins on the date of the political expenditures and runs to the date for mailing a notice of deficiency under section 6212 or, if earlier, the date on which the section 4955 excise tax is assessed. *Id.* § 4955(f)(4).

include any amounts expended on intervention or participation in a political campaign on behalf of or in opposition to a candidate.[353] The regulations embellish the statutory definition of political expenditure by adding that any expenditure that would cause an organization to be classified as an action organization under Treasury Regulations section 1.501(c)(3)-1(c)(3)(iii)[354] is treated as a political expenditure subject to the section 4955 excise tax.[355] Thus, any expenditure by a section 501(c)(3) organization in support or opposition to an individual who is a candidate for public office, or who is offered as a candidate, is subject to the excise tax of section 4955.

Legislative history suggests Congress's belief that the excise tax would function as an effective remedy where revocation of exempt status is ineffective as a penalty or deterrent, "particularly if the organization ceases operations after it has diverted all its assets to improper purposes."[356] Without the excise tax, an organization that lost its exemption simply could transfer its assets to a new kindred exempt organization that may continue the political activity. The Ways and Means Committee report also notes that the Internal Revenue Service might hesitate to revoke the exempt status of an organization where that penalty seems disproportionate to the degree of political activity.[357] The legislative history indicates, however, that adoption of the excise tax does not modify existing law prohibitions on political activity as a prerequisite for qualification for exemption under section 501(c)(3).[358]

In a 1995 Technical Advice Memorandum (TAM),[359] the Internal Revenue Service suggested a broad interpretation of the term "political expenditure" and the prohibited intervention in a political campaign for purposes both of the excise tax of section 4955 and qualification under section 501(c)(3).[360] The TAM held that fund-raising letters mailed by a "non partisan" section 501(c)(3) organization that was engaged in voter

353. *Id.* § 4955(d)(1).

354. *See supra* note 305 and accompanying text.

355. Treas. Reg. § 53.4955-1(c)(1) (1995).

356. H. REP. NO. 100-391, pt.2, at 1624 (1987).

357. *Id.* at 1623. The legislative history also states that the Internal Revenue Service is to strengthen its enforcement of the prohibitions on political activity by exempt charitable organizations. *Id.* at 1627. Another part of the legislation added section 7409, which gives the Internal Revenue Service authority to seek to enjoin a charitable organization from making political expenditures, and section 6852, which provides for an immediate assessment of tax in the case of an organization that makes political expenditures that are a "flagrant violation" of the prohibition. Omnibus Budget Reconciliation Act of 1987, § 10713, Pub. L. No. 100-203, 100 Stat. 1330-468-69.

358. H.R. REP. NO. 100-391, pt.2, at 1624.

359. Priv. Ltr. Rul. 96-09-007 (Dec. 6, 1995).

360. *Id.* at 13, 16.

registration activities constituted intervention in a political campaign.[361] The fund-raising letters were addressed to individuals on one side of the political spectrum and cited the close election or defeat of named candidates adhering to a particular political philosophy as the reason for contributing to the organization's voter registration activities.[362] The bulk of the organization's fund-raising letters was mailed to persons outside of districts in which the named candidates were running who, therefore, were not in a position to vote for or against the candidates described in the fund-raising letters.[363] The Internal Revenue Service took the position in the TAM that "intervention in a political campaign may be subtle or blatant. It may seem to be justified by the press of events. It may even be inadvertent. The law prohibits all forms of participation or intervention in 'any' political campaign."[364] The TAM thus takes the position that express advocacy for the election or defeat of a named candidate is not a necessary component of advocacy that represents prohibited intervention in a political campaign.[365] The scope of this ruling, issued shortly before the 1996 presidential campaign cycle, signaled to exempt organizations that the Internal Revenue Service was serious about restricting the participation of section 501(c)(3) organizations in political campaigns.[366]

Similarly, in a 2000 Technical Advice Memorandum the Service concluded that a fund-raising letter soliciting contributions to an exempt organization that was signed by a nationally prominent political candidate constituted intervention in a political campaign.[367] The letter was printed on the candidate's letterhead.[368] The candidate allowed the use of his signature and letterhead in exchange for a one-time use of the organization's mailing list of persons who responded to the solicitation.[369]

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361. *Id.* at 16-17.

362. *Id.* at 17.

363. *Id.* at 32.

364. *Id.* at 16-17.

365. *See id.*; *see also* Priv. Ltr. Rul. 89-36-002 (May 24, 1989) ("We are not convinced that the Supreme Court's 'express advocacy' standard is controlling in interpreting section 501(c)(3) of the Code which provides for an absolute bar against intervening in any political campaign on behalf of (or in opposition to) any candidate for public office.").

366. *See* Ryan J. Donmoyer, *IRS to Exempts: Politicking Will Cost You*, 71 TAX NOTES 25, 25 (1996).

367. Priv. Ltr. Rul. 2000-44-038 (July 24, 2000). The exempt organization in the ruling has been identified as The Heritage Foundation. Carolyn D. Wright, *EO's Grapple with Emerging Issues at ALI-ABA Gathering*, 89 TAX NOTES 1361, 1364 (2000). The letter was signed by presidential candidate Senator Bob Dole. *Id.* at 1364-65. The letter ruling describes the organization as having been granted an exemption "on the basis of an educational purpose to conduct and sponsor research on the social and economic forces in the country and the governmental interaction with these forces." Priv. Ltr. Rul. 2000-44-038.

368. Priv. Ltr. Rul. 2000-44-038.

369. *Id.* The ruling states that the candidate intermingled the mailing list with his campaign

The use of prominent political figures as signatories to its fund-raising solicitations was a common practice of the organization.[370] The letter ruling also indicates that the technique was common to several fund-raising efforts[371] and the use of the particular politician's signature was a "hot" prospect.[372] The TAM concludes that the organization's use of the candidate's letter was intervention in the campaign under both sections 501(c)(3) and 4955 because the contents of the letter, which coincided with the candidate's election campaign, included affirmative statements about the candidate's positions on various issues and negative statements about the candidate's opponent, all of which were "very much like [the candidate's] campaign statements, positions, and rhetoric."[373] The TAM states that the presence of prohibited political intervention under section 501(c)(3) "does not hinge on whether the communication constitutes 'express advocacy' for Federal election law purposes. Rather for purposes of section 501(c)(3), one looks to the effect of the communication as a whole, including whether support for, or opposition to, a candidate for public office is express or implied."[374] Thus, although the organization's letter signed by the candidate neither expressly advocated election of the candidate nor defeat of the candidate's opponent, the fact that the candidate was a highly visible candidate for elective office led to a conclusion in the TAM that

> recipients of the . . . letter would naturally associate the statements of the letter as indistinguishable from [the candidate's] election effort.... By featuring the [candidate's] signature and using the first person with a text in the letter sounding very much like campaign rhetoric, the fund raising letter is inextricably tied to the election of the signatory of the letter.[375]

In reaching this conclusion, the Service adopts a standard to identify campaign activity that is close to the standard adopted by the Ninth Circuit

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mailing list. *Id.* Subsequently the organization adopted a "seeding" technique to identify a second use of its mailing list. *Id.* The organization was compensated for the candidate's serial use of the mailing list by a transfer of 35,000 names of donors to the candidate's campaign for the purpose of a one-time use by the organization in a fund-raising solicitation. *Id.*

370. *Id.* at 37.

371. *Id.* at 38. The letter ruling stated that "the sale or exchange of lists between exempt organizations for fund-raising purposes is not an uncommon practice." *Id.*

372. *See id.* at 13.

373. *Id.* at 29-30.

374. *Id.* at 26.

375. *Id.* at 30-31.

Court of Appeals in *FEC v. Furgatch*:[376] that campaign advocacy may be identified from the substance of the communication rather than the form of its magic words.[377]

Although the 2000 TAM incorporates a fairly broad view of prohibited campaign intervention, the TAM leaves open the door for interrelated fund-raising between a candidate and an exempt organization. The TAM stresses that it is the content and the timing of the letters signed by the candidate that constitute political intervention.[378] The TAM indicates that the organization's providing the candidate with its mailing list in exchange for the candidates signature on a fund-raising letter was a "legitimate business transaction."[379] The TAM does not specify whether the timing of the mailing in connection with a campaign in which the signer was a candidate alone, in the absence of partisan content, would be sufficient to classify the mailing as intervention in the political campaign. The mailing of the letter signed by the candidate to the organization's supporters, who by the nature of the organization likely would be favorably disposed towards the candidate in contrast to his opponent, is by its nature an indirect statement of support for the candidate. Nonetheless, the TAM seems to approve of the relationship.[380]

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376. 807 F.2d 857 (9th Cir. 1987).

377. *See id.* at 864.

378. Priv. Ltr. Rul. 2000-44-038 (July 24, 2000), 2000 PRL LEXIS 1431, at *35.

379. *Id.* at *38. The ruling states:

> [B]ut the fact remains that A's campaign received the donor list in consideration for A's signature. It did not receive the list as a gift but as bargained for consideration for the use of A's name and signature. If X had paid A cash consideration for his signature on the prospect mailings and the house file mailings, A's campaign could have used the cash to pay costs of developing a list of supporters. X's list transferred to A's campaign for use was originally for a limited one time use. Additional consideration was paid by A's campaign for the excessive use of the lists in violation of the contract between the parties. If the various exchanges were all at fair market value, A's campaign has gained no advantage by virtue of its transaction with X.

Id. at *39-40.

380. *See id.* at *40-41. The TAM also exonerates the organization's managers from liability for the 2½% excise tax of section 4955(a)(2) because the managers had received advice of counsel that the expenditure was permissible. *Id.* at *46-51; *see also* Treas. Reg. § 53.4955-1(b)(7) (1995) (declaring that when a manager reasonably relies on the advice of counsel expressed in a reassured written legal opinion, the manager's agreement to an expenditure is not considered a knowing or willful political expenditure).

b. Educational Activities

Organizations qualify for exempt status under section 501(c)(3) if their purpose is educational.[381] Educational activities include "the instruction of the public on subjects useful to the individual and beneficial to the community."[382] Instruction of the public may include discussion of contemporary political issues, which also may reflect the views of particular political candidates.[383] Thus, Treasury Regulations provide that "[a]n organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion."[384] In Revenue Ruling 78-248[385] the Service acknowledged that voter education about candidates and political office holders "conducted in a non-partisan manner" is not prohibited political activity.[386] The ruling attempted the impossible task of distinguishing permissible from impermissible educational activity with a description of four varied factual situations.[387] Publication of voting records of members of Congress on a wide variety of subjects, or publishing the results of responses to questionnaires on a wide range of topics, in a widely distributed voters' guide, is not treated as intervention in a political campaign.[388] However, the Ruling indicates that if the publication of voting records or the solicitation of position statements is limited to issues of particular interest to the organization, or the nature of questions demonstrates a bias with respect to issues, the activity is interference in a political campaign.[389] The Ruling states that "[w]hile the guide may provide the voting public with useful information, its emphasis

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381. I.R.C. § 501(c)(3) (2001).

382. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b) (as amended in 1990); *see also* Rev. Rul. 78-305, 1978 C.B. 172 (homosexual education); Rev. Rul. 75-285, 1975 C.B. 203 (discrimination education); Rev. Rul. 72-560, 1972-2 C.B. 248 (employment education for minorities); Rev. Rul. 68-15, 1968-1 C.B. 244 (community tension, discrimination, physical detention, and juvenile delinquency education); Rev. Rul. 66-256, 1966-2 C.B. 210 (social, political, and international education).

383. *See Corporate Philanthropy*, *supra* note 5, at 928-30.

384. Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) (as amended in 1990). The regulation adds that "an organization is not educational if its principal function is the mere presentation of unsupported opinion." *Id.* For a discussion of the constitutional infirmities in the regulation, *see infra* text accompanying notes 405-14.

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

386. *Id.* at 154.

387. *Id.* at 154-55.

388. *Id.*

389. *Id.* at 155.

on one area of concern indicates that its purpose is not nonpartisan voter education."[390]

In Revenue Ruling 80-282[391] the Service permitted publication of incumbents' voting records on issues of interest to a section 501(c)(3) organization.[392] The ruling stresses that whether an education program intervenes in a political campaign is a question of the facts and circumstances in each case.[393] Revenue Ruling 80-282 considered an organization's newsletter, which published the voting records of incumbents whether or not running for re-election, that was distributed to a relatively small membership base.[394] The newsletter's reports focused on voting records on issues of importance to the organization and described the organization's viewpoint along with the voting records, but had a narrow distribution that was not targeted to a larger audience in areas where elections were taking place.[395] That permitted a finding that publication of the voting records did not constitute intervention in a political campaign.[396]

The distinction between non-partisan education on a broad range of issues, and biased education intended to influence the outcome of an election is anything but clear. In Revenue Procedure 86-43[397] the Service again attempted to clarify the distinctions between educational and prohibited political advocacy. The Service recognized that advocacy of particular viewpoints may be educational, even if the viewpoint is unpopular or not generally accepted.[398] The Revenue Procedure indicates that the Service will not render judgment as to the particular viewpoint or

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390. *Id.*
391. Rev. Rul. 80-282, 1980-2 C.B. 178.
392. *Id.* at 178.
393. *Id.*
394. *Id.* at 179.
395. *Id.*
396. *See id.* The ruling also points out that

> the voting records of all incumbents will be presented, candidates for reelection will not be identified, no comment will be made on an individual's overall qualifications for public office, no statements expressly or impliedly endorsing or rejecting any incumbent as a candidate for public office will be offered, no comparison of incumbents with other candidates will be made, and the organization will point out the inherent limitations of judging the qualifications of an incumbent on the basis of certain selected votes by stating the need to consider such unrecorded matters as performance on subcommittees and constituent service.

Id.
397. Rev. Proc. 86-43, 1986-2 C.B. 729.
398. *Id.* at 729.

position, but will instead examine the method used by the organization to present its views.[399]

> The method used by the organization will not be considered educational if it fails to provide a factual foundation for the viewpoint or position being advocated, or if it fails to provide a development from the relevant facts that would materially aid a listener or reader in a learning process.[400]

The Revenue Procedure also lists four factors that indicate that the advocacy is not educational:

> 1. The presentation of viewpoints or positions unsupported by facts is a significant portion of the organization's communications.
> 2. The facts that purport to support the viewpoints or positions are distorted.
> 3. The organization's presentations make substantial use of inflammatory and disparaging terms and express conclusions more on the basis of strong emotional feelings than on objective evaluations.
> 4. The approach used in the organization's presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter.[401]

The Revenue Procedure also indicates that the Service will look to all the facts and circumstances, even in the presence of one of the listed negative factors, to determine whether an organization may be considered to be educational.[402] The Revenue Procedure adds that even if an organization is deemed to be educational under the listed criteria, the organization also must meet other requirements of section 501(c)(3), including restrictions on attempting to influence legislation and intervention in a political campaign.[403] Thus, although the Revenue Procedure adopts an approach focused on the method of advocacy, there remains room to deny exemption to an organization whose educational activity is undertaken with a purpose to support or oppose a candidate or specific legislation.[404]

The import of the Internal Revenue Service's methodology test is illustrated by two cases decided by the D.C. Circuit Court of Appeals prior

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399. *Id.*
400. *Id.* at 729-30.
401. *Id.* at 730.
402. *Id.*
403. *Id.*
404. Hill, *supra* note 332, at 239-40.

to the promulgation of Revenue Procedure 86-43. In *Big Mama Rag, Inc. v. United States*,[405] the Service refused to grant charitable organization status under section 501(c)(3) to a feminist oriented organization whose primary activity was to publish a newspaper on issues of interest to women.[406] The Service denied charitable organization status to Big Mama Rag on the grounds that the newspaper was a commercial enterprise, it contained political and legislative commentary throughout, and it contained articles, lectures, and editorials, promoting lesbianism.[407] The district court rejected the Commissioner's argument that the enterprise was not entitled to tax-exemption because of its commercial nature, but agreed with the Commissioner that the organization did not meet the definitions of "educational" and "charitable" of Treasury Regulations section 1.501(c)(3)-1(d)(2) and (3).[408] The court of appeals reversed and remanded the case for further consideration concluding that the regulations were unconstitutionally vague.[409] Both the district court and the court of appeals agreed that the regulatory test for educational activities based on whether an organization provides "instruction of the public on subjects useful to the individual and beneficial to the community"[410] is "too subjective in its application to pass constitutional muster."[411] The reviewing court parted company with the trial court, however, over the provision of the regulations that permits advocacy of a "particular position or viewpoint so long as it presents a sufficiently *full and fair exposition* of the pertinent facts as to permit an individual or the public to form an independent

405. 631 F.2d 1030 (D.C. Cir. 1980).

406. *Id.* at 1032.

407. *Id.* at 1033. The Internal Revenue Service District Director argued:

> The organization in publishing the newspaper is not operated exclusively for educational purposes as required by Code section 501(c)(3) as the content of the publication is not educational, the preparation of the material does not follow methods educational in nature, the distribution of the material is not valuable in achieving an educational purpose and/or the manner in which the distribution is accomplished is not distinguishable from ordinary commercial publishing practices.

Id. at 1033 n.4. Contrast this with Revenue Ruling 78-305, which recognizes section 501(c)(3) exempt status for an organization to educate the public about homosexuality through seminars, forums and discussion groups in order to foster understanding and tolerance. Rev. Rul. 78-305, 1978-2 C.B. 172.

408. *Big Mama Rag*, 631 F.2d at 1033. The taxpayer brought an action for declaratory judgment under Internal Revenue Code section 7428, which provides an action for declaratory relief in the case of a denial of tax-exempt status. Big Mama Rag, Inc. v. United States, 494 F. Supp. 473, 474 (D.D.C. 1979).

409. *Big Mama Rag*, 631 F.2d at 1039-40.

410. Id. at 1035-36 (quoting Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(b) (1959)).

411. *Id.* (quoting *Big Mama Rag*, 494 F. Supp. at 479 n.6).

opinion or conclusion."[412] The circuit court concluded that whether the full and fair exposition test applied only to advocacy organizations or to all organizations was unclear and therefore unconstitutionally vague, and further that the ambiguity resulted in selective application of the standard.[413] The court further opined that the test "is expressly based on an individualistic–and therefore necessarily varying and unascertainable–standard."[414]

Three years after *Big Mama Rag*, the D.C. Circuit resurrected the regulations, at least somewhat, in *National Alliance v. United States*.[415] National Alliance was a white supremacist organization that published a newspaper, a membership bulletin, and organized lectures and meetings.[416] The Internal Revenue Service denied National Alliance's application for exemption under section 501(c)(3) on the ground that the organization's activities were not educational under the same regulations declared invalid by the court in *Big Mama Rag*.[417] In this instance, however, the Service also relied on its four-part "methodology test" as a gloss on the "full and fair exposition" test of the regulations.[418] The court of appeals first

412. *Id.* at 1037 (citing Treas. Reg. § 1.501(c)(3)-1(d)(3)) (italics added).

413. *Id.*

414. *Id.*

415. 710 F.2d 868 (D.C. Cir. 1983).

416. *Id.* at 869. The court described National Alliance's publications as follows:

> *Attack*! is the organization's principal publication; it contains stories, pictures, feature articles and editorials in a form resembling a newspaper. The general theme of the newsletter is that "non-whites"—principally blacks—are inferior to white Americans of European ancestry ("WAEA"), and are aggressively brutal and dangerous; Jews control the media and through that means—as well as through political and financial positions and other means—cause the policy of the United States to be harmful to the interests of WAEA. A subsidiary proposition is that communists have persuaded "neo-liberals" of equality among human beings, the desirability of racial integration, and the evil of discrimination on racial grounds. In support of these themes, each newsletter contains one or two news stories reporting incidents of murder or other violence by black persons, and identifying as Jews persons holding important media or other positions. Reports of black violence are presented as brief factual accounts—though usually without reference to source—accompanied by assertions of a media coverup and the inborn savagery of blacks. Identifications as Jews of individuals holding significant positions are accompanied by assertions of resulting Jewish manipulation of American society. Other articles and editorials attribute political and social events deemed detrimental to WAEA to the integration of non-whites into society or to Jewish manipulation of society.

Id. at 871-72 (footnotes omitted).

417. *Id.* at 873-75.

418. *Id.* at 870. The four-point methodology test utilized by the Service is essentially the same as the methodology test of Revenue Procedure 86-43, 1986-2 C.B. 729. *See supra* note 397 and accompanying text.

concluded that National Alliance's publications could not be considered educational under any definition of the term.[419] In discussing the court's opinion in *Big Mama Rag*, the court in *National Alliance* pointed out that while First Amendment activities need not be subsidized, discriminatory denial of tax exemptions for engaging in particular speech is constitutionally impermissible.[420] The court also stated that the defect in the regulations in *Big Mama Rag* was their vagueness, which might permit the Internal Revenue Service to deny tax-exemption on the basis of acceptance or rejection of the ideas expressed by an organization.[421] That standard, however, does not preclude denial of an exemption "on criteria neutral with regard to viewpoint."[422] The court also observed in *National Alliance* that the methodology test reduces the vagueness found in *Big Mama Rag* as the four criteria "tend toward ensuring that the educational exemption be restricted to material which substantially helps a reader or listener in a learning process."[423] The court declined, however, to indicate whether application of the methodology test is sufficient to cure the vagueness that it found in the regulations in *Big Mama Rag*.[424] Nonetheless, in Revenue Procedure 86-43 the Internal Revenue Service apparently viewed the opinion in *National Alliance* as a green light to apply the methodology test as the standard in all cases "where the educational purposes of an organization that advocates a particular viewpoint or position are in question."[425]

A 1998 Technical Advice Memorandum illustrates the border, as perceived by the Internal Revenue Service, between an exempt organization's educational activity and intervention in a political campaign and lobbying.[426] The exempt organization was engaged in publishing newsletters and producing radio commentaries by the organization's president concerning public policy issues.[427] The organization's president

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419. *National Alliance*, 710 F.2d at 873. The court states that "in order to be deemed 'educational' and enjoy tax exemption some degree of intellectually appealing development of or foundation for the views advocated would be required." *Id.* In other words, as the court points out is required by Treas. Reg. § 1.501(c)(3)-1(d)(3), the organization must "present a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion," and an organization is not educational if its principal function is the mere presentation of unsupported opinion. *Id.* at 869-70.

420. *Id.* at 875 (citing Speiser v. Randall, 357 U.S. 513, 518 (1958)).

421. *Id.*

422. *Id.*

423. *Id.*

424. *Id.* at 876.

425. Rev. Proc. 86-43, 1986-2 C.B. 729, 729.

426. Pvt. Ltr. Rul. 1999-07-021 (May 20, 1998), 1998 PLR LEXIS 2073, at *51-61. The organization involved in the ruling has been identified as the Freedom Alliance, a conservative nonprofit organization headed by Oliver North who ran as a candidate for the United States Senate. Fred Stokeld, *Group Founded By Oliver North Gets Its Exemption Back*, 85 TAXNOTES 1140, 1140 (1999).

427. Priv. Ltr. Rul. 1999-07-021, 1998 PRL LEXIS 2073, at *8.

was directly engaged in political campaign activities on his own behalf as a potential candidate.[428] The TAM addressed several different communications by the organization, all but one of which were found to be educational.[429] Shortly before congressional elections the organization published a communication indicating that it was "fed up" with Congress and urging its members to let Congress know how they felt by voting and urging others to vote.[430] However, the communication did not identify any specific candidates for Congress nor support or oppose an identifiable group of candidates.[431] Thus, the communication did not constitute intervention in a political campaign.[432] The TAM indicated that, "This communication could be viewed as focusing attention on the perceived abuses of the Congress or as a way to send a message of disgust to members of Congress."[433] In June of the following year, almost one and one-half years in advance of the next congressional election, the organization produced commentary criticizing named members of the Congress and Senate for their votes against a particular resolution.[434] Although that series of commentary expressly disapproved of the political positions of named office holders, there was no indication that the named office holders were candidates for election when the statements were distributed.[435] As a consequence, the TAM again concluded that the statements did not constitute intervention in a political campaign.[436] On the other hand, in a radio commentary, the organization's president criticized an announced candidate for the presidential nomination of a particular political party by describing the candidate's political/economic ideology as a failed ideology.[437] The organization claimed that the commentary was educational as criticism of economic issues raised by the candidate.[438] The TAM did not question the educational content of the broadcast and noted that the commentary may have been in response to the candidate's attack on national economic policies.[439] The TAM pointed out that the prohibition against campaign activity on behalf of or in opposition to a candidate for political office "refers not to the motive of the participant but the

428. *Id.*
429. *Id.* at *69.
430. *Id.* at *11-12.
431. *Id.* at *32.
432. *Id.* at *33.
433. *Id.* at *32.
434. *Id.* at *33.
435. *Id.* at *34.
436. *Id.* at *33-36. Although this activity might be considered to be lobbying on behalf of pending legislation, the TAM concluded that the organization's lobbying activity was not "substantial" nor outside of the organization's permitted expenditures under its section 501(h) election. *Id.* at *50.
437. *Id.* at *13.
438. *Id.* at *38.
439. *Id.*

reasonable consequences of his or her activities."[440] The commentary, which occurred in the context of an active campaign and included material that explicitly favored or opposed the views of a named candidate "violate[d] the proscription against political campaign intervention."[441] On the broad question of whether the organization's political commentary was "educational" within the meaning of section 501(c)(3), the TAM reads as follows:

> While nearly all of X's articles discuss various public policy issues from a particular ideological perspective, the articles to some extent set forth the opposition's positions. Despite the perception that X's articles present facts that shed an unfavorable light on opposing ideological perspectives, we cannot say that newsletter articles or X's other informational communications are based upon unsupported opinion. X, on a regular basis, has cited independent sources that support the facts contained in the articles. The communications of an organization such as X are educational, even though they maintain clear and definite positions on public policy issues that are discussed and addressed in the legislative and political realms, because they use an educational methodology.[442]

The statutory, regulatory, and administrative positions barring intervention in political campaigns portray a regime that contains strict limitations on participation in political campaigns by tax-exempt charitable organizations. The authorities describing educational activity, however, illustrate that the proscription against direct political activity by charitable organizations leaves significant space for advocative association with political issues and candidates who share the ideology, or in some cases manage, charitable organizations.[443] The statutory prohibitions on

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440. *Id.*

441. *Id.*

442. *Id.* at *68-69.

443. For example, shortly before the 2000 presidential election a tax-exempt section 501(c)(3) organization called "Voice of the Environment" ran an advertisement in the New York Times headed, "It's Time We Stopped Allowing the Democratic and Republican Parties to Tear our Country Apart!" The ad urged "the 100 million Americans who have 'dropped out' in disillusionment and frustration" to vote. N.Y. TIMES, Oct. 26, 2000, at C21. The ad can be found on the Web at http://www.voteaction.org (last visited July 26, 2001). Editorials on the Web site recommend Ralph Nader, the alternative Green Party candidate for President. The advertisement solicits "tax deductible" contributions to the organization.

A Sierra Club advertisement published in the New York Times was headed, "George Bush's Answer to High Energy Prices? Replace Polar Bears with Oil Derricks." N.Y. TIMES, Oct. 4, 2000, at B14. After quoting speeches by the candidates the ad concluded by saying, "Think there's no difference when it comes to Al Gore and George W. Bush? Think again, if you care

participating in the election of a candidate and the limited permission for lobbying leave unbarred a wide avenue for participation in political activity by section 501(c)(3) organizations. Part III of this Article will explore the methods used by some advocative organizations to exploit these pathways.

ii. Social Welfare Organizations

As noted by the Supreme Court in *Regan v. Taxation with Representation*,[444] an organization whose advocacy is constrained by the prohibitions of section 501(c)(3) can forgo the governmental subsidy for deductible contributions[445] and engage in tax-exempt political advocacy. Section 501(c)(4) of the Code exempts from tax civic organizations and nonprofit organizations "operated exclusively for the promotion of social welfare."[446] The only statutory restriction in the Internal Revenue Code on the activities of a "social welfare" organization is a proscription on the use of the net earnings of the organization for the benefit of any private individual or shareholder.[447]

A social welfare organization satisfies the Treasury Regulations' requirement that it be operated exclusively for the required exempt purpose "if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community."[448] An organization may qualify as a social welfare organization even though it would be described as an "action organization" because of lobbying activities and attempts to influence legislation.[449] The regulations add, however, that the "promotion of social welfare does not include direct or

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about the environment and national treasures like the Arctic Refuge." The ad did not mention voting, but the import of the advocacy is quite clear. The Sierra club has both section 501(c)(3) and section 501(c)(4) organizations within its integrated structure.

444. 461 U.S. 540 (1983).

445. I.R.C. § 6113 requires tax-exempt organizations, other than organizations described in section 170(c), to which deductible contributions are permitted, to disclose in all fund-raising solicitations the fact that contributions are not deductible. There is still some possibility that a mistaken belief that contributions are deductible helps a section 501(c)(4) organization in its fundraising. *See* Brent Coverdale, *A New Look at Campaign Finance Reform: Regulation of Nonprofit Organizations Through the Tax Code*, 46 KAN. L. REV. 155, 161 (1997).

446. I.R.C. § 501(c)(4)(A) (2001). Section 501(c)(4) also exempts associations of employees of a designated employer in a particular municipality. *Id.*

447. *Id.* § 501(c)(4)(B). Incorporated social welfare organizations might be subject to the proscription of the FECA on corporate political expenditures. 2 U.S.C. § 441b(a) (2001). However, under *FEC v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238 (1986), discussed *supra* at note 139, the limitation cannot constitutionally be applied to voluntary nonprofit organizations that are not engaged in business. *Id.* at 263-64.

448. Treas. Reg. § 1.504(c)(4)-1(a)(2)(i) (as amended in 1990).

449. *Id.* §§ 1.504(c)(4)-1(a)(2)(ii), 1.504(c)(3)-1(c)(3)(ii).

indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office."[450] Nonetheless, unlike the case with respect to a section 501(c)(3) organization, Revenue Ruling 81-95[451] holds that as long as an organization that is exempt from tax under section 501(c)(4) is "primarily engaged in activities [that] promote social welfare,"[452] lawful participation[453] in political campaigns is permitted. The ruling based its conclusion, in part, on legislative history to the 1975 enactment of section 527 of the Code that suggests that section 501(c)(4) organizations may engage in political activities.[454] Citing Revenue Ruling 67-368,[455] Revenue Ruling 81-95 also indicated that an organization that is primarily engaged in political campaign activity is not a social welfare organization.[456] Thus, an organization exempt from tax under section 501(c)(4) may intervene in political campaigns, as long as those activities are not its "primary" activity. In addition, a social welfare organization may undertake its campaign activity through a segregated fund that is itself exempt from tax under section 527 of the Code.[457]

The absence of statutory prohibitions on political activity by a tax-exempt social welfare organization also makes the tax-exemption of section 501(c)(4) available for organizations that intervene in state initiative campaigns. An organization may justify advocacy for such issues as gun control, power company regulation or deregulation, pro- or anti-affirmative action, etc. as advocacy for the promotion of social welfare within the meaning of the Treasury Regulations.[458] The regulatory permission for social welfare organizations to participate in influencing

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450. *Id.* § 1.504(c)(4)-1(a)(2)(ii).

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

452. *Id.*

453. General Counsel Memorandum 38,264 (Jan. 30, 1980) raises a question under the FECA whether it is lawful for an incorporated exempt organization to make political contributions or political expenditures. *See* 18 U.S.C. § 610 (1970 & Supp. IV); 11 C.F.R. § 114.7 (2000). The General Counsel Memorandum states that "[i]llegal activities are the antithesis of activities that promote social welfare. Stated otherwise, the common good and general welfare of the people of a community is the cornerstone of the social welfare concept and illegal activities cannot be said to benefit the community." Gen. Couns. Mem. 38,264 (Jan. 30, 1980).

454. S. REP. NO. 93-1357, 93d Cong. 2d Sess. 29 (1974), *reprinted in* 1975-1 C.B. 517, 533. Section 527 is discussed *infra* beginning at note 479.

455. Rev. Rul. 67-368, 1967-2 C.B. 194. A bipartisan organization formed for the purpose of rating candidates for local public office cannot qualify as a social welfare organization under section 501(c)(4) notwithstanding a public purpose to acquaint voters with the candidates. The ruling states that "[c]omparative rating of candidates, even though on a nonpartisan basis, is participation or intervention on behalf of those candidates favorably rated and in opposition to those less favorably rated." *Id.* at 194.

456. Rev. Rul. 81-95, 1981-1 C.B. 332, 333.

457. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996), 1996 PRL LEXIS 1885.

458. *See* Treas. Reg. § 1.504(c)(4)-1(a)(2)(i) (as amended in 1990).

legislation[459] would seem to apply to legislation enacted through the initiative process and related grassroots campaigning. Further, if the primary mission of such an organization is the promotion of social welfare through sponsorship of initiative campaigns, the organization may also lend its support to political candidates whose views are consistent with the organization's initiative positions as long as that activity is subsidiary to the primary mission.

A section 501(c)(3) organization is required to establish its section 501(c)(4) affiliate before it imperils its tax exemption under section 501(c)(3) with political advocacy.[460] Section 504 provides that an organization that loses its exemption under section 501(c)(3) because of political activity is not thereafter allowed to qualify as a section 501(c)(4) organization. Ironically, there is no prohibition on reforming a new section 501(c)(3) organization to accept the assets and continue the charitable activity of the disqualified organization.[461]

iii. Other-Tax Exempt Organizations

In addition to charities and social welfare organizations, section 501 exempts from tax certain organizations such as business leagues,[462] labor organizations,[463] social organizations,[464] fraternal organizations,[465] and others that are organized around common interests of the members. The principal regulatory issues with respect to this type of exempt organization appear to be concerns that the organization does not cross a line into commercial activity that dominates its exempt functions and that the organization is not operated for the personal benefit of particular individuals.[466] With respect to political activity, the Internal Revenue

459. Treas. Reg. § 1.504(c)(4)-1(a)(2)(ii) (as amended in 1990); Treas. Reg. § 1.504(c)(3)-1(c)(3)(ii).

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

461. *See, e.g.*, Treas. Reg. § 1.504-2(b)(5)(ii). In general, Treasury Regulation section 1.504-2 contains rules threatening the tax-exempt status of a commonly controlled transferee organization that receives a transfer from an organization that has lost its section 501(c)(3) exemption because it is a political action organization.

462. I.R.C. § 501(c)(6) (2001).

463. *Id.* § 501(c)(5). Section 501(c)(5) also exempts agricultural and horticultural organizations. *Id.*

464. *Id.* § 501(c)(7).

465. *Id.* § 501(c)(8).

466. *See, e.g.*, Treas. Reg. § 1.501(c)(6)-1 (as amended in 1960) (providing that an exempt business league must be organized for the purpose of improving one or more lines of business); *id.* § 1.501(c)(7)-1(b) (providing that the exemption applies only to clubs organized and operated for pleasure, recreation, and other nonprofitable purposes); Thomas J. McGee Regular Democratic Club, Inc. v. Comm'r, 1 T.C.M. (CCH) 18 (1942) (holding that a club-operated restaurant and bar was not exempt since it could be used to make a profit).

Service concluded in Revenue Ruling 61-177[467] that an otherwise qualified business league whose primary activity was promoting legislation favorable to its members in a particular line of business was eligible for tax exemption under section 501(c)(6).[468] While this ruling may not be directly applicable to an organization organized for social or other interest group purposes,[469] the conclusion of the ruling—that in the absence of specific statutory prohibitions on political activity the political intervention is permissible to a tax-exempt organization—is significant to all exempt organizations other than charitable organizations.[470]

Incorporated organizations that are exempt under sections 501(c)(6), (c)(7), or (c)(8) may be subject to FECA's prohibition on corporate campaign expenditures. Under *Austin v. Michigan Chamber of Commerce*[471] multipurpose corporations, particularly trade unions and organizations with corporate funding, constitutionally may be held subject to the limitations in political expenditures from treasury funds.[472] Such organizations are permitted to engage in political advocacy only through the device of a separate segregated fund.[473]

The Internal Revenue Service suggests in General Counsel Memorandum 34,233[474] that a distinction can be drawn between legislative activities in support of specific positions that are identified with the interests of an organization and its involvement in support of a political candidate.[475] In the latter case, the organization becomes identified with the full range of the candidate's positions whether or not they are germane to the interests around which the organization is formed.[476] Thus, an

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467. Rev. Rul. 61-177, 1961-2 C.B. 117.

468. *Id.* The deduction for dues and other fees to such an organization is constrained by section 162(e). *See supra* note 241. Thus the tax subsidy to lobbying by such an organization is limited. While the exempt organization pays no tax on receipts for its lobbying services, the expenditures are subject to at least one level of tax as after-tax money from the contributors.

469. But see General Counsel Memorandum 34,233 which holds that the same principle applies to a labor organization exempt from tax under section 501(c)(5) of the Code thereby allowing tax exemption to an organization whose primary function is seeking legislation for the benefit of labor. Gen. Couns. Mem. 34,233 (Dec. 30, 1969), 1969 IRS GCM LEXIS 12. This logic would seem to apply to permit tax-exemption under section 501(c)(7) to an organization primarily engaged in lobbying for legislation that protects the recreational interests of its members.

470. Revenue Ruling 61-177 states: "There is no requirement, by statute or regulations, that a business league, chamber of commerce, etc., in order to be considered exempt as such, must refrain from carrying on propaganda or influencing legislation." Rev. Rul. 61-177, 1961-2 C.B. 117 (1961).

471. 494 U.S. 652 (1990).

472. *Id.* at 654-55.

473. 2 U.S.C. § 441b(b)(2) (2001).

474. Gen. Couns. Mem. 34,233 (Dec. 30, 1969), 1969 IRS GCM LEXIS 12.

475. *Id.* at *7.

476. *Id.* at *8.

exempt organization formed for the exclusive benefit of promoting the interests of its members may not be directly promoting those interests if it is primarily engaged in the support of candidates for elective office. The General Counsel Memorandum adds, however, that if the primary activity of an organization qualifies it for tax exemption, incidental involvement with political candidates will not jeopardize the exemption.[477] Thus, the G.C.M. concludes that an organization primarily involved with legislation in support of the interests of its members may also engage in activities in support of political candidates. As a consequence, a wide range of political activity remains open to tax-exempt labor, business, fraternal, and social organizations that may make political contributions or otherwise advocate election of candidates who support its interests. The House Committee on Ways and Means reported that in 1994, nearly 1,300 section 501(c)(4), section 501(c)(5), and section 501(c)(6) organizations reported a total of over $29 million in political expenditures on their Form 990s.[478]

iv. Section 527 Organizations: Political Organizations and Segregated Funds of Exempt Organizations

The door to political campaign activities by tax-exempt organizations is further opened by section 527 of the Internal Revenue Code. Section 527 excludes from income amounts received by a "political organization" that are expended to influence the nomination, election, or appointment of an individual to any federal, state, or local public office.[479] These items are referred to in the Code as "exempt function income."[480] Section 527

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477. *Id.* See also Revenue Ruling 68-266, 1968-1 C.B. 270, which holds that an organization whose membership consists of the members of a particular political party and persons who are interested in the affairs of the party may qualify as a tax-exempt social club under section 501(c)(7). *Id.* The organization invited speeches from political candidates, which was described as an insubstantial part of its activities. *Id.* The organization neither raised funds for candidates nor participated in political campaigns. *Id.*

478. H.R. REP. NO. 106-702, at 13 (2000). The Form 990 requires a report of political expenditures which encompasses only expenses incurred to influence the selection, nomination or election of a person to political office. *See* INTERNAL REVENUE SERVICE, 2000 INSTRUCTIONS FOR FORM 990 AND FORM 990EZ, at 26-27. This does not include expenditures by a separate segregated fund of the exempt organization. Presumably the figure also does not include voter education and issue advocacy expenditures that an organization does not deem to be "political expenditures." Thus, the $29 million figure understates the true degree of political activity by tax-exempt organizations.

479. I.R.C. § 527(d) (2001).

480. *Id.* § 527(c)(1)(A), (c)(3), (e)(2). Section 527(e)(2) defines the "exempt function" of a political organization as,

> 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-

shields from taxation two different but related types of "political organization," the activities of a pure political campaign organization,[481] and the campaign activities of a separate political fund of a tax-exempt organization.[482] A "political organization" is generally defined as any organization that is "organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both," for the purpose of influencing the election or appointment of candidates to public office.[483] The term political organization also includes a "separate segregated fund" of an organization that is exempt from tax by virtue of section 501(c).[484] This latter provision allows a tax-exempt labor union or trade association, for example, to segregate campaign contributions raised by its employees into a separate fund that is treated as a political organization separate from the otherwise tax-exempt organization.[485] Contributions thus raised by a tax-exempt organization and contributed to its separate segregated fund are not treated as contributions by the exempt organization.[486] An organization exempt from tax by virtue of section 501(c), which under Revenue Ruling 81-95[487] may engage in campaign activities as long as that is not its "primary" activity, is expected by Congress to segregate its campaign activities into a separate fund that is thus treated as a separate political organization.[488] In addition, there

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> Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed. Such term includes the making of expenditures relating to an office described in the preceding sentence which, if incurred by the individual, would be allowable as a deduction under section 162(a)

Id. § 527(e)(2).

481. *Id.* § 527 (c).

482. *Id.* § 527(f). Section 527 does not itself sanction participation in campaign activities by an organization that is an exempt charity or similar organization under section 501(c)(3). Treas. Reg. § 1.527-6(g) (1980).

483. I.R.C. § 527(e)(1) (2001). A political organization is one that receives contributions or makes expenditures for an "exempt function." *Id.*

484. *Id.* § 527(e).

485. S. REP. NO. 93-1357, at 30 (1974), *reprinted in* 1975-1 C.B. 517, 534; *see also* Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996); Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997), discussed *infra* in the text beginning at note 500. A separate segregated fund is defined in Treasury Regulation section 1.527-2(b)(1) as a fund maintained by an organization or individual that is separate from the assets of the organization or individual. Treas. Reg. § 1.527-2(b)(1) (as amended in 1985). The amounts in the fund must be dedicated for use in exempt functions; to wit, the election or appointment of candidates to office. *Id.* A savings or checking account used for exempt function contributions and expenditures may qualify as a segregated fund as long as no more than an "insubstantial amount" is expended from the fund for activities that are not exempt function activities under section 527. *Id.*

486. S. REP. NO. 93-1357, at 30 (1974), *reprinted in* 1975-1 C.B. 517, 534.

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

488. S. REP. NO. 93-1357, at 30 (1975), *reprinted in* 1975-1 C.B. 517, 534.

appears to be nothing that restricts a section 501(c)(3) charitable organization from forming a section 501(c)(4) social welfare organization that in turn maintains a separate segregated fund for the support of candidates favored by the tax-exempt charity, as long as tax-deductible contributions to the tax-exempt charity are not used for political campaigns.[489] Indeed, the boundaries between the tax-exempt charity, the tax-exempt social welfare organization, and the tax-exempt political organization may be nothing more than lines on an organization chart and separate accounting documents.

Section 527 was enacted to clarify the status of political organizations and campaign contributions after a series of rulings by the Internal Revenue Service that required political organizations to file tax returns including investment income in taxable gross income.[490] The Committee on Ways and Means asserted that political activity and the financing of political campaigns do not fit the description of a trade or business that is appropriately subject to tax.[491] Thus the Committee's report indicates that political organizations should be treated as tax exempt.[492] The Committee did conclude, however, that the net investment income of such organizations should be subject to tax.[493]

Section 527(c)(3) excludes from income only contributions, membership dues or fees, proceeds derived from political fund-raising and other events, proceeds from the sale of political campaign materials, and the proceeds of the operation of a bingo game.[494] Other income derived by a political organization, less expenses incurred in producing such income, is taxable to a political organization at the highest corporate tax rate.[495] Generally this provision refers to investment income,[496] although it also

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489. *See* Regan v. Taxation with Representation, 461 U.S. 540, 544 (1983). Direct expenditure of charitable contributions by a charity should be treated as intervention in a political campaign. See Gen. Couns. Mem. 33,912 (Aug. 15, 1968), 1968 IRS GCM LEXIS 169, which concludes that political activities of a business subsidiary of an incorporated section 501(c)(3) organization cannot be attributed to the charitable organization. *Id.* Revenue Ruling 68-489 indicates that a section 501(c)(3) organization can transfer funds to non-exempt organizations provided that it maintains control to ensure that the funds are used for section 501(c)(3) exempt purposes. Rev. Rul. 68-489, 1968-2 C.B. 210, 210.

490. S. REP. NO. 93-1357, at 25-26 (1975), *reprinted in* 1975-1 C.B. 517, 531-32. The reference is to Announcement 73-84, 1973-33 I.R.B. 18. *See also* Rev. Rul. 74-21, 1974-1 C.B. 15; Rev. Rul. 74-23, 1974-1 C.B. 17.

491. S. REP. NO. 93-1357, at 26, *reprinted in* 1975-1 C.B. 517, 532.

492. *Id.*

493. *Id.*

494. I.R.C. § 527(c)(3) (2001).

495. *Id.* § 527(b). A principal campaign committee, as designated by a candidate under the FECA, is subject to tax on its taxable income computed under the rate structure of section 11, rather than the highest rate. *Id.* § 527(h).

496. *Id.* § 527(h).

encompasses income from a trade or business other than influencing the outcome of an election or nomination. To prevent avoidance of the tax by a tax-exempt organization that might use investment income to directly fund campaign activity, section 527(f) provides that a tax-exempt organization is subject to tax under section 527(b) at the highest corporate rate on exempt function campaign expenditures to the extent of its investment income.[497] The Treasury Regulations clarify that transfers of campaign contributions by an exempt organization to a separate segregated fund maintained under section 527(f)(3) will not subject the exempt organization to tax.[498]

As is evidenced by a favorable series of private letter rulings from the Internal Revenue Service, political operatives have created a convenient pathway around the disclosure and regulatory scheme of the FECA that leads through tax exemption for political campaign activities under section 527.[499] Private Letter Ruling 96-52-026[500] is illustrative of the organization

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497. S. REP. NO. 93-1357, at 29 (1975), *reprinted in* 1975-1 C.B. 517, 533-34.

498. Treas. Reg. § 1.527-6(f) (1980).

499. The details of this device are discussed in Frances R. Hill, *Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle*, 86 TAX NOTES 387, 387 (2000).

500. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996), 1996 PRL LEXIS 1885, at *7. See also Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997), 1997 PLR LEXIS 404, which appears to involve the same fund, but with slightly different description of some of the fund's activities. The second ruling appears to have resulted from a subsequent correspondence from the taxpayer's representative. Both rulings were in response to concerns that a contribution to the section 501(c)(4) organization's political advocacy program would be subject to gift tax. The taxpayer in Private Letter Ruling 96-52-026 made a loan to the organization that would be forgiven by the taxpayer if the Internal Revenue Service ruled that disbursements by the separate segregated fund to which the loan proceeds were directed are treated as exempt function expenditures. Priv. Ltr. Rul. 96-52-026, at *41-42. Previous Revenue Rulings caused the taxpayer concern. *See, e.g.*, Rev. Rul. 72-355, 1972-2 C.B. 532, 532 (holding that gifts to a political campaign are subject to the gift tax). *But see* Stern v. United States, 436 F.2d 1327, 1327 (5th Cir. 1971) (holding that amounts expended to elect candidates are not gifts under the gift tax provisions). The Internal Revenue Service announced that it would not follow *Stern* except in the Fifth Circuit. Rev. Rul. 72-583, 1972-2 C.B. 534, 534; see also Rev. Rul. 82-216, 1982-2 C.B. 220, 220, stating that

> the Service continues to maintain that gratuitous transfers to persons other than organizations described in section 527(e) of the Code are subject to the gift tax absent any specific statute to the contrary, even though the transfers may be motivated by a desire to advance the donor's own social, political or charitable goals.

The Internal Revenue Code expressly provides that the gift tax does not apply to contributions to organizations that qualify as political organizations under section 527(e)(1). I.R.C. § 2501(a)(5) (2001). Professor Hill states that the development of the section 527 political organization as a vehicle for voter education activities arose out of concerns that contributions in excess of the $10,000 exemption for political activities of a section 501(c)(4) organization would be subject to gift tax. Hill, *supra* note 499, at 391.

and operation of one form of this device. The Internal Revenue Service concluded in the ruling that exempt function activities under section 527(e) include candidate advocacy that is not "express advocacy" by a separate segregated fund of an organization exempt from tax under section 501(c)(4).[501] The fund engaged in a voter education program to raise public consciousness on issues that are important to the fund's parent section 501(c)(4) organization and to educate voters on the positions of incumbent elected officials and candidates for office on those issues.[502] The letter ruling describes the purpose of the fund as being "to expressly advocate the election or defeat of certain federal candidates for public office."[503] The fund's governing documents stated, however, that "[n]o expenditures or activities prohibited by or reportable under the Federal Election Campaign Act shall be paid for from the Fund."[504] The fund accomplishes this result by engaging in voter education and registration activities that are outside of the definition of campaign expenditures under the FECA, issue advocacy without "express advocacy."[505] This statement is an ironic admission that voter education and other issue advocacy is in fact advocacy for the election or defeat of candidates, but without the magic words directly soliciting votes for or against a candidate.[506]

The Internal Revenue Service's analysis in Private Letter Ruling 96-52-026 of exempt function income under section 527(e)(2) is significant. The letter ruling uses the converse of the factors considered in Revenue Rulings 78-248[507] and 80-282[508] as indicators of the presence of exempt function expenditures under section 527(e)(2).[509] Revenue Ruling 78-248 focused on the distinction between nonpartisan voter education through publication of voting records and position statements on a broad array of topics versus publication of voting records and positions on issues that reflect the interests and viewpoint of the organization.[510] Revenue Ruling 80-282 held that publication of voting records on a narrow list of issues that were significant to a tax-exempt charitable organization was not prohibited intervention in political campaigns in which the fund's activities were neither aimed at the general public nor timed to coincide

501. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996), 1996 PRL LEXIS 1885, at *41.

502. *Id.* at *4-5.

503. *Id.* at *9.

504. *Id.*

505. 11 C.F.R. § 114.4(c)(4), (5) (2000). *See* discussion *supra* note 102.

506. The Private Letter Ruling does not address the status of the fund's expenditures under the FECA. A conclusion that the campaign activities are outside of the FECA regulatory scheme is not clear. *See* Hill, *supra* note 499, at 394-95.

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

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

509. For a detailed discussion, see Hill, *supra* note 499, at 391.

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

with elections in targeted geographical areas.[511] In Private Letter Ruling 96-52-026 the fund's activities consisted of the creation of voter education materials and voter guides that identified candidates' positions on specific issues.[512] The ruling described the fund as attempting to influence the public through education that links candidates to issues advocated by the fund's parent social welfare organization.[513] As described in the letter ruling,

> X's Board resolution creating the Fund states that it was formed "for the purpose of supporting X's efforts to educate the public . . . so that people can make judgments about the . . . positions and qualifications of their elected officials and candidates during the 1996 election season." This purpose is equivalent to accepting and expending funds not to expressly advocate for or against candidates, but to promote a program of issue advocacy designed to influence the public to give more importance to . . . issues when they decide among the candidates.[514]

The fund's voter education program is thus designed to "identify candidates for public office whose philosophy about [selected issues] is in harmony with [the social welfare organization's] own stance."[515] Distributions of the fund's materials were to be geared to the timing of elections.[516] The distributions were to be made to the general public and not limited to members of the fund's parent organization.[517] The letter ruling contrasts the organization's viewpoint oriented voter education with the nonpartisan voter education allowed to section 501(c)(3) organizations by Revenue Ruling 78-248.[518] In addition, the letter ruling points to the timing of the fund's voter education activities.[519] Whereas, under Revenue Ruling 80-282, information regarding voting records of incumbents related to an organization's interests that is directed to a limited group of members and not timed to coincide with an election is permissible educational activity for a tax-exempt charitable organization, voter education targeted to an election is treated as an exempt function campaign activity under

511. Rev. Rul. 80-282, 1980-2 C.B. 178, 179.
512. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996), 1996 PRL LEXIS 1885, at *6.
513. *Id.* at *35.
514. *Id.* at *33-34 (alterations in original).
515. *Id.* at *36.
516. *Id.* at *4.
517. *Id.* at *12.
518. *Id.* at *38-39.
519. *Id.* at *39.

section 527(e)(2).[520] The letter ruling thus implies that voter education that is barred to a tax-exempt charity under section 501(c)(3) as political activity qualifies as exempt function expenditure under section 527(e). One of the consequences of this conclusion is that a tax-exempt charitable organization is directed to funnel its political campaign activity through a separate segregated fund maintained by an affiliated section 501(c)(4) activity, which is consistent with suggestions in legislative history of section 527.[521] This ruling allows an integrated organization with an exempt charitable arm, a social welfare organization, and a separate political organization, to marshal its tax-exempt funds into a variety of political activities focused on the election of favored candidates using a combination of double and single subsidized funds.[522]

Private Letter Ruling 98-08-037[523] applies the same analysis to the voter education and issue advocacy activities of a stand-alone incorporated political organization that is not related to a tax-exempt entity. The letter ruling describes the organization's activities as, "a public education program to raise public consciousness about the importance of social and economic values that it favors and about the positions of incumbent public officials at all levels of government and candidates on those values, *without engaging in express advocacy for or against any identified candidates.*"[524] Again, the organization's disavowal of "express advocacy" was an attempt to qualify its political expenditures as "issue advocacy" that is outside the reach of the contribution limits and disclosure requirements of the FECA.[525] The organization's education program linked the records and positions of various incumbent office holders and candidates to issues of importance to the organization.[526] The organization would distribute information on incumbents' voting records, timed to coincide with federal, state and local elections.[527] The organization's

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520. *Id.* at *40.
521. *See* S. REP. NO. 93-1357, at 30 (1974), *reprinted in* 1975-1 C.B. 517, 534.
522. Rev. Rul. 80-282, 1980-2 C.B. 178, 179.
523. Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997), 1997 PRL LEXIS 1964.
524. *Id.* at *4 (italics added).
525. The letter ruling further states:

> No expenditures or activities prohibited by or reportable under the Federal Election Campaign Act shall be paid for by the Fund. The Fund's materials, including voter guides and voting records, shall be prepared and distributed by the Fund's staff without cooperation or coordination with any candidate, candidate's campaign or agent regarding the candidate's plans, projects, or needs in accordance with the Federal Election Commission's regulations.

Id. at *5-6.
526. *Id.* at *6.
527. *Id.* at *7.

distributions "may indicate how identified legislators stand on particular legislation and, by strong implication, how those legislators stand on issues important to the Fund."[528] The organization's materials would also provide information about the views of certain candidates and how those individuals may act on issues of interest to the organization.[529] As in Private Letter Ruling 96-52-026, the Service based its conclusion that the organization's expenditures qualified it for tax exemption as exempt function activities on an analysis of authorities identifying permissible non-partisan voter education activities of charitable organizations under section 501(c)(3).[530] In support of its holding that the organization's expenditures were for exempt function activities, the ruling states that

> [t]he repeated public presentation of the importance of selected issues, targeted to geographical areas and timed to coincide with the election, together with legislators' positions on those issues as compared with the Fund's views, is intended to have an effect on how the public will judge the positions of the incumbents and their challengers in November. The link between these issues and the various candidates will be reinforced through the voting records and the voter guides.[531]

Again in Private Letter Ruling 1999-25-051[532] the Internal Revenue Service turned to an analysis of voter education that is permitted to a tax-exempt charity to find that the voter education activities of an incorporated section 527 political organization qualified as exempt function activities under section 527(e)(2).[533] The ruling describes the organization's advocacy program as including "development and distribution of voter guides and voting records, mass media advertisements, grassroots lobbying, direct mail campaigns, and the active use of ballot measures, referenda, initiatives, and other public opinion campaigns, all linked to the primary purpose of influencing the political process in [five] states."[534] Unlike the organizations in Private Letter Rulings 96-52-026 and 98-08-037, the organization in Letter Ruling 1999-25-051 indicated that as a

528. *Id.* at *8.

529. *Id.* at *9.

530. *Id.* at *25-26.

531. *Id.* at *42.

532. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999), 1999 PLR LEXIS 500, at *1. The official release does not include the full text of the letter. The full text that was released to Tax Analysts may be found in TAX NOTES TODAY. *Political Organization Receives Favorable Letter Ruling*, 1999 TAX NOTES TODAY 83-22.

533. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999), 1999 PRL LEXIS 500, at *1.

534. *Id.*

minor part of its program some of its activities would include direct expenditures and expenditures expressly advocating the election or defeat of identified candidates that would be reportable under the FECA.[535] The organization in Private Letter Ruling 1999-25-051 also undertook voter registration activities and participated in state initiative campaigns.[536] Both of these activities were found to qualify as exempt function activities.[537] With respect to the voter registration, the organization convinced the Internal Revenue Service that the voter registration was a partisan activity.[538] The ruling states, "[w]hile these activities may not be specifically identified with a candidate or party in every case, they are partisan in the sense that you intend to use these techniques to increase the election prospects of pro-issue candidates as a group."[539] Similarly, the organization participated in ballot measures related to its issues by identifying ballot measures with candidates who supported or opposed the organization's issue positions.[540] The organization's activities with respect to ballot measures included identification of ballot measures with particular candidates, selection of ballot measures by which voters could hold office holders accountable on measures affecting the organization's issues, developing resources such as donor lists and making those resources available to selected candidates or redirecting resources to candidates, and coordination of ballot measure campaigns with the campaigns of candidates.[541] The letter ruling indicates that the organization's activities with respect to ballot measures were distinguishable from the type of activities commonly undertaken by either public charities or social welfare organizations.[542] Although participation in initiative campaigns normally is not the type of activity that qualifies as an exempt function for a section 527 organization, the letter ruling indicates that

> a political organization may support or oppose ballot measures provided that such activities are not its primary activity. Furthermore, such expenditures will be considered

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535. *Id.*

536. *Id.*

537. Tech. Adv. Mem. 92-49-002 (June 30, 1992) (holding that an organization that promotes referenda as part of an overall electoral strategy to elect candidates supportive of the organization's goals qualifies as a political organization under section 527). *But cf.* Tech. Adv. Mem. 92-44-003 (Apr. 15, 1992) (holding that an organization formed to promote a municipal referendum without any relation to electing candidates is not a section 527 political organization).

538. Priv. Ltr. Rul. 1999-25-051.

539. *Political Organization Receives Favorable Letter Ruling, supra* note 532.

540. *Id.*

541. *Id.*

542. *Id.*

> for an exempt function where it can be demonstrated that such expenditures were part of a deliberate and integrated political campaign strategy to influence the election for state and local officials by making active use of ballot measures, referenda, and initiative campaigns. You have indicated that your participation in such campaigns is for the purpose of linking candidates, in the minds of voters, to positions on certain issues within your identified area of interest, and encouraging voters to give greater weight to these issues when making judgments about candidates.[543]

The organization also convinced the Internal Revenue Service that its litigation program directed at influencing the selection of candidates who favored its issues constituted an exempt function activity.[544] The organization in Private Letter Ruling 1999-25-051 thus convinced the Internal Revenue Service to allow an expansive interpretation of exempt function activities to provide a tax exemption for a broad program of political activity at several levels.

The expansion of section 527 political organizations and their use to avoid the FECA limitations, particularly disclosure of the identity of contributors, ultimately proved to be too much for Congress. In the summer of 2000, Congress enacted section 527(i) and section 527(j), which require registration of section 527 political organizations and disclosure of contributions and expenditures.[545] In its report of a similar, but broader bill that would have included the political activities of other tax-exempt organizations in the disclosure requirements, the majority of the House Committee on Ways and Means opined that the activities of section 527 organizations were being designed to avoid engaging in express advocacy reportable under the federal election laws and that the organizations were "being used to exploit the lack of information reporting and disclosure under the present-law Federal tax rules."[546] The Committee described the "use of tax-exempt organizations generally to engage in

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543. *Id.*; *see also* S. REP. NO. 93-1357, 93d Cong., 2d Sess. 30 (1974), *reprinted in* 1975-1 C.B. 517, 532 ("a qualified organization could support the enactment or defeat of a ballot proposition, as well as support or oppose a candidate, if the latter activity was its primary activity").

544. *Political Organization Receives Favorable Letter Ruling, supra* note 532.

545. 26 U.S.C. § 527(i), (j) (2001).

546. H.R. REP. 106-702, at 12 (2000), reporting on H.R. 4717. The bill reported by the Ways and Means Committee would have required registration and disclosure of contributors by section 501(c)(4), (c)(5), and (c)(6) organizations that engaged in political expenditures in addition to section 527 organizations. The minority Democratic members of the committee complained that inclusion of social welfare and labor organizations to the disclosure requirements was a "poison pill" designed to kill the legislation. *Id.* at 40. The Democratic minority asserted that any expansions beyond section 527 organizations should apply fairly to all entities–taxable and tax-exempt. *Id.*

political activities [as] substantial and increasing."[547] The Committee report refers to the requirements that section 501(c) organizations file information returns with the Internal Revenue Service that are available to the public and which disclose political expenditures.[548] Prior to the 2000 amendments, section 527 political organizations were required to file a tax return only if political expenditures were made from net investment income in excess of $100.[549] These returns were not public documents.[550] The Committee on Ways and Means concluded that disclosure of political activities and contributors by both section 527 organizations and section 501(c)(4) through section 501(c)(6) organizations that are engaged in political activity was warranted.[551] The Committee report states:

> The Committee believes that enhancing the information reported to the IRS with respect to section 527 organizations and section 501(c)(4), section 501(c)(5), and section 501(c)(6) organizations would enable the IRS to better monitor whether such organizations are complying with the present-law rules requiring the organizations to pay tax on the net investment income used to engage in political activities. Furthermore, requiring additional reporting of activities that appear to be political in nature would assist the IRS in its efforts to ensure that organizations are not impermissibly characterizing certain activities as educational, rather than political.[552]

The Committee report also states that, given the tax benefits provided to political organizations and organizations exempt from tax under section 501(c)(4), (c)(5) and (c)(6), "the public interest is served by greater public disclosure of information relating to the political activities of such organizations, including a detailed listing of expenditures for political activities and the source of funds (i.e., contributions) used for this purpose."[553] The report further justifies disclosure with the statement that

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547. *Id.* at 13.

548. *Id.* at 11; *see also* I.R.C. §§ 6033(a), 6104(d) (2001). The information return, Form 990, must disclose the identity of persons who contributed $5,000 or more to the organization. Treas. Reg. § 1.6033-2(a)(2)(ii)(f) (as amended in 1995). The Form 990 also requires reporting of political campaign expenditures. *See supra* note 478.

549. H. REP. 106-702 at 11 (2000). See I.R.C. § 6012(a)(6) as in effect prior to amendment by Pub. Law 106-230, effective after June 30, 2000. Tax-exempt organizations that make exempt function expenditures and political organizations with investment income are required to file form 1120-POL to report taxable income. *See* I.R.C. § 527(b), (f), discussed *supra* note 495.

550. H. REP. 106-702, at 12.

551. *Id.* at 14.

552. *Id.* at 14-15.

553. *Id.* at 14.

"[p]ublic disclosure of information enables the general public to provide oversight of the political activities of these organizations."[554]

Notwithstanding the lofty aspirations expressed by the majority report in the House Committee on Ways and Means, Public Law 106-230 only requires disclosure by political organizations.[555] Section 527(i) of the Code requires written and electronic notice to the Internal Revenue Service within twenty-four hours after formation by any organization that intends to be treated as a political organization under section 527.[556] The requirement applies to any organization that anticipates gross receipts of $25,000 or more for any taxable year.[557] Registration requires identification of the organization,[558] a description of its purpose,[559] identification of the officers, directors and highly compensated employees,[560] and identification of related organizations.[561] The registration forms are collected by the Internal Revenue Service which makes them available for public inspection on the Internal Revenue Service website.[562] An organization that fails to file the required notice becomes taxable on its exempt function income, which would include political contributions.[563]

Section 527(j) of the Code requires reporting of expenditures and contributions by a political organization that anticipates gross receipts of $25,000 or more during a taxable year.[564] Section 527(j) applies to a political organization that is not otherwise required to report political expenditures and contributions under the FECA as a political committee

554. *Id.*

555. *Id.*

556. I.R.C. § 527(i) (2001).

557. *Id.* § 527(i)(5)(B).

558. *Id.* § 527(i)(3)(A).

559. *Id.* § 527(i)(2)(B).

560. *Id.* § 527(i)(3)(c) "Highly compensated employees" are defined as the five highest paid employees who are likely to have compensation in excess of $50,000. Internal Revenue Service, Form 8871, at 4 (2000).

561. I.R.C. § 527(i)(3)(D) (2001). "Related organization" is defined by reference to I.R.C. section 168(h)(4) in part as related governmental entities, entities that have significant common purposes or membership, or are directly or indirectly under substantial common direction or control, and entities connected through 50% ownership of capital or profits. I.R.C. § 168(h)(4) (2001).

562. I.R.C. § 6104(a)(3). Copies of the Form 8871, filed by political organizations to give notice of exempt status under section 527, are available at http://www.irs.gov/forms-pubs/forms.html. Section 6104(a)(1)(A) also requires the Internal Revenue Service to provide for public inspection at the national office documents submitted in an application for exempt status as a political organization. I.R.C. § 6104(a)(1)(A) (2001).

563. I.R.C. § 527(i)(4) (2001).

564. *See id.* § 527(j)(5)(C).

or State committee of a political party.[565] A covered organization is required to identify the recipient of political expenditures of $500 or more, including the occupation and employer of individuals to whom payment is made.[566] The organization also is required to disclose the name and address of contributors of $200 or more along with the occupation and employer of individual contributors.[567] In an election year, reports are required to be filed quarterly with an additional pre-election report due no later than the twelfth day before an election in which the organization makes a contribution or expenditure, and a post-election report due thirty days after the general election.[568] In a non-election year, biannual reports are due on July 31 for the period January 1 through June 30, and on January 31 for the period between July 1 and December 31 of the preceding year.[569] Alternatively, a political organization may file monthly reports with pre-general election and post-general election reports for November and December of any election year.[570] These reports, filed on Form 8872, are also available for public inspection on the Internal Revenue Service website.[571]

The disclosure requirements imposed on section 527 organizations might lead political entrepreneurs to return to the section 501(c)(4) social welfare organizations and section 501(c)(3) charities as their conduits of choice for political activity.

C. *Summary Conclusions*

The Supreme Court's First Amendment jurisprudence regarding political finance leaves us with two fairly clear propositions. First, restrictions on campaign expenditures and contributions to campaign activities restrain speech that is protected by the First Amendment.[572]

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565. *Id.* § 527(j)(5)(A), (B). For definitions of political committees, see the text *supra* at note 68.

566. I.R.C. § 527(j)(3)(A) (2001).

567. *Id.* § 527(j)(3)(B).

568. *Id.* § 527(j)(2)(A)(i). The quarterly reports are due by the fifteenth day after the last day of the quarter, except that the year end report is due by the following January 31. *Id.* § 527(j)(2)(A)(i)(I). Pre-election reports submitted by registered or certified mail must be posted by the fifteenth day preceding the election. *Id.* § 527(j)(2)(A)(i)(II). The post-election report must be complete as of the twentieth day following a general election. *Id.* § 527(j)(2)(A)(i)(III). "Elections" for these purposes include a general, special, primary or runoff election for federal office, conventions or caucuses of political parties with authority to nominate candidates for federal office, primary elections for the selection of delegates to a nominating convention, and primary elections for nomination of individuals to the office of President. *Id.* § 527(j)(6).

569. *Id.* § 527(j)(2)(A)(ii).

570. *Id.* § 527(j)(2)(B).

571. *See supra* note 562.

572. Buckley v. Valeo, 424 U.S. 1, 19 (1975).

Limitations on campaign finance are thus subject to strict scrutiny.[573] The Court is willing to find the necessary compelling governmental interest only in efforts that "limit the actuality and appearance of corruption resulting from large individual financial contributions."[574] Second, while Congress cannot act to restrict campaign contributions and expenditures, except on a narrowly defined compelling state interest, Congress has broad discretion to create or withhold tax subsidies for a range of activities that include content-neutral choices regarding advocacy protected by the First Amendment.[575] Indeed, as suggested by the Court in *Cammarano v. United States*,[576] withholding a tax subsidy for the political activity of certain organizations may "express a determination by Congress that since purchased publicity can influence the fate of legislation which will affect, directly or indirectly, all in the community, everyone in the community should stand on the same footing as regards its purchase so far as the Treasury of the United States is concerned."[577] *Cammarano* thus accepts the proposition, later rejected in *Buckley*, that there is a governmental interest in maintaining an equal footing at the doorstep of democracy. It may remain the case, however, that not only can Congress act to provide or withhold subsidies, but a tax subsidy to particular political activity may infringe on the First Amendment interests of others on a level playing field.[578] While Congress has the discretion to provide tax subsidies to some interests over others,[579] as a matter of good policy such distinctions might be avoided.

As the Supreme Court recognized in *Regan*, federal tax subsidies to political organizations take two forms.[580] Congress has eliminated one form of subsidy by enacting provisions to ensure that political activity is funded with after-tax money by disallowing deductions for contributions to political activity. However, the Code continues to provide the second form of subsidy with tax exemption for the receipts of numerous organizations that are engaged in political activity. Indeed, the application of this subsidy through the labyrinth of the exempt organization rules of sections 501(c) and 527 of the Code directs the organizational form and

573. *Id.* at 25.

574. *Id.* at 26.

575. Regan v. Taxation with Representation, 461 U.S. 540, 544-45 (1983).

576. 358 U.S. 498 (1959).

577. *Id.* at 513.

578. Recognize, of course, that *Buckley* rejected the idea that leveling the playing field is a sufficient governmental interest to support restrictions on campaign expenditure. *Buckley*, 424 U.S. at 48-49. However, restricting the speech of one group in order to enhance the influence of another is distinguishable from the validity of a governmental subsidy to one group of speakers over another. *See id.*

579. *Regan*, 461 U.S. at 544-45.

580. *Id.* at 544.

activities of the various entrepreneurs of political influence. Political entrepreneurs have designed the activities of section 527 political organizations to represent advocacy for the election or defeat of named candidates without qualifying the advocacy as direct election expenditures subject to the regulations and limitations of the FECA. Whether this form of governmental subsidy comports with public policy in the campaign finance area requires an examination of public policy as reflected in existing restrictions on campaign finance activities under the FECA and the application of that policy in connection with organizational structures of tax-exempt entities.

III. THE USE AND ABUSE OF THE REGULATORY REGIME AND SUBSIDIES OR THE FLOW OF TAX-SUBSIDIZED MONEY INTO THE POLITICAL PROCESS

As the preceding discussion illustrates, there are numerous routes to the purchase of political influence by individuals and organizations. Some are limited by FECA, but the ways around the FECA limitations provide other avenues for political expression by moneyed interests. Many are subsidized with combinations of tax exemption and deduction. While public policy against federal tax subsidy is expressed in legislation, legislative history, and judicial opinions, tax-exempt entities, including charitable organizations, are active players in the business of influencing electoral choice. Coupled with the campaign regulatory regime hobbled by *Buckley*,[581] the tax subsidies encourage large institutional influence in the electoral process directed through tax-exempt business of marketing and exercising political influence.[582]

The diversity of access for money into the political system through the pathways of regulated and unregulated channels offers political entrepreneurs the opportunity to structure political investment in a fashion that is one step ahead of the regulators in the Federal Election Commission and Internal Revenue Service.[583] Restraint imposed on one part of the

581. *Buckley*, 424 U.S. at 1.

582. Hill, *supra* note 5, at 923 (describing the benefit of the tax exemption).

> The absence of an entity-level tax is a fundamental benefit in making any type of an exempt organization a more attractive conduit than other taxable entities or individuals. If the essence of a pure conduit is that earmarked money simply flows through it, then imposing a tax on the transfer from the contributor to the conduit reduces the economic efficiency of the transaction. The tax becomes a cost of doing political business.

Id.

583. *See* MALBIN & GAIS, *supra* note 1, at 101. They point out that "complexity makes it

system simply directs political money into another route. This section examines multiple opportunities for political influence in the context of a hypothetical pair of individuals with a specific agenda.[584] Opportunities to acquire political influence through campaign contributions fit within three broad categories: direct campaign contributions subject to limitation and disclosure, unlimited contributions to political parties that are also subject to disclosure, and unlimited contributions through exempt organizations that are free from disclosure. Professor Hill describes these categories as hard money, soft money, and softer money.[585]

Imagine A and B, two unrelated individuals, who are the major shareholders of Environmental Safe Drilling, Inc., ("ESD"), which owns geologic maps that detail a vast natural gas reserve underneath Yosemite National Park. ESD believes that it can drill wells and install pipelines without doing significant harm to the Yosemite environment, other than disturbing a few bears, other creatures, and a plant or two. ESD requires federal legislation for permission to invade the park and drill. Thus, ESD needs to elect and maintain access to friendly members of Congress, particularly from the regions of California that are adjacent to Yosemite National Park. The relevant congressional districts have elected representatives from both major political parties.[586] California's two

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harder for observers to determine who is getting support from whom, let alone why." *Id.* The complexity makes enforcement more difficult and favors the use of tactics that favor the most sophisticated and adaptable of groups. They add that,

> No matter how well thought out the strategy, excessively ambitious goals will be defeated by the First Amendment—and by human ingenuity. Organizations affected by new laws will adapt and use constitutionally protected end runs to pursue their own purposes, obeying the letter of the law but not accepting—because they have no reason to accept—the reformers' goals as their own.

Id. at 164.

584. The taxonomy of contributions used here in part is from Weine, *supra* note 82. He writes:

> Until the 1970's, federal campaign money was raised in unlimited amounts, and most funds ended up in the accounts of candidates. . . . Today, individuals can inject money into electoral politics through at least nine outlets, some of which are also open to corporations and unions, and candidates can benefit from at least six pipelines of political funds.

Id. at 10. Weine describes the six "pipelines" for political money as candidate committee money, political party coordinated expenditures, political party independent expenditures, political party soft money, non-party independent expenditures, and issue advocacy money. *Id.* at 12-18.

585. Hill, *supra* note 20, at 27.

586. Arguably, members from the Third, Fourth, Fifth, Eleventh, Eighteenth, Nineteenth, and Twentieth Congressional Districts (before reapportionment in 2001), all of which have some

Senators will be important to any proposed legislation. A, B and ESD are also concerned with the re-election of key members of Congress from outside of California who deal with both energy policy and national parks. In addition, ESD would benefit from the election of a president who is sympathetic to the development of new energy sources, and that president's appointment of sympathetic heads of administrative agencies. A's and B's goals require not only the election of sympathetic politicians, but public education to both reduce opposition to ESD's planned drilling activities and to convince individuals to vote for candidates who are sympathetic to the drilling plans. A's, B's, and ESD's available resources for the achievement of its political ends are unlimited given the potential wealth for the company available from exploiting the Yosemite gas reserve. In addition, ESD's unionized employees would benefit from the creation of additional jobs in the development of the Yosemite gas field. Thus, the Gasdrillers United Labor Union, which represents ESD's employees and employees in other companies that may benefit from the drilling operation, also has an interest in supporting sympathetic federal candidates and incumbents. There are political risks associated with public knowledge of A's and B's self-interested role in coordinating a major political effort on behalf of particular candidates. Thus, funneling contributions through multiple conduits has great political advantage to A's and B's efforts. At the same time, it is important to A and B that their political beneficiaries understand the source of A's and B's largesse.

A. *Contributions to Candidates and Parties*

1. Direct Contributions to Candidates

A and B's direct political activity is primarily limited by the annual overall $25,000 contribution limit on direct political contributions.[587] If A or B are married, their spouses, and children if any, may also make contributions of up to $25,000, subject to the provision that no person shall make a contribution in the name of another person.[588]

A and B may each contribute $1,000 for the primary and $1,000 for the general election to candidates in each congressional, senatorial and presidential race in which they are interested.[589] In addition, A and B may collect contributions from ESD employees, shareholders, officers,

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relation to the Sierra Nevada mountain range, and which are in an economic sphere that would be affected by the hypothetical energy development, would be interested in the ESD project. In the 107th Congress, those districts are represented by four Republicans and three Democrats.

587. 2 U.S.C. § 441a(a)(3) (2001).

588. *Id.* § 441f.

589. *Id.* § 441a(a)(1)(A).

shareholders and employees of ESD's suppliers and customers, as well as just plain friends of ESD's development plans, and present the bundle of contributions to favored candidates.[590] A's and B's solicitation of checks and bundling of the contributions is not itself considered as a campaign contribution.[591] Instead, the contributions are treated as coming from each individual check writer.[592] Nonetheless, if A and B each manage to collect $2,000 for a candidate from each of ten contributors, the candidate will take appropriate notice of A and B's presentation of $20,000 to the candidate's election effort.[593] While each of these contributions is subject to disclosure by the political committee receiving the contribution,[594] the bundled contributions will not be identified as related to A and B, but attributed to each individual contributor.[595] Thus, A's and B's broader participation in the campaign is shielded.

Although ESD cannot itself contribute directly to candidates,[596] ESD can establish a political action committee to solicit contributions from shareholders, management personnel, and their families.[597] The political action committees are separate segregated funds exempt from tax under section 527 of the Code.[598] Individuals are permitted in each calendar year to contribute $5,000 each to the ESD PAC.[599] The ESD PAC can in turn contribute $5,000 to candidates for each election cycle, a total of $10,000 for the primary and general elections.[600] Gasdrillers United can also form a PAC, solicit contributions of up to $5,000 from each of its members, and contribute $5,000 in each election cycle to each candidate whose position the Union believes is favorable to its interests.

The ban on corporate contributions does not prevent either ESD or Gasdrillers United from indirectly aiding favored candidates in campaigns for the House or Senate. Both organizations can communicate to their own

590. *Id.*

591. *Id.* § 431(8)(B(i). Personal services provided to a candidate are excluded from the definition of "contribution." *Id.* As an alternative to actually bundling the contributions, A and B could send a letter soliciting others to directly send contributions to the favored candidate. *See* MALBIN & GAIS, *supra* note 1, at 87.

592. 2 U.S.C. § 441a(a)(8).

593. *See* Weine, *supra* note 82, at 12. A and B now have a list of willing contributors. In a variation of the bundling theme, A and B may be called upon to respond in critical elections by energizing this network to make contributions in support of their issues. *See* MALBIN & GAIS, *supra* note 1, at 86.

594. 2 U.S.C. § 434(b)(3) (2001).

595. *Id.*

596. *Id.* § 441b(a).

597. *Id.* § 441b(b)(4) (1997). Expenditures by ESD in forming and operating its PAC are not treated as campaign contributions. *Id.* § 441b(b)(2).

598. I.R.C. § 527(f)(3) (2001).

599. 2 U.S.C. § 441a(a)(1)(C) (2001).

600. *Id.* § 441a(a)(2)(A).

shareholders, management personnel of ESD, or members of Gasdrillers, on any topic, including express advocacy for the election of favored candidates, including communication that is coordinated with the candidate.[601] Both ESD and Gasdrillers can arrange meetings for shareholders and management, or members, with favored candidates.[602] ESD may offer to fly candidates in its company jet to the West Coast, which of course presents an opportunity for A and B to have uninterrupted conversations with favored candidates on the importance of their drilling plans.[603] At election time, ESD and Gasdrillers may undertake voter registration and get-out-the-vote campaigns focused on shareholders, executive personnel, members, and their families, which includes express advocacy for favored candidates.[604] The corporation and the union can also engage in public oriented voter registration and get-out-the-vote campaigns, but these must be undertaken on a non-partisan basis without advocacy on behalf of a candidate.[605]

In combination, A and B along with ESD and the Union are able to direct $24,000 to each favored candidate, along with the amount that A and B are able to collect as bundled contributions to candidates. This is not a large amount of money in the scheme of campaign finance, but perhaps enough to permit A and B to bring the Yosemite gas drilling project to the candidate's attention. But clearly more is required to achieve sufficient access to the political process to move the issue forward.

2. Contributions to Political Parties for Coordinated Campaign Expenditures

A and B are not limited to direct contributions to candidates. Again subject to the $25,000 overall calendar year limitation, they each can contribute $20,000 to political party campaign accounts, or the House and Senate campaign committees that are coordinated with the parties' candidates.[606] ESD PAC and Gasdrillers United PAC can each contribute

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601. 11 C.F.R. §§ 114.1(a)(2)(i), 114.3(a)(1) (2001).

602. *Id.* § 114.3(c)(2)(i).

603. Laura Brown Chisolm, *Sinking the Think Tanks Upstream: The Use and Misuse of Tax Exemption Law to Address the Use and Misuse of Tax-Exempt Organizations by Politicians*, 51 U. PITT. L. REV. 577, 624 (1990); Thomas J. Schwarz et al., *Corporate Political Activity: Providing Transportation and Related Travel Expenses to Members of Congress*, 41 BUS. LAW 15, 16 (1985). As an example, Greg Gordon and Kristin Gustafson report that Vice Presidential Candidate and Senator Joe Lieberman had "flown on Pfizer Inc.'s corporate jet, spoken before the pharmaceutical industry's trade association and accepted more than $161,000 in campaign donations from prescription drug makers since 1993." Greg Gordon & Kristin Gustafson, *Big Money is Drug Lobby's Rx for D.C. Challenges*, SACRAMENTO BEE, Aug. 27, 2000, at A5.

604. 2 U.S.C. § 441b(b)(2)(B).

605. 11 C.F.R. § 114.4(d)(1) (2001).

606. 2 U.S.C. § 441a(a)(1)(B).

$15,000 to these national party organizations.[607] The problem with these contributions is that the contributors cannot direct the parties to expend the contributions on specific candidates, although one can imagine that the parties would take the interests of contributors into account in deciding on how to spend these funds.[608] Also note that there are expenditure limitations on the national parties' use of these coordinated funds.[609]

3. Unlimited Contributions to Parties/"Soft Money"

Unlimited contributions for "party building" activities provide a broader avenue for A, B, ESD, and Gasdrillers United to curry favor in the political process. These contributions cannot be used for express advocacy of the election of candidates.[610] The funds are available to the state and local parties for distribution of slate cards, voter registration and get-out-the-vote drives.[611] More importantly, the parties use this soft money for issue advocacy that mentions the names of candidates without using the "magic words" of express advocacy.[612] Thus, these contributions can be used to fund advertisements that describe the favored candidates' views on the importance of a sound energy policy based on environmentally sound drilling practices employed in Yosemite National Park and the importance of the issue to the political party, but without exhortation to vote for or against a particular candidate. The national political parties are required to allocate party building and issue advocacy expenditures among FECA regulated funds devoted to the election of federal candidates and unregulated money, which is a significant limitation on the use of party building contributions.[613] These party building contributions are also subject to reporting requirements that identify the contributor and the expenditures.[614] Thus, A, B, ESD, and Gasdrillers run the risk of too-closely identifying candidates and parties with their self-interested campaign activities.

B. *Independent Campaign Activities*

Our hypothetical campaign to elect federal candidates who are friendly to the Yosemite gas drilling project has encountered three impediments:

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607. *Id.* § 441a(a)(2)(B).

608. WEINE, *supra* note 82, at 13. Contributions that are earmarked for a specific candidate as are treated as contributions to the candidate. 2 U.S.C. § 441a(a)(8) (2001).

609. 2 U.S.C. § 441a(d).

610. WEINE, *supra* note 82, at 16.

611. 2 U.S.C. § 431(8)(B)(xii).

612. WEINE, *supra* note 82, at 16-17; F.E.C. Advisory Opinion 1995-25, Republican National Committee (F.E.C. advisory opinions are available on the Web at http://www.fec.gov).

613. 11 C.F.R. § 106.5 (2001); *see* Hill, *supra* note 20, at 41-42.

614. 2 U.S.C. § 434(b)(2)(A), (C), (3) (2001).

the FECA limitations on the amount of contributions, disclosure requirements, and lack of direct control of funds contributed to parties. Fear not. Wider opportunities for the purchase of political influence are available outside of the FECA-regulated political environment.[615]

1. Independent Expenditures

A and B may each purchase advertising and otherwise individually campaign for favored candidates, as long as their activities are not coordinated with any candidate.[616] Their independent campaign expenditures are not considered to be contributions to the candidates and regulation of independent campaign advocacy is not permitted under *Buckley*.[617] Independent expenditures are subject to the FECA's disclosure requirements, however.[618] Also, A and B must each act independently. Collective activity would classify the effort as a "political committee" subject to additional FECA regulation.[619] Short of expressly advocating the election or defeat of identified candidates, A and B may also undertake unlimited campaigns to educate the public on the issues of gas drilling in Yosemite, with discussion of the positions taken by individual candidates.[620] While this campaign would be free from the restriction of the FECA, there are more effective collective activities available to A and B.

The ESD PAC and the Gasdrillers United PAC are also permitted to make unlimited expenditures on express advocacy for the election or defeat of candidates, but contributions to the PACs are limited to $5,000 from each contributor.[621] Thus, the PACs are limited to the expenditure of "hard" money. The hard money aspect of this device, plus the availability

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615. The experience of Los Angeles in the recent mayoral election is instructive. The City of Los Angeles enacted a voluntary public finance of elections provision that would limit campaign expenditures of recipients, and imposed contribution limitations. As a consequence, unrestricted spending by political parties, individuals, and businesses increased from $323,203 in 1993 to more than $2.5 million in the past election. Jeffrey L. Rabin, *Spending in L.A. Elections Defied Limits: Huge Amounts of Money Poured Through Loopholes in Laws Intended to Restrict Campaign Cash*, L.A. TIMES, June 10, 2001, at A1, *available at* http://www.latimes.com/news/state/20010610/t000048.

616. *See* Buckley v. Valeo, 424 U.S. 1, 47 (1976).

617. *Id.*; *see also* Colo. Republican Fed. Campaign Comm. v. Fed. Election Comm'n, 518 U.S. 604, 614-18 (1996).

618. 2 U.S.C. § 434(c) (2001); 11 C.F.R. § 109.2 (2001); *see also Buckley*, 424 U.S. at 81.

619. WEINE, *supra* note 82, at 17; *see also* 2 U.S.C. § 431(4)(a) (2001). Contributions to a political committee are thereby limited to $5,000 from a single individual. 2 U.S.C. § 441a(a)(1)(C) (2001).

620. *See supra*, text accompanying notes 102-13.

621. 2 U.S.C. § 441a(a)(1)(C).

of less restrictive outlets for "issue advocacy" that accomplish the same result, reduces the incentives for this approach.[622]

2. The Environmentally Sensitive Oil and Gas Drillers Trade Association

ESD may form a trade association to promote the interests of environmentally sound methods of drilling for gas in sensitive areas.[623] ESD will solicit membership contributions to the association from all of its suppliers and other interested parties. The association will be exempt from tax under section 501(c)(6).[624] In addition, contributions to the association will be deductible by its members, except to the extent that the association incurs expenditures to lobby specific legislation or intervene in a political campaign.[625] Thus, the association's activities are funded with before-tax money to the extent not limited by section 162(e).[626] The trade association can qualify for tax exemption under section 501(c)(6) if its primary activity is the passage of legislation favorable to the interests of its members,[627] and is permitted to engage in political campaign activities that support its legislative goals.[628]

The trade association may engage in a broad public education program that serves the interests of its members by advising the public of the general need for energy development and the environmentally sound methodology of its members. The costs of this program may stay on the deductible side of section 163(e) of the Internal Revenue Code if the education campaign is not conducted around pending or proposed legislation and the organization refrains from asking people to contact legislators regarding pending legislation.[629] The education program must also refrain from advocating for or against governmental action.[630] On the

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622. WEINE, *supra* note 82, at 18. It has been argued that the $5,000 limit on contributions to PAC's "is rendered meaningless when individuals contribute sums substantially in excess of that amount in order to fund multi-million dollar advertising campaigns that attempt to influence the outcome of specific electoral races." Glenn Moramarco, *Regulating Electioneering: Distinguishing Between "Express Advocacy" & "Issue Advocacy," in* CAMPAIGN FINANCE REFORM SERIES 10 (Brennan Center for Justice 1998).

623. For an example of the value of industry association lobbying, see Martin A. Sullivan, *Congress Quietly Slips Life Insurers a $645 Million Windfall*, 89 TAX NOTES 842 (2000).

624. I.R.C. § 501(c)(6) (2001).

625. *Id.* § 162(e) (2001); *see also supra* text accompanying notes 241-56.

626. *See* I.R.C. § 162(e).

627. Rev. Rul. 61-177, 1961-2 C.B. 117, 117.

628. *See* Gen. Coun. Mem. 34,233 (Dec. 30, 1969), 1969 IRS GCM LEXIS 12.

629. Treas. Reg. § 1.162-20(c)(4) (as amended in 1995); *see also, e.g.*, Rev. Rul. 78-114, 1978-1 C.B. 44 (holding that communications to members urging them to contact legislators on pending legislation is not grassroots lobbying).

630. Consumers Power Co. v. United States, 427 F.2d 78, 80 (6th Cir. 1970).

other hand, the education activities can include publication of papers and speeches of elected officials or funding "town meetings" featuring elected officials and others to discuss energy needs and drilling on environmentally sensitive lands, without constituting contributions to those officials or campaign expenditures under the FECA.[631] Similarly, under the methodology test of Revenue Procedure 86-43,[632] the trade association may construct an advocacy program for its drilling activities that features the views of political figures without intervention in a political campaign.[633]

Of course, the trade association may undertake a lobbying campaign in support of legislation permitting its gas drilling in Yosemite, and may undertake advocacy for candidates whose election would promote the interests of its members, as long as campaign advocacy is not its primary purpose.[634] The cost of more direct advocacy is the loss of business expense deductions for contributions by the members to the extent of the association's expenditures for political activities.[635] Thus, amounts expended for the association's political activities are subject to one level of tax, as income not offset by deductions to the members. In addition, the trade association may form a separate segregated fund, exempt from tax under section 527, to engage in independent election advocacy without running afoul of the FECA limitation on corporate contributions.[636] The trade association can fund the administrative and operational costs of its political action committee as long as the contributions from the trade association are segregated into a "soft" money account that is dedicated to operational expenses.[637] Contributions to candidates and independent

631. *See, e.g.*, F.E.C. Advisory Opinion 1980-25 (Apr. 20, 1980) (letter written by a candidate expressing a position on issues that does not advocate election or defeat of a candidate is not campaign advocacy that requires disclosure of funding source under 2 U.S.C. § 441d (1997)); F.E.C. Advisory Opinion 1980-22 (Apr. 15, 1980) (town meetings to discuss issues facing the steel industry funded by a trade association are not contributions). These opinions are discussed in Chisolm, *supra* note 603, at 607-08 (stating that the "F.E.C. has determined that, absent solicitation of contributions or express advocacy of the election or defeat of any candidate, neither the publication and distribution of a candidate's views on a public policy issue nor the republication and sale of articles written previously by a candidate implicate 'contributions' or 'expenditures.'"). *Id.*

632. Rev. Proc. 86-43, 1986-2 C.B. 729, 729.

633. *See, e.g.*, Priv. Ltr. Rul. 1999-07-021, 1998 PLR LEXIS 2073 (May 20, 1998).

634. Rev. Rul. 61-177, 1961-2 C.B. 117; Gen. Couns. Mem. 34,233 (Dec. 30, 1969), 1969 IRS GCM LEXIS 1.

635. I.R.C. § 162(e)(3) (2001).

636. 2 U.S.C. § 441b(a), (b)(2) (2001).

637. See Private Letter Ruling 85-16-001, 1984 PRL LEXIS 44 (Oct. 22, 1984), holding that a contribution made by a trade association to its PAC was earmarked for the PAC's "soft money" account, (rather than for its general account) to be used for operating and administrative expenses and thus was not subject to the tax provided by section 527 of Code as a "directly related exempt

campaign expenditures must be funded with contributions from others subject to the FECA's $5,000 limit on contributions to a PAC.[638]

3. The Institute for the Promotion of Governmental Action for Environmentally Sound Energy Independence

A and B, with help from their friends and associates, can also invest in the formation of an unincorporated[639] tax-exempt social welfare organization. The organization will be formed for the purpose of bringing about energy independence through environmentally sound drilling practices. A and B can fund this organization with unlimited contributions that are not subject to disclosure, and with contributions solicited from friends, business associates, employees, etc. The organization may maintain its tax exemption under section 501(c)(4) even if its primary purpose is promoting legislation.[640] Because contributions to this organization are not deductible, its contributions will come from income taxed to the contributors when earned and thus its expenditures are funded with money that has been subject to one level of tax. Individual contributions may be limited to $10,000 per person by the potential for gift tax liability on contributions in excess of that amount.[641]

The Institute's program can include grassroots lobbying and education programs that prominently feature the positions of favored elected legislators and potential candidates. Under the Internal Revenue Service's published and private rulings, an educational program that satisfies the methodology test of Revenue Procedure 86-43[642] might not be classified as the exempt function activity of a political organization for purposes of section 527 of the Code if the institute's materials present both sides of the issue. In fact, the Institute may assist A's and B's overall political aspirations by presenting the views of candidates and elected officials who disagree with the institute's positions, especially if the presentation casts these individuals in a negative light. While disparaging advocacy may convert the education program into campaigning that becomes "exempt function income" under section 527 of the Code,[643] undoubtedly the

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function" expenditure.

638. 2 U.S.C. § 441a(a)(1)(C) (2001).

639. Incorporation may subject the institute to the limitation of 2 U.S.C. § 441b (2001) on corporate contributions. Alternatively, if incorporated, the institute may be funded only with contributions from individuals, which is workable because corporate contributions to the overall effort may be focused through the trade association described in the preceding section. *See* Fed. Election Comm'n v. Mass. Citizens for Life, Inc., 479 U.S. 238 (1986).

640. Treas. Reg. §§ 1.501(c)(4)-1(a)(2)(ii), 1.501(c)(3)-1(c)(3)(ii) (as amended in 1990).

641. I.R.C. §§ 2501(a), 2503(b) (2001).

642. Rev. Proc. 86-43, 1986-2 C.B. 729.

643. The consequence is the imposition of tax at the highest corporate rates on the Institute's

institute can retain sufficiently skilled writers to craft its position in language that more appropriately educates the public towards the "correct point of view." The Institute's education program, in which the views of named proponents are discussed, will be most useful, and least vulnerable to treatment as intervention in a campaign, if it is undertaken during the period preceding the congressional election.[644] In addition, the Institute must take care to establish that its overall purpose is education on its important issue, rather than electing particular candidates.

The Institute's more direct campaign advocacy that is aimed at electing candidates can be channeled through a separate segregated fund that is tax exempt under section 527 of the Code.[645] The political fund's advocacy may be limited to issue advocacy—advocacy for a clearly identified candidate that does not expressly urge any person to vote for or against an individual or make contributions to a candidate—so as not to constitute the organization as a political committee under the FECA.[646] The fund will be required to register with the Internal Revenue Service as a political organization and provide a list of its contributors and expenditures.[647] Private Letter Rulings 96-52-026, 98-08-037, and 1999-25-051[648] provide a roadmap of the activities that the segregated fund might pursue. First, the fund should substantiate the political impact of its activities by consulting experts, collecting data from opinion polls, focus groups, and similar kinds of research, which is brought together in planning sessions to develop effective partisan methodologies.[649] The Institute can prepare and circulate voter guides that compare candidate's views on the institute's positions on energy independence through environmentally sound drilling practices.[650] Information on incumbents' voting records on the issue may be targeted to the public, or selected members of the public, around the time of critical elections.[651] The message may call for legislative action and by implication raise public awareness as to the identity of candidates and incumbents who are likely to support the appropriate positions.[652] All of this is done without expressly advocating the election or defeat of named candidates. Although the primary purpose of the parent social welfare organization is to promote its energy independence program and not elect candidates, one can

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exempt function expenditures, but only to the extent of the Institute's investment income. I.R.C. § 527(f) (2001).

644. *See* Priv. Ltr. Rul. 1990-07-021 (May 20, 1998), 1998 PLR LEXIS 2073.

645. I.R.C. § 527(f)(3)(2001).

646. Id. § 527(e)(1).

647. *Id.* § 527(i), (j) (2001).

648. *See supra* text accompanying notes 499-544.

649. *See* Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999), 1999 PRL LEXIS 500, at *4-6.

650. Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996), 1996 PRL LEXIS 1885, at *26.

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

652. Priv. Ltr. Rul. 1999-25-051, 1999 PRL LEXIS 500, at *17-18.

imagine that careful professional political entrepreneurs can effectively coordinate the timing and content of the educational activities of the social welfare organization with the candidate-oriented issue advocacy of the section 527 organization.

4. The Environmentally Sound Energy Independence Educational Foundation

Education is the principal activity of the tax-exempt educational organization created by A and B for the purpose of enlightening the public on the national need for natural gas recovered through environmentally sound drilling techniques, wherever applied. As an exempt organization under section 501(c)(3) of the Code, the Foundation will neither advocate legislation (or at least no substantial part of its resources will be so used) nor intervene in a political campaign. Nonetheless, the Foundation's educational activities might be concentrated on the most significant recipients of its information: potential voters in key districts. Also, as long as it presents information using methodologies that incorporate assertions based on facts, avoids distortions and inflammatory language, and aims its information to the development of an understanding of the issues, the education program can be aimed towards the Foundation's particular position on its issues.[653] The Foundation may present educational programs and debates featuring incumbent politicians.[654] Indeed, close sponsorship relationships with politicians will help the Foundation achieve its educational goals with maximum impact.[655] The Foundation might also undertake "nonpartisan" get-out-the-vote and voter registration drives in selected districts.[656] The Foundation might also direct some of its funds to the Institute for the Promotion of Governmental Action for Environmentally Sound Energy Independence to be used in the Institute's educational activities.[657] All of these educational activities can be focused on the years leading up to elections in order to shield the Foundation from claims that it is intervening in political campaigns, leaving the more direct activity to other parts of the structure. The advantage of the Foundation to A and B and their friends is the tax deductibility of contributions, thereby funding the Foundation's activities with before-tax funds.[658]

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653. Rev. Proc. 86-43, 1986-2 C.B. 729.

654. *Id.* at § 3.

655. Chisolm, *supra* note 603, at 608-09.

656. See the description of the activities of Vote Now 96 in Robert Paul Meier, *The Darker Side of Nonprofits: When Charities and Social Welfare Groups Become Political Slush Funds*, 147 U. PA. L. REV. 971, 976-78 (1999).

657. *See* Hill, *supra* note 20, at 30.

658. For examples of the use of charitable organizations by the major political parties, see Meier, *supra* note 656.

A and B will of course serve in significant decisionmaking roles in all of these activities. Savvy incumbents and potential candidates will be aware of the combined political influence of the collective enterprise and its potential benefits to their electoral success. The combination is likely to serve A and B well, at least in terms of direct access to the players in the political process.

As a corollary to A and B creating an educational foundation, incumbent legislators and potential candidates each may create an exempt charitable organization to promote a cause with which the candidate is closely associated.[659] As an example, a congressional member may create a foundation for environmentally sound energy independence. Alternatively, the member may promote the creation of a think tank devoted to positions on a wide variety of issues that are consistent with the member's political philosophy. The member may thereafter travel around the country to participate in seminars and lectures on the need for energy independence.[660] In addition, the foundation would broadly distribute the Congress member's views on the subject. To ensure that these organizations are appropriately oriented, they are operated by the legislator's current and former staff members. For the member who walks too close the line of campaign and legislative regulation, the creation of a legal defense fund provides an additional vehicle for donors to curry favor outside of the FECA regulatory scheme.[661]

IV. A DIFFERENT TAX REGIME: DOWN WITH SUBSIDIES IF YOU FIND THEM

The campaign finance regulatory scheme and federal income taxation are inextricably linked with multiple pathways under section 501 of the Code to direct money into the political arena in forms that avoid the restrictions on campaign finance of the Federal Elections and Campaign Act. The question for this section is whether this system creates tax subsidies for political activity that are contrary to the public policy reflected in the FECA, or broader notions of public policy in general. If undesirable tax subsidies are believed to exist, then the final question is

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659. This device is extensively discussed in Chisolm, *supra* note 603. *See also* Lee Sheppard, *Does Gingrich's Admission Mean He Owes Taxes*, 74 TAX NOTES 9, 9 (1997); Carolyn D. Wright, *Did IRS Do Its Job in Progress and Freedom Foundation Audit*, 86 TAX NOTES 1678, 1678 (2000) (describing the method by which a tax-exempt charitable organization assisted Newt Gingrich's "education" program).

660. Charitable organizations reportedly have been used to pay travel, housing and throw a party for the benefit of California Governor Grey Davis. Dan Morain, *Firms Seeking State Favor Finance Davis Foundations*, L.A. TIMES, Nov. 15, 2000, at A1.

661. Kathleen Clark, *Paying the Price for Heightened Ethics Scrutiny: Legal Defense Funds and Other Ways that Government Officials Pay Their Lawyers*, 50 STAN. L. REV. 65, 69 (1997).

whether there are workable revisions to the tax-exempt organization regime that are worthy of consideration.

A. *Are There Tax Subsidies for Political Expenditures?*

As discussed in Part II, the Court in *Regan v. Taxation with Representation*[662] identified two potential subsidies to political activity; exemption from tax, which is equivalent to a cash grant in the amount the organization would otherwise pay on its income, and a tax deduction for contributions to the organization, which is the equivalent of a cash grant of a portion of the contributor's contributions.[663] The subsidy is evident in the case of a charitable organization that is exempt from tax under section 501(c)(3). The donor claims a deduction for contributions,[664] thereby providing untaxed dollars to the organization, which also is exempt from tax on its income. Thus, to the extent that the charitable organization is engaged in political activity, the funding comes from money that is not subject to taxation at any level. As a participant in the political process, the tax-exempt charity is thereby allowed to purchase its political influence with funds derived at a lower cost than a competing participant who is allowed the use of only money that is derived after tax.[665] This is the form of subsidy condemned by the Supreme Court in *Cammarano v. United States*[666] when it upheld Treasury Regulations denying a deduction for grassroots lobbying expenditures.[667]

The same level of subsidy exists to the extent that a business entity is permitted a deduction for contributions and payments to a tax-exempt trade association or social welfare organization that is able to undertake education-oriented political activity not classified as lobbying or intervention in a political campaign. Again the political activity is financed with money that is not subject to tax.

Identifying a subsidy is more difficult with respect to political activity by a trade association that receives contributions that are not deductible under section 162(e), or by a social welfare organization that does not receive deductible contributions. Here the political activity is funded with money that has been subject to at least one level of income tax: the tax imposed on income earned by the contributor and transferred to the entity. The political expenditures in this category are perhaps on the same footing

662. 461 U.S. 540 (1983).

663. *Id.* at 544.

664. I.R.C. § 170(a) (2001).

665. *See* Hill, *supra* note 5, at 923. "The absence of an entity-level tax is a fundamental benefit in making any type of an exempt organization a more attractive conduit than other taxable entities or individuals." *Id.*

666. 358 U.S. 498 (1959).

667. *Id.* at 505.

as an individual's independent political expenditure, the cost of the expenditure is measured in terms of before-tax earnings less tax payable.[668]

A subsidy is present only if a political organization is viewed as a separate taxable entity that receives income subject to tax that is not offset or eliminated by deductions for its political expenditures. Political organizations in the form of a social welfare organization, trade organization, or section 527 political organization, are associations of like-minded individuals and business enterprises who fund the activity with a view to producing the benefit of a political result. The entity status of the organization enhances the benefit to individual members. The Supreme Court has recognized in the context of its First Amendment jurisprudence that individuals contribute their money in order to enable others to speak for them in the political arena because the collective effort enhances their individual influence.[669] In the hypothetical cases described in the preceding section, the political result is favorable to the contributors' perceived economic interests. On the other side of the issue, there are strong environmental groups to which individuals contribute for more altruistic reasons.[670] In either case, the organizations produce a "benefit" to the contributor in the form of collective political influence. Although these enterprises do not operate with a profit motive in a dollar sense, the court recognized in *Madison Gas & Electric Co. v. Commissioner*,[671] that an entity formed for the joint production of a product, albeit a tangible product, and its division in-kind, may be viewed as an activity engaged in for joint-profit.[672] Similarly, an entity formed for the development of

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668. This is the equivalent of the expenditure multiplied by 1/(1-the tax rate). Thus, a $100 expenditure by an individual in a 36% tax bracket require $156.25 of before-tax earnings.

669. The Court states in *NAACP v. Alabama*, 357 U.S. 449, 460 (1958), that "[e]ffective advocacy of both public and private points of view, particularly controversial ones, is undeniably enhanced by group association, as this Court has more than once recognized by remarking upon the close nexus between the freedoms of speech and assembly." *See also* Bradley A. Smith, *Money Talks: Speech, Corruption, Equality and Campaign Finance*, 86 GEO. L.J. 45, 57 (1997).

670. *See* David A. Strauss, *Corruption, Equality, and Campaign Finance Reform*, 94 COLUM. L. REV. 1369, 1378 (1994),

> Compare ... civil rights groups and, say, the lobby for agricultural subsidies.... One side's chief examples of narrow and self-interested groups will be the other side's examples of groups that pursue the public interest. If campaign finance reform is intended to restrict the power of supposedly narrow and pernicious interest groups, while not disadvantaging supposedly public-interested interest groups, then reform necessarily takes on an extremely partisan cast.

Id. This highlights the importance of removing the government entirely from the business of providing subsidies to particular groups.

671. 633 F.2d 512 (7th Cir. 1980).

672. *Id.* at 513.

political influence for the benefit of its contributors may be viewed as a venture formed for producing a product in-kind for the mutual profit of its benefactors.[673] Contributions to a political entity do not produce a property interest in the entity in the sense of a shareholder's interest received in exchange for a capital contribution or a partner's interest in a partnership, but rather the benefit of collective political influence for the benefit of contributors. Rather than capital investments, the contributions represent payment for the services rendered by the entity in its attempts to mould public opinion.

Although the Internal Revenue Service historically has treated campaign contributions as not constituting income under section 61 of the Code, the Service as never made a case for the exemption.[674] Contributions are not gifts under the most commonly accepted definition of non-taxable gifts—payments motivated by disinterested generosity without any expectation of a quid-pro-quo.[675] In contrast, contributors to political organizations do so with an expectation that the organization will pursue the contributors' political interests.[676] A contributor's expectation that the organization will use funds in a specified fashion may mean that the organization receives the funds as a conduit subject to a "trust" that limits the organization's receipt of income that it can direct to its own purposes. As a consequence, the contributions are not includable in the organization's gross income.[677] However, in most cases political organizations are not restricted by their contributors in the use of the contributions as long as the contributor is convinced that the organization is providing the expected political benefit.[678] The political organization generally is not required to spend its funds entirely for specified purposes, other than accomplishment of the organization's broad goals.[679] The absence of shareholders or others with a financial stake in a tax-exempt

673. See Technical Advice Memorandum 9130008 (9/14/1978), holding that an unincorporated organization formed to promote passage of a municipal referendum, which is not a political organization because it did not support candidates for election, was an association taxable as a corporation that had associates and an objective to carry on activities in furtherance of the purpose for which it was formed.

674. *See supra* text accompanying notes 207-21.

675. Comm'r v. Duberstein, 363 U.S. 278, 285 (1960).

676. *See, e.g.*, Rev. Rul. 75-146, 1975-1 C.B. 23, 25; Rev. Rul. 76-276, 1976-2 C.B. 14, 14.

677. *See* Ford Dealers Adver. Fund v. Comm'r, 55 T.C. 761, 771 (1971), *aff'd per curiam*, 456 F.2d 255 (5th Cir. 1972); Dri-Powr Distribs. Ass'n Trust v. Comm'r, 54 T.C. 460, 477 (1970); Angelus Funeral Home v. Comm'r, 47 T.C. 391, 397 (1967), *aff'd* 407 F.2d 210 (9th Cir. 1969).

678. In the context of the FECA prohibition on corporate contributions to candidates, the contributor's ability to withdraw from a voluntary organization was recognized as the contributor's recourse if the contributor is dissatisfied with the work of the organization. Fed. Election Comm'n v. Mass. Citizens for Life, Inc., 479 U.S. 238, 260-61 (1986); Austin v. Mich. Chamber of Com., 494 U.S. 652, 663 (1990).

679. 479 U.S. at 260-61.

organization means that contributions to the organization are received subject to the dominion and control of the entity without any obligation to return capital to contributors on a liquidation and without obligation to share in financial reward. In fact, contributions are received from persons who desire to implement the results promised by the organization, the furtherance of the organization's exempt purpose. Where the intent of the contributor is to maximize political influence through association with other like-minded contributors, the collective influence exercised with the benefit of a separate identifiable entity facilitates the organization's creation of political benefit, its product, to the contributors. The organization thereby receives compensation for its services that could be recognized as gross income.

If a political organization is required to include contributions in gross income, tax exemption does not provide a subsidy if the organization expends its receipts in a tax-deductible fashion that eliminates taxable income. The political organization's expenses for its education program, lobbying expenses, and political contributions may be viewed as the deductible, ordinary and necessary expenses of its business of producing political influence.

There are a couple of major limitations on the deductibility of these expenses, however. First, as discussed above,[680] section 162(e) bars deductions for expenditures incurred to influence legislation and elections.[681] The provision has been interpreted to include expenditures incurred to influence the public on issues of legislative interest such as expenditures that are part of a program to achieve a legislative result.[682] On the other hand, section 162(e)(5)(A) allows deductions to organizations that are in the trade or business of incurring political expenditures "directly on behalf of another person."[683] This provision is intended to prevent a "cascading" of the limitation on deductions so that loss of the deduction only applies at one level.[684] Legislative history clarifies that the limitation only applies to a direct, one-on-one relationship between the lobbying

680. *See supra* text accompanying note 241.

681. I.R.C. § 162(e)(1)(A), (B) (2001).

682. *See* Consumers Power Co. v. United States, 427 F.2d 78, 79-80 (6th Cir. 1970); Rev. Rul. 74-407, 1974-2 C.B. 45, 45; Rev. Rul. 78-111, 1978-1 C.B. 41, 41-42. In *Geary v. Commissioner*, 235 F.3d 1207 (9th Cir. 2000), the court disallowed deductions for the expense of gathering signatures for a successful initiative campaign by a San Francisco police officer to qualify a ballot measure permitting the officer to continue patrolling with a puppet named Officer O'Smarty. *Id.* at 1210-11. The taxpayer claimed that the puppet helped to improve community relations while he was on patrol and that his expenditures for the initiative campaign were ordinary and necessary business expenditures in the form of advertising to educate the public about the puppet issue. *Id.* at 1210.

683. I.R.C. § 162(e)(5)(A) (2001).

684. H.R. REP. 103-213 pt. 4, at 610 (1993).

business and a client, and that the provision is not applicable to a membership organization that serves the interests of all of its members rather than one particular member.[685] Thus, the political expenditures of a political organization, as well as contributions to the organization, are not deductible.

Beyond section 162(e), current deduction of the political expenditures of a political organization also should be limited by the capitalization requirement.[686] In general, expenditures that create a benefit that extends beyond the current taxable year must be capitalized rather than currently deducted.[687] The general education program of social welfare organizations and trade associations that are engaged in building political influence may be characterized as creating benefits that extend over the life span of favored legislation or the political careers of favored politicians. On the other hand, treasury regulations explicitly provide for the current deduction for goodwill advertising that keeps the taxpayer's name before the public.[688] The regulation requires that the expenditures be related to "the patronage the taxpayer might reasonably expect in the future."[689] The regulation adds that deductible expenditures may include expenditures for advertising "which presents views on economic, financial, or social, or other subjects of a general nature."[690] However, this language appears to encompass the requirement that the expenditure be related to expected patronage. Thus, in *Cleveland Electric Illuminating Co. v. United States*,[691] advertising expenditures incurred to reduce public opposition to granting a license to operate a nuclear power plant were required to be capitalized.[692] The expenditure was not related to seeking patronage for the taxpayer, but was incurred for the purpose of influencing the public in the permit process.[693] Revenue Ruling 92-80, which holds that advertising expenses are generally deductible even though the expense may create a future benefit, adds that capitalization is required in the "unusual circumstance where advertising is directed towards obtaining future benefits significantly beyond those traditionally associated with ordinary product advertising or with institutional or goodwill advertising."[694] In the context of the educational program of a political organization, the expenditures are incurred for the purpose of influencing political views

685. *Id.*
686. I.R.C. § 163 (2001).
687. INDOPCO, Inc. v. Comm'r, 503 U.S. 79, 87 (1992).
688. Treas. Reg. § 1.162-20(a)(2) (as amended in 1995).
689. *Id.*
690. *Id.*
691. 7 Cl. Ct. 220 (1985).
692. *Id.* at 233.
693. *Id.* at 232.
694. Rev. Rul. 92-80, 1992-2 C.B. 57, 57.

and are not directed towards the identification of a particular taxpayer's business. The generalized benefit from political persuasion, once created, has an indefinite, or at least immeasurable, lifetime. For tax purposes the consequence should be the denial of current deductions and the absence of capital recovery deductions that are available for capitalized expenses with definite and limited useful lives.

The presence or absence of taxable income in a political organization raises difficult technical questions. Most political advocacy organizations avoid the possibility of income taxation by virtue of exemption under section 501. The tax exemption permits the creation of a political organization to take advantage of the collective benefit of pooled resources for the creation of political influence free of concern over the organization's potential liability for tax on its activities. Thus, even if one were to question the presence of the subsidy described in *Regan*,[695] tax exemption remains as an important governmentally provided benefit to many political advocacy organizations.

Tax exemption is justified when the purpose for which an entity is organized and operated advances public policy. Public policy here must, in a pluralist sense, recognize the value of encouraging diverse approaches and viewpoints on controversial social and political issues. On the other hand, unrestricted payments received by the organization to advance a political agenda should not necessarily enjoy exemption from tax where the tax subsidy contradicts governmental policy. Avoidance of governmental subsidy to advocates in the election process on a content neutral, nonpartisan basis may be viewed as a governmental policy that suggests the elimination of exemptions from tax.

B. *Tax Benefits and Policy*

This author once wrote,

> [e]xpenditure of governmental resources in terms of foregone revenue should be limited to items which reduce or mitigate governmental costs. Thus tax expenditures might be limited to activities that benefit the common good, as opposed to enhancing return on private investment, in those areas that are unable to independently attract capital because of the absence of profit potential.[696]

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695. *Regan*, 461 U.S. at 544-45.

696. Daniel L. Simmons, *The Tax Reform Act of 1986: An Overview*, 1987 BYU L. REV. 151, 222.

The deduction for charitable contributions and the accompanying tax exemption for charitable organizations have been justified in similar terms.[697] The contribution and exemption relieve the government of burdens that are assumed by charitable organizations. This tax benefit, born out of public policy, should not be available to organizations that operate in a manner that defeats governmental policy.[698] Thus, the courts have recognized a range of congressional latitude in granting or denying tax subsidies to particular activities.

The Court in *Cammarano v. United States*[699] expressed an important policy goal in terms of governmental participation in campaign finance when it recognized that a tax benefit to one party in a political contest because of that party's ability to fund election advocacy with tax-free money provides an unfair advantage in terms of competing interests in the political process that are not so favored.[700] Indeed, there is a suggestion in

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697. Daniel Shaviro, *Assessing the "Contract Failure" Explanation for Nonprofit Organizations and Their Tax-Exempt Status*, 41 N.Y.L. SCH. L. REV. 1001, 1007 (1997).

> I believe that fundamentally the case for tax exemption, as well as other special tax and non-tax benefits for nonprofit organizations, must rest squarely, and more or less exclusively, on the view that the activities these organizations engage in merit public support. . . . First the organizations are providing public goods or engaging in activities that have positive externalities. And second, in areas where the organizations are active, decentralized private provision is either preferable–at least in part–to direct government provision, or necessary in practice to compensate for government's failure to do all that it should.

Id.; *see also* Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849, 853-54 (10th Cir. 1972).

> The exemption to corporations organized and operated exclusively for charitable, religious, educational or other purposes carried on for charity is granted because of the benefit the public obtains from their activities and is based on the theory that: " . . . the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare."

Id. (quoting H.R. REP. NO. 18-60 at 19 (1939). There are, of course, multiple alternative theoretical justifications for the tax exemption to charities. For a discussion of various theories, see Nina J. Crimm, *An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419 (1998).

698. See *Bob Jones Univ. v. United States*, 461 U.S. 574, 602, 605 (1983), which denied a free-exercise challenge to revocation of 501(c)(3) status to a religious organization on the grounds of its racial discrimination. Exemption as a charitable organization violated a public policy against racial discrimination. *Id.* at 605.

699. 358 U.S. 498 (1959).

700. *Id.* at 513.

Cammarano that the advantage of tax subsidy to one side of a political issue may suffer some constitutional infirmity under the First Amendment.[701] Congress adopted a similar posture with its enactment of limitations on deduction of lobbying and political campaign expenses as a trade or business expense.[702] Congress also provided benefits to campaign finance in the form of tax exemption for political organizations that collect contributions for expenditure on the election of individuals to political office.[703] Possibly that legislation is limited to election campaigns because organizations formed for the purpose of influencing legislation, including organizations that participate in grassroots initiative campaigns, are exempt from tax as social welfare organizations or trade associations.[704] In any event, creation of the section 527 political organization reflects a congressional attempt to channel campaign activity into a single entity.

A second set of important congressional policy goals is reflected in the campaign limitations of the FECA. Under the justification allowed to Congress by the Supreme Court in *Buckley*, Congress limited campaign contributions and expenditures to avoid corruption of elected officials. In so doing Congress has attempted, albeit in a very limited fashion, to regulate the flow of campaign finance.

Numerous political entities that advocate political causes operate outside of the reporting and limitations regime of the FECA. Commonly the tax-exempt political organization operates under the guise of providing an education program that furthers the political interest of a candidate or candidates. To the extent that these organizations operate with tax-favored money, the United States Treasury is a partner in their political advocacy. To the extent that these organizations operate outside of the purview of the FECA's limitations and disclosure requirements, the federal subsidy proceeds on a course contrary to congressional policy in campaign finance regulation.

The obvious recommendation that follows from all of this is to harmonize federal tax exemption policy with the policy of campaign finance regulation. That means that the subsidy of tax exemption, and tax deduction in the case of charitable organizations should be restricted to campaign finance activity that is consistent with the limitations of the FECA. In other words, the income tax benefits should be limited to FECA regulated campaign activity.[705] To the extent that a political organization

701. *See id.* at 515 (Douglas, J., concurring).
702. I.R.C. § 162(e) (2001); *see also supra* text accompanying note 241.
703. I.R.C. § 527 (2001); *see also supra* text accompanying note 480.
704. I.R.C. § 501(c) (2001).
705. *See* Lieberman, *supra* note 295, at 8.

broadens its advocacy beyond the FECA defined political contributions and expenditures, the organization undertaking the activity should not be eligible for tax exemption under section 501(c) of the Internal Revenue Code. The technical problems of accomplishing that result are difficult, but perhaps not insurmountable.[706]

C. *Options for Tax Revision*

1. Distinguish Campaigning From Education for Social and Economic Change

The principal hurdle to limiting federal tax subsidies in the public arena is in drawing the line between the educational activities of tax-exempt organizations and political campaigning that is not subject to tax benefits. The Internal Revenue Service's line drawing has to date left open a superhighway for tax-exempt campaign activity by charities and non-charities alike. One improvement will lie in identifying permissible issue advocacy/education in terms that are consistent both for purposes of tax exemption and the FECA. The education program of tax-exempt organizations clearly is the favored pathway to political advocacy. Consistent definition of campaign communication for purposes of the FECA disclosure and limitation rules and for purposes of identifying intervention in political campaigns for purposes of tax exemption under section 501(c) would promote the goals of both legislative schemes.

There potentially are three somewhat different approaches available under the authorities for distinguishing campaign advocacy from issue-related education. One possibility is to define election advocacy in terms similar to those used in the definition of influencing legislation found in section 4911(d)(1)(A) of the Code. Under this approach, intervention in a campaign would include (a) any attempt to influence the election of any candidate for elected political office through an attempt to affect the opinions of likely voters for the office. Section 4911(d)(2)(A) contains an important exception to the definition which excludes the communication

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> These provisions [referring to I.R.C. § 527] reflect Congress's judgment that although taxpayers should subsidize the activities of groups working in the public interest by granting them favored tax status, that subsidy should not extend to organizations that focus primarily on political campaign work, unless those organizations are willing to comply with the regulation of the election laws.

Id.

706. Whether there is the political will to limit federal subsidies to campaign organizations is a separate issue beyond the scope of this Article. *See* Marshall, *The Last Best Chance for Campaign Finance Reform*, 94 NW. L. REV. 335, 339 et. seq. (2000); GOIDEL, *supra* note 10, at 169.

of "nonpartisan analysis, study, or research."[707] This standard is somewhat similar to the Internal Revenue Service standards in Revenue Ruling 78-248,[708] Revenue Ruling 80-282,[709] and the ruling position reflected in Revenue Procedure 86-43.[710] But placing the definition in the statutory requirements for tax-exempt status under section 501 could enhance enforcement.

The Ninth Circuit Court of Appeals in *Federal Election Commission v. Furgatch*[711] suggested a subjective approach that would treat a communication as express advocacy for a candidate if the communication "when read as a whole, and with limited reference to external events, [is] susceptible of no other reasonable interpretation but as an exhortation to vote for or against a specific candidate."[712] Under the *Furgatch* standard, communications would represent express advocacy if the message is unmistakable and unambiguous, it presents a clear plea for action, and it is clear that the contemplated action is a vote for or against a candidate.[713] This standard is based on factual judgment as to what is unambiguous advocacy for a particular candidate and may, therefore, face difficulty under the Supreme Court's limited tolerance for vagueness as expressed in *Buckley*.[714] On the other hand, the standard is easier to avoid than the existing standards under the Internal Revenue Service's ruling position because of the requirement for unambiguous election advocacy. The political methodologies of contemporary exempt-organizations undoubtedly are more subtle than the speech contemplated in the *Furgatch* approach.

A more objective definition of election advocacy is suggested by the McCain-Finegold legislation.[715] The bill would define an independent electioneering communication subject to disclosure under FECA as including a communication that refers to a clearly identified candidate for federal office, is made sixty days before a general, special or runoff

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707. I.R.C. § 4911(d)(2)(A) (2001).

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

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

710. Rev. Proc. 86-43, 1986-2 C.B. 729. *See supra* text accompanying notes 397-404; *see also* Priv. Ltr. Rul. 96-09-007 (Dec. 6, 1995), 1995 PRL Lexis 2000; Priv. Ltr. Rul. 89-36-002 (May 24, 1989), 1989 PRL LEXIS 1814.

711. 807 F.2d 857 (1986).

712. *Id.* at 864.

713. *Id.* A similar concept was proposed in the Shays-Meehan Bipartisan Campaign Reform Act of 1998, H.R. 3526, 105th Cong. § 201(b) (1998), which would have defined express advocacy in part as expressing unmistakable and unambiguous support for or opposition to one or more clearly identified candidates when taken as a whole and with limited reference to external events, such as proximity to an election.

714. Buckley v. Valeo, 424 U.S. 1 (1975).

715. S. 27, 107th Cong. § 2001 (adding 2 U.S.C. § 434(f)(3)) (as passed by the Senate on Apr. 2, 2001).

election, or thirty days before a primary election, and is made to an audience that includes voters for the election.[716]

The first of these approaches focuses somewhat on the subjective intent of an "attempt" to influence voters. The *Furgatch* standard would treat a communication as campaign advocacy if its unmistakable intent and/or impact is to influence voters.[717] The McCain-Feingold standard would identify campaign participation by exempt organizations at the end of the election cycle by categorizing all references to a candidate for election within the time-frame of the electoral campaign as campaign advocacy.[718] The McCain-Feingold definition, while valuable, would only limit election activity of tax-exempt organizations in the periods immediately preceding an election. Other uses of tax-exempt think tanks and other educational organizations to further a politician's longevity in office would continue. However, in combination, these definitions of campaign activity would encompass a significant portion of the sphere of disguised election advocacy. The combination would (1) treat as campaign advocacy all attempts to influence the voter for or against an identified candidate, (2) provide a device to recognize unmistakable campaign advocacy, and (3) recognize as campaign advocacy all intervention by tax-exempt organizations in the electoral process on the eve of an election. Recognizing political advocacy disguised as education as campaign speech and encompassing that activity within the tax-exempt organization would permit policy-makers to determine which activity is appropriate for tax benefited organizations.

There is an overbreadth problem in the proposed definition which would sweep within the last part bona fide news reporting of a tax-exempt organization that publishes news periodicals.[719] The proposed McCain-

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716. *Id.* The definition only applies to broadcast, cable, or satellite communications, apparently not intending to include newspaper or other written communication. In case the definition of electioneering communication proposed in the McCain-Feingold bill is rejected on constitutional grounds, the legislation contains an alternative that would define electioneering communication as,

> any broadcast, cable, or satellite communication which promotes or supports a candidate for that office, or attacks or opposes a candidate for that office (regardless of whether the communication expressly advocates a vote for or against a candidate) and which also is suggestive of no plausible meaning other than an exhortation to vote for or against a specific candidate.

Id. § 2001.

717. Fed. Election Comm'n v. Furgatch, 807 F.2d 857, 864 (1986).

718. S. 27, § 2001.

719. An example is TAX NOTES, which is published by Tax Analyst, an exempt section 501(c)(3) organization. Tax Analysts exemption letter may be found on the Web at http://www.tax.org/About/990/Irs.pdf. Tax Notes is a weekly publication that often contains stories

Feingold definition of electioneering communication would exclude a communication appearing in a news story, commentary, or editorial distributed through the facilities of any broadcasting station.[720] Similarly, a definition of political advocacy for tax-exempt organization purposes may exclude non-partisan reporting of current events and analysis contained in a periodical regularly published by a tax-exempt organization that is distributed to a subscriber base that is not formed on the basis of elections either geographically or temporally.[721] The provision also could be drafted to exclude from campaign advocacy the nonpartisan presentation of candidates' views in their own words in a written or electronically communicated forum that included all of the major candidates in a particular election.[722]

2. Options to Revise the Tax Regime for Political Organizations

a. Tax Exempt Charities

Congress's expression of its policy choice is clear regarding campaign activity by tax-exempt charitable organizations. Charitable organizations that are exempt from tax under section 501(c)(3) are prohibited from intervention in a political campaign.[723] Yet the record is equally clear that the muddled definition of educational advocacy on social issues versus

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about federal office holders and tax legislation. For an interesting variation of this issue, however, see Richard L. Hasen, *Campaign Finance Laws and the Rupert Murdoch Problem*, 77 TEX. L. REV. 1627 (1999), which advocates the elimination of the FECA exemption for corporate limits on campaign contributions that is available for news media.

720. S. 27, 107th Cong. § 201 (adding 2 U.S.C. § 434(f)(3)(A)(ii)) (as passed by the Senate Apr. 2, 2001). The exception would not be available in the case of a broadcast facility that is owned by a political committee, political party, or a candidate. Under the bill, electioneering communications also do not include independent expenditures, not coordinated with a candidate, that expressly advocate the election or defeat of a candidate. The legislation would impose an independent disclosure requirement on these expenditures. *Id.* See Fred Stokeld, *McCain Article Raises Questions of EO Political Participation*, 86 TAX NOTES 1839 (2000), reporting on an article severely criticizing Senator John McCain published in the newspaper of God's World Publications, an exempt charity, WORLD, Feb. 19, 2000, published immediately before the South Carolina Presidential primary.

721. See Fred Stokeld, *McCain Article Raises Questions of EO Political Participation*, 86 TAX NOTES 1839 (2000), reporting on an article severely criticizing Senator John McCain published in the newspaper of God's World Publications, an exempt charity, WORLD, Feb. 19, 2000, published immediately before the South Carolina Presidential primary.

722. *See, e.g.*, Rev. Rul. 86-95, 1986-2 C.B. 73; Fulani v. League of Women Voters Educ. Fund, 882 F.2d 621 (2d Cir. 1989). Note the study by Hasen, *supra* note 102, which found that only a tiny fraction of so-called issue advertisements appearing on television in the thirty and sixty day periods preceding congressional elections were "genuine" issue-oriented communications rather than election advocacy.

723. *See supra* text accompanying notes 297-303.

campaign advocacy for or against specific candidates has permitted extensive political campaign activity by exempt charities.

Broadening and clarifying the definition of political intervention to include all campaign advocacy, particularly advocacy that meets the definition of an electioneering communication under the McCain-Feingold standard, will help identify charitable organizations that attempt to influence the outcome of elections. Further steps are required, however, to prevent tax subsidies for otherwise tax-free money that flows through tax-exempt charities. Revocation of the exempt status of a charitable organization that is intervening in political campaigns will not prevent abuse.[724] The revocation process is long and difficult, revocation generally would be initiated after tax-free money has already been expended in the electoral process and after the charitable organization has attempted to accomplish its political purpose, and the promoters of the charitable organization are not restrained from the creation of a new organization to carry on the political activities.[725]

Recognizing that contributions intended to effect political advocacy may be includable as income to the charity operating as a political organization, and that deduction of the expense of earning that income potentially is limited, the subsidy to a charitable organization's political advocacy may be removed by taxing the organization on its receipts that are directed to campaign advocacy at the highest tax rates imposed either on corporations or trusts, as would be appropriate to the characterization of the organization.[726] To avoid questions involving whether contributions can be treated as income under section 61, a meaningful tax on political advocacy could be structured as an increase in the excise tax of section 4955 of the Code.[727] The excise is imposed on the use of a tax-exempt charitable organization for political advocacy. Basing the rate on the highest income tax rates, rather than the ten percent rate currently applied by section 4955, would remove the subsidy of tax exemption.

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724. See Sheppard, *supra* note 659, at 13, which states that "investigations of violations only come after the election. Potential disqualification of a purportedly exempt organization is no barrier; by the time it happens, the money has been spent, the organization has been dissolved, and everyone has moved on to the next election." *Id.*

725. For example, see the procedural history of *Branch Ministries v. Rossotti*, 211 F.3d 137, 140-41 (D.C. Cir. 2001). *See also supra* note 327.

726. The corporate rate would be directed to incorporated organizations, the trust rate imposed on unincorporated organizations that may be characterized as trusts formed for the purpose of pooling property for nonprofit purposes. *See* Treas. Reg. § 301.7701-4(a) (as amended in 1996). The highest rate for trusts, the same as the individual rate, could be imposed on a partnership if the joint production of political influence in the electoral process can be recognized as a joint profit motive. *See* Madison Gas & Elec. Co. v. Comm'r, 633 F.2d 512 (2d Cir. 1980).

727. *See supra* text accompanying notes 349-58.

Taxing a tax-exempt charity at income tax rates on its political advocacy expenditures would only eliminate one of the two subsidies described in *Regan v. Taxation with Representation.*[728] Contributors to the organization would still be permitted a deduction for their charitable contributions. In order to eliminate this subsidy, the concepts of sections 162(e)(3) and 170(f)(9) might be expanded to require a charitable organization to notify each of its contributors of any expenditures for political advocacy and indicate the proportion of its total expenditures that are represented by political advocacy. Contributors would thereafter be required to include in gross income the amount of any deductions claimed for charitable contributions to organizations with political expenditures.[729] Although such a reporting requirement would be burdensome to a charitable organization, as recognized in *Regan,*[730] the organization may avoid both the reporting requirements and the potential tax liabilities by directing its political advocacy, including both the receipt of contributions and its expenditures, through an organization that does not avail itself of governmental subsidies. That is precisely the goal that this proposed scheme is intended to accomplish.

b. Tax Exempt Social Welfare and Other Non-Charitable Tax Exempt Organizations

The registration and disclosure requirements of section 527(i) and section 527(j)[731] that are imposed on organizations designated as political organizations will lead many political entrepreneurs to increase their use of tax-exempt social welfare organizations for campaign advocacy. In addition, the ability to use a section 501(c)(4) organization to avoid the FECA limitation on corporate contributions under *Federal Election Commission v. Massachusetts Citizens for Life, Inc.*[732] puts additional pressure on the use of the social welfare organization for political advocacy.[733] The fact that political advocacy through a social welfare organization may shield contributors from disclosure and in general

728. 461 U.S. 540, 544 (1983).

729. This proposal is framed in terms of an inclusion in gross income in order to capture only the tax benefit to the contributor of deducted expenses. Thus, non-itemizers who claim no deductions for charitable contributions would not be affected.

730. *Regan,* 461 U.S. at 544, 544 n.6.

731. *See supra* note 545.

732. 479 U.S. 238, 241 (1986).

733. The McCain-Fiengold bill exacerbates the problem by specifically excluding communications by a § 501(c)(4) organization supported by contributions from individuals who are U.S. citizens from the definition of electioneering communication that is subject to disclosure under the FECA. S. 27, 107th Cong. § 203(b) (adding 2 U.S.C. § 441b(c)(2)) (as passed by the Senate Apr. 2, 2001).

provide a way to avoid the FECA provisions warrants an examination by policy makers of whether political activity in this form should be encouraged by the availability of a tax benefit.

The Internal Revenue Service has ruled that a certain amount of campaign advocacy is consistent with the exempt function of social welfare organizations and other forms of tax-exempt interest group associations.[734] Imposition of a prohibition on intervention in political campaigns, such as is applied to charitable organizations under section 501(c)(3), may not be appropriate in the case of section 501(c)(4) and other tax-exempt organizations.[735] However, it may be desirable to eliminate the subsidy for campaign activity. Contributions to a social welfare organization that are intended by the contributor to provide political influence by supporting candidates represent compensation to the organization for developing and providing the political influence. That compensation may be deemed income that appropriately is the subject of the income tax. In addition, section 527(f) already withholds the subsidy for investment income of a tax-exempt organization that is directed to campaign advocacy by imposing a tax at the highest corporate rate on campaign expenditures financed with investment income.[736] Recognizing the additional subsidy provided to the exempt organization, the tax on exempt organizations that engage in campaign advocacy may be expanded to include contribution income to the extent that contributions are expended for campaign advocacy.[737] Again, for this purpose, campaign advocacy should be defined to include attempts to influence voters, unmistakable exhortations to vote for or against identified candidates, and election-eve communications that identify a candidate.[738] As discussed in the context of charitable organizations, issues of whether contributions constitute gross income may be avoided by characterizing the tax as an excise on the benefit of operating as a tax-exempt entity engaged in campaign advocacy modeled on the lobbying excise tax of section 4911.[739] The rate could reflect the benefit of tax exemption with a tax at the highest corporate rate on campaign advocacy expenses of a tax exempt organization.

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734. Rev. Rule. 81-95, 1981-1 C.B. 332.

735. *See* Coverdale, *supra* note 445, proposing that the restrictions on intervention in political campaigns applicable to section 501(c)(3) organizations be extended to section 501(c)(4) organizations. *Id.* at 176-77. The article also proposes disclosure requirements for contributions and expenditures. *Id.*

736. I.R.C. § 527(f) (2001).

737. Section 527(i)(4) includes political contributions in the taxable income of a political organization that fails to comply with the disclosure requirements of section 527(i). I.R.C. § 527(i)(4) (2001).

738. *See supra* text accompanying notes 708-23.

739. *See supra* text accompanying note 321.

The consequence of the proposed income or excise tax on the campaign advocacy of a tax-exempt organization is that political entrepreneurs would direct their activities towards the remaining tax exempt political organization defined in section 527. The benefit of that result is that all campaign activity would be conducted through a single form of entity. Congress could then readily identify the types of campaign activity that it would choose to benefit through the benefit of tax-exemption.

c. The Tax Exempt Political Organization

The Senate Finance Committee explanation of the original adoption of section 527 of the Code expressed the legislative expectation that

> a section 501(c) organization that is permitted to engage in political activities would establish a separate organization that would operate primarily as a political organization, and directly receive and disburse all funds related to nomination, etc., activities. In this way, the campaign-type activities would be taken entirely out of the section 501(c) organization, to the benefit both of the organization and the administration of the tax laws.[740]

In other words, Congress intended that the tax subsidies for campaign advocacy be located in a single organizational format, the section 527 political organization. The Committee on Ways and Means hinted at the advantage of this approach where it suggested that tax-exempt organizations appropriately could avoid the disclosure requirements proposed by the Committee in its version of H.R. 4762 by forming a section 527 segregated fund.[741] The proposals for the taxation of campaign activity of charitable, social welfare, and other tax-exempt organizations are intended to further this result by removing the tax subsidy for campaign activity from any form of tax-exempt organization except for political organizations qualified under section 527.

If Congress were to enact provisions designed to focus exempt organization campaign advocacy into section 527 political organizations and segregated funds, Congress must also consider the extent to which the subsidy of tax exemption is to be available. Existing legislation attempts to ensure that campaign money is subject to at least one level of tax with attempts to limit deductions for contributions to political organizations and to tax exempt organizations on investment income that is deflected into

740. S. REP. NO. 93-1357, at 3 (1974), *reprinted in* 1975-1 C.B. 517, 534.

741. H. REP. NO. 106-712, at 13 (2000). H.R. 4762 was folded into Pub. Law 106-230, discussed *supra,* text accompanying notes 545-63.

campaign advocacy.[742] The 2000 addition of section 527(i) and section 527(j) require disclosure of campaign contributions and expenditures of a section 527 organization that are outside of FECA mandated disclosure rules.[743] One may legitimately conclude that there are sufficient constraints on the section 527 tax benefit. As reflected in the Internal Revenue Service's ruling stance, however, there remains a disconnect between campaign advocacy subject to the FECA regulatory scheme and the advocacy qualified for tax exemption under section 527.[744] There is an area of campaign issue advocacy that is outside of the FECA regulatory scheme that nonetheless qualifies for tax exemption as exempt function income and expenditure under section 527. Thus, Congress's tax subsidy may extend to activities that are structured to avoid Congress's regulatory policy. The distinctions continue to encourage political entrepreneurs to disguise campaign advocacy as issue advocacy.

The FECA and the tax benefits of section 527 could be harmonized by including in the taxable income of a political organization its exempt function income[745] to the extent that expenditures for candidates for federal office[746] are not treated as "expenditures" under the FECA regulatory scheme.[747] Thus, political organizations would become taxable with regard to money devoted to campaign advocacy that is designed to avoid the FECA regulatory scheme for federal elections. For this purpose campaign advocacy within the concept of exempt function under section 527 should include attempts to influence voters, as contemplated by the current definition in section 527(e)(2), as well as both unmistakable advocacy for or against identified candidates under the *Furgatch* definition,[748] and election-eve communications that feature a candidate's name or likeness as proposed by the McCain-Feingold approach.[749] As a consequence,

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742. I.R.C. § 162(e) (2001). For a discussion of this section, see *supra* text accompanying notes 241-53. See *also id.* § 527(b), (f). For a discussion of this section, see supra note 497. In addition, theoretically no deductible contributions to tax-exempt charities under section 501(c)(3) may be directed to campaign advocacy, or at least campaign advocacy that is not effectively disguised as education.

743. I.R.C. § 527(i), (j) (2001).

744. *See* Priv. Ltr. Rul. 96-52-026, 98-08-037, and 1999-25-051; *see also supra* text accompanying notes 499-545.

745. I.R.C. § 527(c)(3) (2001). "Exempt function income" of a political organization is defined in § 527(c)(3) to include contributions, membership dues, and the proceeds from political fund-raising and entertainment events. *Id.*

746. 2 U.S.C. § 341(3) (2001). Candidates for federal office include those running for President, Vice President, Senator, Member of the House of Representatives, or Delegate or Resident Commissioner to the Congress. *Id.*

747. *See id.* § 431(9)(A).

748. Federal Election Comm'n v. Furgatch, 807 F.2d 857, 864 (9th Cir. 1987); *see also supra* text accompanying note 96.

749. S. 27, 107th Cong. § 201 (adding 2 U.S.C. § 434(f)(3)) (as passed by the Senate Apr. 2,

campaign advocacy will receive tax exemption only if channeled through a section 527 political organization or segregated fund and, in the case of federal elections, only if within the scope of advocacy subject to the FECA.[750]

Federal tax benefits for campaign advocacy that violates state campaign finance and disclosure laws also is an inappropriate subsidy that Congress may attempt to limit. The problem is complicated because state laws are variable in their approach to campaign finance regulation.[751] Strengthening the definition of political advocacy by tax-exempt organizations and directing that activity through section 527 organizations will assist states that adopt disclosure laws as part of campaign finance regulation because of the registration and disclosure requirements of section 527(i) and section 527(j). Congress could go further by adopting an approach similar to the option suggested in the preceding paragraph with a provision analogous to the disallowance of illegal payments found in section 162(c).[752] Taxable income of a political organization would thereby include contributions that are expended in state or local election contests if the expenditure is not reported or is in excess of contribution or expenditure limits under validly enforced state and local campaign finance regulatory scheme.

D. *Constitutional Restrictions*

The tax regime proposed in the preceding section involves differential taxation of organizations that expend resources in campaign advocacy. *Buckley* is clear regarding governmental restraint on the flow of campaign money as a restriction on speech subject to strict scrutiny under the First Amendment.[753] The Court is equally clear, however, that Congress has much broader discretion in enacting subsidies through the tax statute.[754] The opinion in *Regan*, while pointing out that statutory classifications that interfere with the exercise of fundamental rights are subject to strict scrutiny, expressly states that legislatures have broad latitude in creating

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2001).

750. Note that this suggestion does not limit exemptions to advocacy that is subject to disclosure or limitation under the FECA. Reference to FECA defined campaign expenditure includes advocacy that, while representing an expenditure as defined by the FECA, is advocacy that cannot be limited by Congress under *Buckley v. Valeo*, 424 U.S. 1 (1975), and other authorities.

751. For an analysis of state campaign finance reform efforts and their effect, see MALBIN & GAIS, *supra* note 1.

752. I.R.C. § 162(c) (2001). Section 162 disallows deductions as ordinary and necessary business expenses payments to foreign government officials if the payment is an illegal bribe or kickback, or is illegal under the Foreign Corrupt Practices Act of 1977, and illegal payments under laws of the United States, or the law of any state provided that the law is generally enforced. *Id.*

753. *Buckley*, 424 U.S. at 39-59.

754. Regan v. Taxation with Representation, 461 U.S. 540, 550 (1983).

classifications and distinctions in tax statutes.[755] Thus, the Court allowed Congress to withhold tax subsidies from charitable organizations that engage in lobbying and political campaign advocacy—protected forms of speech. The Court also has held that tax benefits cannot be denied as a penalty for certain forms of speech.[756] Can Congress restrict the benefit of tax exemption to organizations that do not engage in campaign advocacy under these authorities?

Speiser v. Randall[757] held that the State of California could not constitutionally condition the grant of property tax exemptions to veterans on signing a loyalty oath stating that the individual did not advocate the overthrow of the United States or California governments by force or other unlawful means, nor advocate support of a foreign government in the case of hostilities against the United States.[758] The Court stated that, "[t]o deny an exemption to claimants who engage in certain forms of speech is in effect to penalize them for such speech. Its deterrent effect is the same as if the State were to fine them for this speech."[759] The Court assumed, without actually deciding, that the state could deny tax exemptions to persons who engage in proscribed speech for which they may be criminally punished,[760] and concluded that the California tax exemption scheme did not afford due process in advance of denying the exemption to hold an individual punishable for criminal conduct through a restriction on speech.[761] In distinguishing prior opinions upholding loyalty oaths in certain employment situations, the Court indicated that the "congressional purpose was to achieve an objective other than restraint on speech."[762] The concurring opinions in *Speiser* clarify the First Amendment infringement by pointing out that "California, in effect, has imposed a tax on belief and expression."[763] The Court in *Regan* recognized this distinction and refused to apply *Speiser* to void the section 501(c)(3) restraint on political advocacy of charitable organizations noting that the organization is not denied its right to lobby, nor its ability to receive non-deductible contributions for its non-lobbying activity, stating "Congress has merely

755. *Id.* at 547.

756. Speiser v. Randall, 357 U.S. 513 (1958).

757. 357 U.S. 513 (1958).

758. *Id.* at 514, 528.

759. *Id.* at 518.

760. *Id.* at 519-20.

761. *Id.* at 528-29.

762. *Id.* at 527. Distinguishing Am. Communications Ass'n. v. Douds, 339 U.S. 382 (1950), the Court indicated that the referenced objective was to "minimize the danger of political strikes disruptive of interstate commerce by discouraging labor unions from electing Communist Party members to union office." *Id.*

763. *Id.* at 529 (Black, J., concurring).

refused to pay for lobbying out of public moneys."[764] Under *Regan*, Congress is not barred from choosing the kind of activity for which it is willing to grant subsidies through tax benefits.[765]

Regan might be described as recognizing that the section 501(c)(3) restrictions on political advocacy by a tax benefited organization is in fact a restriction on a particular form of activity, albeit one that involves speech, but not a restraint on the content of expression or the subject matter of expression.[766] Indeed, the Court permits differential taxation among speakers where it finds that denying deductibility of contributions to exempt section 501(c)(3) organizations that engage in lobbying, while allowing deductible contributions to veterans organizations exempt under section 501(c)(19) that are permitted to lobby, was not a violation of equal protection under the due process clause of the Fifth Amendment.[767] The Court in *Leathers v. Medlock* described *Regan* as standing "for the proposition that a tax scheme that discriminates among speakers does not implicate the First Amendment unless it discriminates on the basis of ideas."[768]

Restricting the availability of tax exemption to organizations that do not engage in political advocacy does not restrain the content of advocacy nor the vigor of the expression. To paraphrase the language of the Court in *Cammarano*, political organizations are not being denied a tax benefit "because they engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own

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764. Regan v. Taxation with Representation, 461 U.S. 540, 545 (1983).

765. *Id.* at 550-51.

766. *See also* Rust v. Sullivan, 500 U.S. 173 (1991). In *Rust*, the Court upheld prohibitions on abortion counseling and referral services by family planning clinics that received federal funds. The prohibitions included lobbying for legislation that would permit an increase in the availability of abortion. The Court stated:

> The Government can, without violating the Constitution, selectively fund a program to encourage certain activities it believes to be in the public interest, without at the same time funding an alternative program which seeks to deal with the problem in another way. In so doing, the Government has not discriminated on the basis of viewpoint; it has merely chosen to fund one activity to the exclusion of the other.

Id. at 193.

767. *Regan*, 461 U.S. at 547.

768. Leathers v. Medlock, 499 U.S. 439, 450 (1991). *Leathers* upholds a state receipts tax on cable and wireless television distributors. *Id.* at 453. The Court states that "differential taxation of First Amendment speakers is constitutionally suspect when it threatens to suppress the expression of particular ideas or viewpoints." *Id.* at 447. *But cf.* Minneapolis Star v. Minn. Comm'r of Revenue, 460 U.S. 575 (1983) (holding that a state use tax which only applied to a few newspapers violated First Amendment protections).

pockets as everyone else engaging in similar activities is required to do under the provisions of the Internal Revenue Code."[769] An income or excise tax on campaign expenditures by organizations that receive the benefit of tax exemption merely insures that exempt organizations do not obtain an advantage in the political process over speakers whose advocacy cannot be funneled through tax exempt organizations. In addition, as the Court emphasized in *Regan*, directing campaign advocacy to a section 527 organization and away from other tax-exempt forms of organization does not impermissibly bar electoral advocates from expressing their views through other outlets.[770] Limiting the subsidy to organizations that engage in campaign advocacy does not prevent their creation of taxable entities to engage in campaign speech.[771] Campaign advocacy is not restrained by removing the tax benefit from organizations that advocate the election or defeat of candidates but the government is removed from the process of funding the activity.

V. CONCLUSION

Money talks. Election to political office requires lots of talk and therefore lots of money. Because the United States Supreme Court has so closely associated campaign expenditure with speech that is protected by the First Amendment, governmental regulation of campaign finance will only have a marginal impact on the flow of money through the electoral process.[772] In addition, campaign professionals and political entrepreneurs will continue to find new devices to navigate around whatever blockades legislatures erect to restrict the flow of campaign money. Mandated disclosure of the identity of major funders of candidates may be the limit on effective governmental restraint on campaign expenditures.

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769. Cammarano v. United States, 358 U.S. 498, 513 (1959).

770. *See Regan*, 461 U.S. at 550-51.

771. Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849, 857 (10th Cir. 1972). In California, professional political organizations play a major role in qualifying state ballot initiatives. *See* Charlene Wear Simmons, *California's Statewide Initiative Process*, Calif. Res. Bur. 97-006, 9 (May 1997); *see also* Elizabeth Garrett, *Money, Agenda Setting, and Direct Democracy*, 77 TEX. L. REV. 1845, 1851 (1999).

772. *See* MALBIN & GAIS, *supra* note 1, at 162, which states:

> No matter how well thought out the strategy, excessively ambitious goals will be defeated by the First Amendment—and by human ingenuity. Organizations affected by new laws will adapt and use constitutionally protected end runs to pursue their own purposes, obeying the letter of the law but not accepting—because they have no reason to accept—the reformers' goals as their own.

Id.

Congress and the Supreme Court have, on the other hand, recognized that there is a valid public policy reason to limit the availability of governmental subsidies to participants in election advocacy and lobbying. The presence of tax benefits in the form of deductible contributions and tax exemption for political organizations reduces the cost of campaign advocacy for partisans who are able to take advantage of the tax savings. Individuals and campaign advocates who operate outside of large associations are disadvantaged in the competition with tax subsidized campaign advocates. In its opinions in *Cammarano* and *Regan,* the Supreme Court has permitted Congress a significant degree of latitude to regulate tax subsidies to campaign activities through tax-exempt organizations.[773] While Congress is limited in its ability to regulate election advocacy, Congress should exercise its control over the largesse of governmental subsidy to limit the subsidy to campaign expenditures that otherwise comply with its existing regulatory structure in the FECA. The existing tax subsidy itself defeats congressional policy as reflected in the FECA.[774] To state the proposition in the converse, the subsidy of tax-exemption should not be available to organizations that are formed or availed of to skirt the campaign expenditure disclosure and limitation provisions of the FECA.

The diverse and unregulated structure of campaign activities through a variety of tax-exempt organizations suggests that tax-subsidized political expenditure be directed through the political organizations and separate segregated funds provided for in section 527 of the Code. This can be accomplished by denying tax exemption to campaign expenditures of all organizations that are exempt from tax under section 501(a) by virtue of their identification in section 501(c). This will require a provision including inclusion in an exempt organization's taxable income an amount equivalent to the organization's expenditures for campaign advocacy. Campaign advocacy for this purpose should be defined to include attempts to influence voters to vote for or against an identified candidate, unmistakable advocacy for a candidate, and any election-eve communication to voters that includes the name or image of a candidate for election. Tax exemption for contributions that are used for campaign advocacy may be exempt from tax only if directed through a section 527 organization or separate segregated fund. In that fashion, tax subsidized campaign advocacy is, at the very least, subject to the disclosure requirements of section 527(j). Section 527(j) is itself consistent with the

773. *Regan,* 461 U.S. at 550-51; *Cammarano,* 358 U.S. at 509-13.

774. *See* Chisolm, *supra* note 603, at 589, which states, "The legislative history of [FECA and the Revenue Act of 1971] and the amendments that followed yields ample evidence that the reform efforts were driven substantially by a desire to diminish the susceptibility of elected officials to undue pressure by economic interest which have the enhanced leverage of aggregated wealth." *Id.*

disclosure goals of the FECA, even though it is a separate regime administered by the Internal Revenue Service. Finally, tax exemption under section 527 should be limited to campaign contributions and expenditures that are treated as contributions and expenditures under the FECA. In this manner the tax subsidy would conform to Congress's enacted policy regarding the regulation of campaign finance.