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By Electronic Mail

Ms. Mai T. Dinh
Assistant General Counsel
Federal Election Commission
999 E Street, N.W.
Washington, D.C. 20463

Re: Comments on Notice 2005-20: Definition of "Electioneering Communication"

Dear Ms. Dinh:

These comments are submitted in response to the Commission's Notice of Proposed Rulemaking ("NPRM") 2005-20, published at 20 Fed. Reg. 49508 (August 24, 2005), seeking comments on proposed changes to its rule defining "electioneering communication" under 11 C.F.R. § 100.29.

For reasons set forth below, I urge the Commission to:

(1) Eliminate the current exemption from the definition of "electioneering communication" at 11 C.F.R. § 100.29(c)(6) for organizations described in section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code" or "IRC");

(2) Reject the proposal to incorporate a promote, attach, support, oppose ("PASO") standard into the current exemption for section 501(c)(3) organizations at 11 C.F.R. § 100.29(c)(6); and

(3) Reject the proposal to retain the exemption for section 501(c)(3) organizations provided that no Federal officeholder or candidate for federal office creates, funds, or maintains such organization.

I request the opportunity to testify at the hearing on this rulemaking, which is scheduled for October 19-20, 2005.

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I. In Creating an Exemption from the Electioneering Communication Provisions for Section 501(c)(3) Organizations the FEC Disregarded Important Characteristics of the Structure and Operation of Such Organizations

The Federal Election Commission ("FEC") crafted an exemption from the electioneering communication provisions of BCRA for any electioneering communication that is paid for by any organization operating under section 501(c)(3) of the Code. 11 C.F.R. 100.29(c)(6). The FEC explained this action by stating that section 501(c)(3) organizations "by their nature" cannot engage in electioneering communications. *Final Rules and Explanations and Justifications for Regulations on Electioneering Communications* ("FEC E&J"). 67 Fed. Reg. 65190 (Oct. 23, 2002).

The FEC did not explain how it came to this conclusion about the "nature" of section 501(c)(3) organizations. It did, however, decide that conclusions about the "nature" of such organizations required no inquiry into the structure or operation of section 501(c)(3) as set forth in the Code, the applicable regulations, and guidance issued by the Internal Revenue Service ("IRS").[1] As a result, the FEC conflated the tax status of an organization with an analysis of the particular activities conducted by such organizations. Had the FEC conducted this analysis, it would have discovered that section 501(c)(3) organizations are not properly understood as undifferentiated entities but rather as aggregates of multiple types of activities. It would also have become clear that characterizing any activity for purposes of determining whether such activity is consistent with the requirements of section 501(c)(3) is far from straightforward and even experts in the field often disagree about the proper characterization of an activity. Such disagreements over characterization of a communication as either an issue ad or as a campaign message have even been common within the IRS, which has reversed itself with respect to particular organizations on more than one occasion.

The FEC also decided that conclusions about the "nature" of section 501(c)(3) organizations required no consideration of, or even reference to, the long history of controversy over the campaign roles of exempt entities, including section 501(c)(3) organizations. The 1987 Hearings relating to the campaign activities of section 501(c)(3) organizations, the Thompson Committee Hearings in 1996, and the Congressional inquiry into then-Speaker Newt Gingrich's relationships with various exempt entities that funded his controversial lectures on Renewing American Civilization all strongly suggest that section 501(c)(3) organizations have long found ample opportunity to engage in activities that seem inconsistent with the prohibition on participation or intervention in political campaigns. While Congress in 1987adopted certain procedural provisions that might be thought to have toughened its enforcement stance, the

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[1]For a detailed analysis of the law applicable to exempt entities, including section 501(c)(3) organizations, see FRANCES R. HILL & DOUGLAS M. MANCINO, TAXATION OF EXEMPT ORGANIZATIONS (New York: Warren, Gorham &Lamont, 2002, with semi-annual cumulative supplements). This work focuses on both the structural features of exempt entities and practical operational considerations in tax planning.

discussion at Part IV below suggests that these provisions have not had a significant effect. Neither Congress nor the IRS has clarified how activities are to be characterized for purposes of determining whether they constitute participation or intervention in a political campaign. For this reason, the kinds of activities at issue in 1987 or 1996 or 2000 remain at issue today.

The 1987 Hearings on the political activities of exempt organizations were held in response to ostensible issue ads run by certain exempt entities that supported the so-called Contras in Nicaragua. *Subcommittee on Oversight, House Ways and Means Committee, Hearings on Lobbying and Political Activities of Tax-Exempt Organizations* (1987). These exempt organizations paid for a series of televised ads attacking certain named members of Congress for their positions on U.S. aid to the Contras and for their positions on the Reagan administration's sale of sophisticated weaponry to the fundamentalist regime in Iran as a means of funding the Contras in the absence of Congressional appropriations for direct aid. One target of these advertisements was Representative J.J. Pickle (D-Tex.), who then chaired the Subcommittee on Oversight of the House of Representatives Committee on Ways and Means. The Subcommittee on Oversight has jurisdiction over exempt organization issues. The Hearings provided evidence that the pro-Contra organizations were not alone in engaging in activities that were inconsistent with the prohibition on participating or intervening in political campaigns. In its Report to the full Ways and Means Committee, the Oversight Subcommittee expressed concern that "[t]he increasing use of tax-exempt organizations to benefit a political candidate for public office runs counter to Federal tax concerns and allows for the circumvention of the contribution and spending restrictions contained in the Federal Election Campaign Act." *Subcommittee on Oversight of the Committee on Ways and Means, Report and Recommendations on Lobbying and Political Activities by Tax-Exempt Organizations* 45 (1987). The Subcommittee concluded that "[t]he alarming use of tax-exempt organizations to further the political ambitions of a particular candidate demonstrates the need for clarification of current law and additional restrictions on this type of activity." *Id.* The full Committee on Ways and Means called for more effective enforcement of the tax laws by the IRS and greater coordination between the IRS and the FEC "for purposes of assuring that the assets of tax-exempt charities are not being diverted to prohibited purposes." *Ways and Means Committee, Report on HR 3545, Revenue Bill of 1987* at 1625 (1987).

The controversy over the relationship between then-Speaker of the House of Representatives Newt Gingrich and several section 501(c)(3) organizations provides compelling evidence that the characterization issue highlighted by the 1987 Hearings remained unresolved in the 1990s. Congress regarded the matter as so serious that the Ethics Committee hired an outside counsel and a tax expert to investigate the matter. Congressman Gingrich's legal team also hired tax lawyers. It is scarcely surprising that the experts disagreed. The Ethics Committee did not resolve the issue of whether the lectures constituted participation or intervention in a political campaign within the meaning of section 501(c)(3). *Report of the Select Committee on Ethics, In the Matter of Representative Newt Gingrich*, 105th Cong., 1st Sess. (1997)("House Ethics Committee Report"). The House Ethics Committee Report contained documents in Congressman Gingrich's handwriting stating that his course was intended to recruit party

workers and candidates for his political party. The IRS had previously ruled in another case that recruiting precinct workers constituted impermissible participation or intervention in a political campaign. Rev. Rul. 67-71, 1967-1 C.B. 125. The House Ethics Committee referred the Gingrich matter to the IRS and levied monetary sanctions on Congressman Gingrich.

The IRS ruled on whether two section 501(c)(3) organizations which funded the Gingrich lectures participated or intervened in a political campaign. The IRS's determinations in these two cases have served primarily to increase confusion in this area, especially in light of its prolonged failure to issue precedential guidance in this area. After almost two years, The IRS revoked the exempt status of the Abraham Lincoln Opportunity Fund ("ALOF"). *Letter from the IRS to ALOF* on December 7, 1998 (1999 TNT 51-27). Five years later, the IRS restored the exempt status of ALOF as a section 501(c)(3) retroactive to its founding. *ALOF Determination Letter* (2003 TNT 72-13). What one might conclude from this remains unclear.

On December 1, 1998, the IRS determined that another organization, the Progress and Freedom Foundation ("PFF") actively involved in funding the Gingrich lectures had not participated or intervened in a political campaign.[2] This decision was the product of what appears to have been a significant disagreement between the District Office to which the matter had been referred and the National Office of the IRS, which took control from the District Office when it appeared that the District Office intended to rule that the PFF, too, had participated or intervened in a political campaign. *Memorandum from the Chief Counsel's Office* on May 3, 1997 (2000 TNT 51-16) and *Memorandum from the Chief Counsel's Office* on December 30, 1997, disagreeing with the District Office's proposed adverse determination (2000 TNT 51-17). Several of the positions in the PFF Ruling are inconsistent with what had been thought to have been the IRS position. Most notably, the IRS appeared to base much of the PFF defense on the educational nature of the lectures despite the evidence in the House Ethics Committee Report of the election campaign purposes being served. This means that in cases where a communication could be characterized as both public education and participation or intervention in a political campaign, it will not necessarily be characterized as participation or intervention in a political campaign.

The Thompson Committee Hearings held in 1998 addressed numerous campaign finance issues arising with respect to the 1996 general election campaign. *Committee on Governmental Affairs, Final Report: Investigation of Illegal or Improper Activities in Connection with 1996 Federal Election Campaign*, S. Rep. No. 105-167 (March 1998)(6 volumes). Among the improper or illegal activities investigated were activities of certain exempt entities.

The FEC decided that there was no need to consider the particular attractiveness of section 501(c)(3) organizations to candidates and their contributors. Section 501(c)(3) organizations can

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[2]This Technical Advice Memorandum has no number because it was never issued in redacted form by the IRS. It is referred to here as the "PFF Ruling." The Progress and Freedom Foundation made the ruling public on its website in February 1999 (1999 TNT 24-25).

offer contributors not only the protection from disclosure of contributions or expenditures available through other exempt entities but also a section 170 charitable contribution deduction for all contributions no matter how the organization ultimately uses the money contributed.

The FEC decided that there was no need to consider the ambiguity inherent in the idea that an electioneering communication is "paid for by" a section 501(c)(3) organization. Section 501(c)(3) organizations can lawfully accept contributions from a broad range of persons who cannot lawfully contribute to political committees or make expenditures in connection with an election campaign. Foreign individuals, foreign entities, domestic business corporations, domestic trade unions, and other exempt entities, whether foreign or domestic, may lawfully contribute to the section 501(c)(3) organizations and may claim a deduction reducing any income that may be taxable in the United States. Once a section 501(c)(3) organization has received a contribution, it may use the funds as it sees fit, including for activities that are ultimately characterized as participation or intervention in an election campaign. Only in rare cases will contributors lose their charitable contribution deduction even in this event. The exemption of section 501(c)(3) organizations from the electioneering communication provisions provides no guidance on tracing the contributions to a section 501(c)(3) organization that pays for an electioneering communication. In the absence of such guidance, any person who may lawfully contribute to a section 501(c)(3) organization may also fund electioneering communications.

The FEC decided there was no need to discuss IRS enforcement procedures and practices to determine whether even those section 501(c)(3) organizations that have clearly violated the prohibition on participating or intervening in election campaigns must necessarily lose their exempt status as organizations described in section 501(c)(3).

The FEC failed to consider the implications of this exemption for orderly administration of the tax law and the importance of this issue in light of the efforts in Congress and among exempt organizations themselves to ensure that exempt entities operate for exempt purposes. Instead of addressing these issues, the FEC simply asserted that it could interpret the "nature" of section 501(c)(3) organizations in ways that support this exemption.

II. The Exemption from the Electioneering Communications Provisions which the FEC Crafted for Section 501(c)(3) Organizations Is Inconsistent with the Language and Purposes of BCRA

Title II of the Bipartisan Campaign Reform Act of 2002 ("BCRA") amended the Federal Election Campaign Act ("FECA") by adding new provisions relating to "electioneering communication." An "electioneering communication" is defined as any broadcast, cable, or satellite communication that: (i) refers to a clearly identified federal candidate; (ii) is made within 60 days before a general, special or runoff election and 30 days before a primary or preference election or a convention or caucus of a political party that has authority to nominate a

candidate; and (iii) is targeted to the relevant electorate, which is defined as the population of the state of a candidate for the United States Senate or at least 50,000 persons in the district of a candidate for the United States House of Representatives. 2 U.S.C. § 434(f)(3). In the case of elections for President or Vice President, no targeting requirement applies. 2 U.S.C. § 434(f)(C).

The concept of "express advocacy" plays no role in defining an electioneering communication. Senator Olympia Snowe (R-Maine), one of the chief sponsors of the electioneering communication provision, made it clear that the provision was directed at purported issue ads that are intended to affect the outcome of candidate elections. She stated during the floor debate on this provision:

> I have spoken of the exploding phenomenon of the so-called issue advertising in elections...These are broadcast ads on television and on radio that masquerade as informational or educational but are really stealth advocacy ads for or against candidates.

147 Cong. Rec. S2455-56 (daily ed. March 19, 2001).

The absence of an express advocacy limitation in the definition of electioneering communication was the basis of a challenge to the electioneering communication provision in *McConnell v. FEC*, 540 U.S. 93 (2003). The Court in *McConnell* rejected this challenge, holding that the definition of an electioneering communication "raises none of the vagueness concerns that drove our analysis in *Buckley*." *Id.* at 194. The Court reasoned:

> Nor are we persuaded, independent of our precedents, that the First Amendment erects a rigid barrier between express advocacy and so-called issue advocacy. That notion cannot be squared without longstanding recognition that the presence or absence of magic words cannot meaningfully distinguish electioneering speech from a true issue ad...Indeed, the unmistakable lesson from the record in this litigation, as all three judges on the District Court agreed, is that *Buckley's* magic-words requirement is functionally meaningless. Not only can advertisers easily evade the line by eschewing the use of magic words, but they would seldom choose to use such words even if permitted. And although the resulting advertisements do not urge the viewer to vote for or against a candidate in so many words, they are no less clearly intended to influence the election. *Buckley's* express advocacy line, in short, has not aided the legislative effort to combat real or apparent corruption, and Congress enacted BCRA to correct flaws it found in the existing system. *Id.*

The Court cited examples of advertisements that did not use the magic words "but are no less clearly intended to influence the election." *Id.* The Court cited as an example of the kind of ad it had in mind the now famous Bill Yellowtail ad, which accused Bill Yellowtail of hitting his wife and neglecting his children. The ad urged viewers: "Call Bill Yellowtail. Tell him to support family values." The Court observed: "The notion that his advertisement was designed purely to discuss the issue of family values strains credulity." *Id.* Based on this and other examples in the

record, the Court concluded that "*Buckley's* express advocacy line, in short, has not aided the legislative effort to combat real or apparent corruption, and Congress enacted BCRA to correct the flaws it found the existing system." *Id.*

BCRA sets forth four exceptions to the definition of an electioneering communication. 2 U.S.C. § 434(f)(B). At issue here is the fourth exception, which applies to "[a]ny other communication...under such regulations as the Commission may promulgate (consistent with the requirements of this paragraph) to ensure the appropriate implementation of this paragraph, except that under any such regulation a communication may not be exempted if it meets the requirements of this paragraph and is described in 2 U.S.C. § 431(20)(A)(iii)." 2 U.S.C. § 434(f)(3)(B)(iv). Section 431(20)(A)(iii) refers to a "public communication" that constitutes "federal election activity," which is defined in section 431(20)(B) as 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)." Congress unambiguously precludes the use of discretionary regulatory authority to permit the continuation of the sham issue ads that it addressed in Title II of BCRA.

The Congressional sponsors of BCRA addressed both the limited nature of the section 434(f)(3)(B)(iv) provision and the anticipated abuse of section 501(c)(3) organizations pursuant to this authority. Congressman Christopher Shays (R-Conn.) stated that the regulatory authority was limited to communications that "are plainly and unquestionably not related to the election" or even that are "wholly unrelated to an election." 148 Cong. Rec. H410-11 (daily ed. February 13, 2002). He stated explicitly that "[w]e do not intend that Section 201(3)(B)(iv) be used by the FEC to create any per se exemption from the definition of 'electioneering communications' for speech by Section 501(c)(3) charities." *Id.* Congressman Martin Meehan (D-Mass.), Senator John McCain (R-AZ), and Senator Russell Feingold (D-WI), the other primary sponsors of BCRA, all made statements explicitly agreeing that the FEC should not use section 434(f)(3)(B)(iv) to craft an exception for section 501(c)(3) organizations.

This exception finds no basis in the language of BCRA. Indeed, the language of the delegation of regulatory authority requires that the regulation be "consistent" with requirements of the electioneering communication provision and that it "ensure the appropriate implementation" of the electioneering communication provision. The FEC's exemption for section 501(c)(3) organizations does not satisfy these criteria. To the contrary, the exemption from the electioneering communication provisions crafted by the FEC undermines much of the statutory scheme of BCRA and creates a pathway for the very abuse of exempt entities that the Supreme Court addressed extensively in *McConnell*. In so doing, the FEC invited candidates to offer their supporters a tax deduction for undermining the integrity of federal elections. In the process, the FEC created an entirely avoidable instance of statutory intersection.

III. Tax Law Requirements for Exemption as an Organization Described in Section

501(c)(3) Permit Such Organizations to Engage in Electioneering Communications

Section 501(c)(3) provides that an organization is exempt under section 501(a) as an organization described in section 501(c)(3) only if 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." The applicable regulations do not address the multiple questions that arise under this provision, and the IRS has issued very little guidance addressing the many issues that arise with respect to this requirement.

As become clear when reading the following discussion of guidance that IRS has issued, tax lawyers are in the position of relying to a remarkable extent on the Continuing Professional Education publications ("CPE Text") the IRS first issued in 1993 and re-issued in 2003. These CPE Texts are available on the IRS website (www.irs.gov). The CPE Text is prepared for the purpose of training field agents. It is not precedential guidance. Tax lawyers also rely on private letter rulings, which bind the IRS only with respect to the organization to which the private letter ruling was issued and then only if the facts were fully set forth in the ruling request. The FEC asks in the NPRM to what weight it should give private letter rulings. The answer is that tax lawyers read these private letter rulings very carefully for guidance on what the IRS might be thinking in a particular case involving particular facts and circumstance. The persistent absence of precedential guidance means that private rulings command more attention than they otherwise would. At the same time, no lawyer would rely upon such rulings as substantial authority for purposes of issuing an opinion to a client. Even revenue rulings that bind the IRS and can be relied upon by any organization can be revoked by the IRS.

A. Section 501(c)(3) Organizations Engage in Three Types of Advocacy Activities That Are Not Readily or Reliably Distinguished by the IRS

Understanding how this requirement applies and why it permits section 501(c)(3) organizations to engage in certain activities that would be treated as an electioneering communication under FECA without losing their section 501(c)(3) status requires consideration of the broader structure of exemption. Section 501(c)(3) organizations may engage in both exempt and non-exempt but permissible activities. The activities that are relevant to the exemption for electioneering communication are:

(1) Public education, an exempt activity not subject to any limitation with respect to amount or timing or targeting

(2) Legislative lobbying, a permissible but not an exempt activity subject to limitations

(3) Participation or intervention in political campaigns, a prohibited activity that is neither exempt nor permissible.

These three activities are not readily or even reliably characterized for purposes of section 501(c)(3). Each of these activities might be characterized in more than one way, and the IRS has issued virtually no guidance for addressing these issues. The IRS has issued no guidance whatsoever on whether an electioneering communication would be treated as participation or intervention in a political campaign or under what circumstances an electioneering communication would or would not be so treated. Participation or intervention in a political campaign can be recharacterized as either the exempt activity of educating the public or the permissible but non-exempt activity of legislative lobbying. Many activities can be characterized in more than one way.

The three types of activities that a section 501(c)(3) organization might conduct overlap in the following four patterns:

(1) Public education overlaps participation or intervention in a political campaign

(2) Public education overlaps legislative lobbying

(3) Legislative lobbying overlaps participation or intervention in a political campaign

(4) Public education, legislative lobbying, and participation in a political campaign overlap.

When an activity could reasonably be treated as falling into one of these patterns of overlapping characterizations, it is not certain that the most restrictive characterization will be the prevailing characterization. The IRS has not provided any guidance on what characterization is the default position in the case of these overlapping characterizations.

Public Education or Participation or Intervention in a Political Campaign?

The fundamental question of the relationship between permissible educational activities and prohibited political activities is at the center of current controversy over the political prohibition. Until it issued the PFF Ruling, the Service had consistently taken the position that activities that can be treated as education within the meaning of Section 501(c)(3) may nevertheless violate the political prohibition. The Service stated in nonprecedential guidance in 2003:

> The most common question that arises in determining whether an IRC 501(c)(3) organization has violated the political campaign prohibition is whether the activities constitute political intervention or whether they are educational, one of the purposes for which an IRC 501(c)(3) organization may be formed. A misperception has developed that educational and political activities are somehow mutually exclusive. Sometimes, however, the answer is that the activity is both—it is educational, but it also constitutes intervention in a political campaign. 2003 CPE Text at 349.

The Service took the position that "[a]ctivities that meet the methodology test of Rev. Proc. 86-43, 1986-2 C.B. 729, may nevertheless constitute participation or intervention in a political campaign." 2003 CPE Text at 350. As an example of an activity that would satisfy the methodology test, the Service cited the rating of judicial candidates prepared by the Association of the Bar of the City of New York. *Id.*, citing *Association of the Bar of the City of New York v. Commissioner*, 858 F. 2d 876 (2d. Cir. 1988), rev'g. 89 T.C. 599 (1987), cert. denied, 490 U.S. 1030 (1989). The Service also cited the organization in Revenue Ruling 67-71 that endorsed a slate of candidates in a school board election. *Id.* citing Rev. Rul. 67-71, 1967-1 C.B. 125. Even if an activity is educational, it may also violate the political prohibition. In Tech. Adv. Mem. 19907021 (May 20, 1998) the Service stated that "[e]ven if the organization's advocacy is educational, the organization must still meet all other requirements for exemption under section 501(c)(3), including the restrictions on influencing legislation and political campaigning." This position is consistent with the position in a 1989 ruling that "[e]ducating the public is not inherently inconsistent with the activity of impermissibly intervening in a political campaign." Tech. Adv. Mem. 8936002 (May 24, 1998). The IRS takes the general position that:

> In situations where there is no explicit endorsement or partisan activity, there is no bright-line test for determining whether the IRC 501(c)(3) organization participated or intervened in a political campaign. Instead, all the facts and circumstances must be considered. 2003 CPE Text at 344 and 1993 CPE Text at 410.

Some exempt organizations time their issuance of advocacy-related materials to coincide with elections, arguing that heightened public attention to policy matters during the campaigns makes their advocacy efforts more effective. Issue advocacy during an election campaign is not prohibited or limited. The Service has taken this position with respect to issue advocacy during a political campaign:

> No situation better illustrates the principle that all the facts and circumstances must be considered than the problem of when issue advocacy becomes participation or intervention in a political campaign. On the one hand, the Service is not going to tell IRC 501(c)(3) organizations that they cannot talk about issues of morality or social or economic problems at particular times of the year, simply because there is a campaign occurring. One the other hand, the Service is aware that an IRC 501(c)(3) organization may avail itself of the opportunity to intervene in a political campaign in a rather surreptitious manner. 1993 CPE Text at 411; 2003 CPE Text at 344-45.

This issue arose with respect to an advertising campaign timed to coincide with televised debates during a presidential campaign. Describing the case as "a very close call," the Service concluded:

> While the ads could be viewed as focusing attention on issues of war and peace during the 1984 election campaign, individuals listening to the ads would generally understand them to support or oppose a candidate in an election campaign. The timing of the release of the ads so close to the November votes, even though the reference was changed to

> "join the debate," is also troublesome. Taking into account all the facts and circumstances, especially that it is arguable that the ads could be viewed as nonpartisan, we reluctantly conclude A, through its C project, probably did not intervene in a political campaign on behalf of or in opposition to a candidate for public office. Tech. Adv. Mem. 8936002 (May 24, 1989).

The distinction between public education and participation or intervention in a political campaign was blurred markedly by the controversy over lectures given by then-Speaker of the House of Representatives Newt Gingrich, which was discussed above. The IRS referred repeatedly in the PFF Ruling to the fact that Congressman Gingrich held an "earned Ph.D." and once taught college-level history courses. Throughout the PFF Ruling the IRS used the asserted educational nature of the content of the lectures as a defense against treating these lectures as participation or intervention in a political campaign.

Public Education or Legislative Lobbying?

The second overlap, that between legislative lobbying and public education, has been addressed in the regulations under section 501(h) and section 4911(f). Grassroots lobbying is distinguished from public education by the presence of a call to action with respect to a specific piece of legislation.. A call to action takes the form of an exhortation to contact a member of a legislative body. Because ballot measure drives are treated as legislative lobbying for purpose of section 501(c)(3), as well as for other section 501(c) organizations, calls to support particular positions or to vote on ballot measures in a particular way are calls to action that distinguish the education content of the message from the purpose of which the message is being conveyed.

Legislative Lobbing or Participation or Intervention in an Election Campaign?

The third overlap, that between political campaign activity and legislative lobbying has not been addressed in guidance of any kind directly applicable to section 501(c)(3) organizations. The planning strategy is to characterize as much activity as possible as legislative lobbying because this is a permissible but limited activity, not a prohibited activity. This is generally a fallback position when it is not possible to characterize a communication as exempt public education rather than as prohibited participation or intervention in a political campaign. Broad latitude for section 501(c)(3) organizations to characterize activities as permissible legislative lobbying rather than as prohibited participation or intervention in cases that might well support either characterization would permit such organizations greater scope for offering candidates a tax deductible campaign finance structure. This effort would appear to be inconsistent with the structure of exemption as an organization described in section 501(c)(3). It would seem that preventing prohibited activity would take precedence, but the Service has issued no guidance on this issue.

Rev. Rul. 2004-6, 2004-4 IRB 328, which applies to section 501(c)(4), section 501(c)(5), and section 501(c)(6) organizations appears to support an interpretation of this overlap that treats

activities falling within it as lobbying. The ruling does not recognize the overlap issue directly or consider the consequences of its position for the structure of exemption. Because this ruling does not apply to section 501(c)(3) organizations, an absolute prohibition on political campaign activities is not the issue. Instead, the ruling addresses characterization of communications as legislative lobbying. For this purposes the same standards that apply in the case of section 501(c)(3) organizations apply in the case of section 501(c)(4) organizations. Nevertheless, two well-respected tax lawyers wrote to the IRS to express their concern that this revenue ruling would make section 501(c)(3) organizations more attractive vehicles for participation or intervention in political campaigns in light of the exemption from the electioneering communication provisions the FEC crafted for section 501(c)(3) organizations. *Letter to the IRS from Gregory Colvin and Rosemary Fei* (2004 TNT 1-25).

Public Education or Legislative Lobbying or Participation or Intervention in an Election Campaign?

The fourth overlap, the overlap among political campaign activity, education, and legislative lobbying offers even more fertile ground for planning. It, too, has never been addressed by the Service. The planning goal is to treat activities falling into this overlap as education, which avoids the political campaign activity prohibition and preserves the legislative lobbying permissible amount for other activities. Characterization as legislative lobbying is the fallback planning option. No guidance is available on this issue.

B. In Some Cases the IRS Has Relied on Private Benefit Doctrines Which Do Not Involve Absolute Prohibitions in Dealing with Campaign Activities

An alternative to the instability of the characterization of activities has been to treat certain campaign activities as providing a private benefit to candidates or political parties. This approach avoids the increasingly creative characterization strategies and looks instead at whether there has been an impermissible private benefit. The result for the section 501(c)(3) organization can be revocation of exempt status. This was the approach successfully argued by the IRS before the Tax Court in *American Campaign Academy*, 92 T.C. 1053 (1989).

Under a private benefit approach, however, there is no absolute prohibition. A large section 501(c)(3) organization could engage in a considerable amount of otherwise prohibited campaign activity without jeopardizing its exempt status. Private benefit jeopardizes the exempt status of a section 501(c)(3) organization only once it exceeds an undefined percentage of receipts or staff time. This percentage is thought to be at least 20 percent, which then becomes a safeharbor for election activity.

IV. Enforcement Procedures with Respect to Participation or Intervention in Election Campaigns Provide for Alternatives to Revocation

Even if the IRS has issued timely and useful precedential guidance, both the structural differences in enforcement and the limited scope of IRS enforcement in practice mean that what is nominally an absolute prohibition is not absolute even as a matter of law and is far from absolute in practice. Even in those rare instances where exemption has been revoked, the revocation takes effect long after the election.

A. Tax Law Does Not Require Revocation of Exemption Even If a Section 501(c)(3) Organization Has Participated or Intervened in a Political Campaign

Section 4955 imposes an excise tax on both a Section 501(c)(3) organization and its managers if the organization makes a political expenditure prohibited under Section 501(c)(3). For purposes of the Section 4955 excise tax, a political expenditure is "any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." IRC § 4955(d)(1). Regulations issued under Section 4955 expressly provide that this section does not change the standards for exemption under Section 501(c)(3). Treas. Reg. § 53.4955-1(a).

If an organization makes a political expenditure, it is liable for an excise tax equal to 10 percent of the amount of that expenditure. IRC § 4955(a)(1). In addition, an excise tax of 2.5 percent is imposed on "the agreement of any organization manager to the making of any expenditure, knowing it is a political expenditure ... unless such agreement is not willful and is due to reasonable cause." IRC § 4955(a)(2) Section 4955 imposes additional excise taxes equal to 100 percent of the political expenditure on the organization in any case in which the expenditure is not corrected within the taxable period. IRC § 4955(b)(1). Correction of a political expenditure means "recovering part or all of the expenditure to the extent recovery is possible, establishment of safeguards to prevent future political expenditures, and where full recovery is not possible, such additional corrective action as is prescribed by the Secretary by regulation." IRC § 4955(f)(3). The regulations give the IRS broad flexibility and discretion in prescribing corrective action. Treas. Reg. § 53.4955-1(e).

In the case of both the first-level tax imposed on managers under Section 4955(a)(2) and the second-level tax imposed on managers under Section 4955(b)(2), more than one such manager may be subject to tax. Total liability is capped at $5,000 for any one political expenditure in the case of the first-level tax and at $10,000 for any one political expenditure with respect to the second-level tax. IRC § 4955(c)(2). If more than one manager is liable for either the first- or second-tier tax, or both, with respect to any one political expenditure, such managers are jointly and severally liable for the tax. IRC § 4955(c)(1).

The application of Section 4955 is rendered ambiguous by uncertainty over whether Section 4955 is an intermediate sanction or an additional penalty in the event an organization's exempt status is revoked. Application as an intermediate sanction would be inconsistent with

the absolute prohibition. The Service has expressed the view that "[f]undamentally, it appears that Congress viewed the IRC 4955 taxes, not so much as an intermediate sanction to replace revocation, but, primarily, as an additional tax, and secondarily, as a sanction to be considered instead of revocation in certain limited circumstances." 2003 CPE Text at 353. The Service took the position that use of Section 4955 as an intermediate sanction would be appropriate "where the violation was unintentional, involved only a small amount, and the organization had subsequently corrected the violation and adopted procedures to assure that similar expenditures would not be made in the future." *Id.* at 354. In its 1993 CPE Text the IRS placed limits on the use of section 4955 as an intermediate sanction, stating that "the tax/correction structure of IRC 4955 does not appear to lend itself to situations where there is a clear endorsement or a clear statement of opposition to a candidate--when these occur, the genie is out of the bottle and to make the correction that IRC 4955 requires, to get the genie back, would be a task that strains the imagination." 1993 CPE Text at 419. This limiting language does not appear in the 2002 CPE Text. The preamble to the final regulations under section 4955 takes the position that "there may be individual cases where, based on the facts and circumstances such as the nature of the political intervention and the measures that have been taken by the organization to prevent a recurrence, the IRS may exercise its discretion to impose a tax under section 4955 but not to seek revocation of the organization's tax-exempt status." T.D. 8628, 60 Fed. Reg. 62,209 (Dec. 5, 1995).

The Service has used section 4955 as an intermediate sanction in lieu of revocation of exemption in the two most recent private letter rulings issued with respect to participation or intervention in a political campaign by section 501(c)(3) organizations. In Tech. Adv. Mem. 200437040 (June 7, 2004), the IRS ruled that urging the audience of a religious broadcast not to vote for a presidential candidate of one of the two major political parties meant that the organization had "impliedly endorsed" the candidate of the other major party. The founder of the organization made such statements on several occasions during the campaign. The IRS imposed section 4955 financial penalties, but did not revoke the organization's exempt status. The continued exemption of this organization is inexplicable in light of the same organization's multiple acts in violation of the private benefit and inurement prohibitions and its repeated engagement in excess benefit transactions within the meaning of section 4958. For rulings relating to these issues, see Tech. Adv. Mem. 200435018 (May 5, 2004) (founder's son-in-law); Tech. Adv. Mem. 200435019 (May 5, 2004) (founder's son); Tech. Adv. Mem. 200435020 (May 5, 2004) (founder); Tech. Adv. Mem. 2004-35-021 (May 5, 2004) (founder's wife); and Tech. Adv. Mem. 2004-35-022 (May 5, 2004) (founder's son). There seem to be few requirements for exemption that this organization failed to violate. Its continued exemption provides powerful evidence of the IRS's reluctance to use its statutory authority to enforce the prohibition on participation or intervention in political campaigns by section 501(c)(3) organizations by revoking the exempt status of such organizations.

In Tech. Adv. Mem. 200446033 (Nov. 12, 2004), the IRS ruled that a section 501(c)(3) organization that administered a payroll deduction plan through which employees of the public charity made contributions to a hospital industry PAC affiliated with a section 501(c)(6) trade

association representing hospital and health care systems constituted prohibited participation or intervention in a political campaign. The chief executive officer of the section 501(c)(3) organization became the president of the section 501(c)(6) trade association and announced his intention to stimulate increased interest in making contributions through the PAC created to support candidates backed by the hospital industry trade association. To that end, he made a video, distributed to the employees of the section 501(c)(3) organization, in which he urged the employees to participate in the payroll deduction plan. The video was shown to employees during the normal work day, with showing arranged by supervisors who distributed forms for enrolling the payroll deduction plan. The IRS ruled that the section 501(c)(3) organization had "indirectly intervened in political campaigns" by such actions. The private ruling is silent on revocation, referring instead to sanctions under section 4955 of the Code.

B. The IRS Does Not Use the Authority Congress Has Given It Even When Section 501(c)(3) Organizations Have Expressly Endorsed Particular Candidates

Examinations of possible violations of the section 501(c)(3) political prohibition face a procedural dilemma arising from the fact that most exempt entities will file their annual information return long after the election is over. If the organization is found to have violated the political prohibition, any penalties can be treated simply as a cost of doing political business because they will not impede the organization's effort to engage in the participation or intervention for which the organization is being penalized.

Congress recognized this problem when it enacted section 4955. It was clear that waiting until the annual information return was filed to take any action in the case of participation or intervention in a political campaign was tantamount to giving a section 501(c)(3) organization a blank check before the election. To address this problem, Congress enacted two provisions intended to permit the IRS, in defined situations and through defined procedures, to take actions before the organization filed its annual return. Section 6852(a)(1) provides for termination assessments in the case of "flagrant violations of the prohibition against making political expenditures." The IRS has provided no guidance on what violations constitute "flagrant violations."

Section 7409 provides that the IRS may seek "to enjoin any section 501(c)(3) organization from making further political expenditures and for such other relief as may be appropriate to ensure that the assets of such organization are preserved for charitable or other purposes specified in section 501(c)(3). This provision requires that the Commissioner make a determination that the activity in question is a "flagrant" violation of the prohibition on participation or intervention in a political campaign. Here, as in section 6852, neither the Code nor the applicable regulations defines "flagrant" beyond the observation that "flagrant political intervention" is any violation of the section 501(c)(3) prohibition on participation or intervention in an election campaign "if the participation or intervention is flagrant." Treas.

Reg. § 301.7409-1(c).

The IRS has never used its authority under section 7409. Most observers would have found that paying for full page ads in two national newspapers four days before a national election declaring one of the two major candidates for President of the United States to be morally unfit for the presidency would be a flagrant violation. In this case, the Service took action that resulted in the ultimate revocation of the organization's exempt status, but did so without using any of its special authority for dealing with flagrant violations of the prohibition on participation or intervention in a political campaign. The IRS's determination upheld by the courts. *Branch Ministries, Inc. v. Commissioner*, 40 F. Supp. 2d 15 (D. D.C. 1999), aff'd, 211 F. 3d 137 (D.C. Cir. 2000). In 2004, at least one organization put on its website an express endorsement of one of the two major party candidates. In this case, the website of the Jerry Falwell Ministries, Inc. contained an express endorsement of President Bush for re-election. Two organizations wrote to the IRS calling this matter to its attention. *Letter to IRS from Americans United for Separation of Church and States* (2004 TNT 147-18) and *Letter to IRS from the Campaign Legal Center* (2004 TNT145-13). The Service did not invoke its authority under either section 6852 or 7409 with respect to this endorsement of a presidential candidate.

C. Procedures for Recognizing and Revoking Create Ambiguity about When an Entity Is Properly Treated as a Section 501(c)(3) Organization for Purposes of the FEC's Exemption from the Electioneering Communication Provisions

An organization which wishes to be treated as exempt under section 501(a) as an organization described in section 501(c)(3) files Form 1023, Application for Recognition of Exemption. The overwhelming proportion of these applications are approved. However, an organization may file this application up to fifteen months after it has incorporated or otherwise organized and its exempt status, should it be recognized, will be effective retroactively to the time of its organization. This timing issue does not pose difficulties for federal income tax purposes, but it raises obvious questions for purposes of the matter at issue here. When is an organization properly treated as a section 501(c)(3) organization for purposes of the FEC rule exempting section 501(c)(3) organizations from the electioneering communication provisions? When it files its application? When it receives a determination letter from the IRS informing it that its application has been successful? What if the election in question, and the electioneering communication periods specified in election law, occur after the organization has been established but before it has filed its application?

Similar questions arise in the rare event that the IRS revokes an organization's exempt status. Any organization has the right to seek a declaratory judgment that the revocation was in error. Such proceedings may be in the courts for a protracted period. Is such an organization a section 501(c)(3) organization while its declaratory judgment action is pending even if the courts ultimately rule in favor of the IRS?

In some cases, the IRS enters a closing agreement with a section 501(c)(3) organization rather than revoking its exempt status as a section 501(c)(3) organization. This was the course of action the IRS chose to follow when Jimmy Swaggert explicitly endorsed Pat Robertson for President of the United States during his televised sermon. The Jimmy Swaggert Ministries revoked the section 501(c)(3) organization's exempt status for a period but then reinstated it. *Public Statement of Jimmy Swaggert Ministries* (December 27, 1991)(92 TNT 31-31). In a case like this, was the organization a section 501(c)(3) organization for purposes of the FEC rule exempting section 501(c)(3) organizations from the electioneering communication provision during the period that its exempt status was revoked?

D. IRS Enforcement Procedures Are Inconsistent with FEC Enforcement Procedures in Ways that Undermine the Public's Legitimate Interests in the Orderly Administration of Election Law

No private person has standing to challenge the exempt status of a section 501(c)(3) organization. Unlike the complaint process which permits private parties to bring issues before the FEC, only the IRS can open examinations of exempt organizations. Private persons can and do write to the IRS identifying activities of an organization that appear to be inconsistent with the organization's exempt status. The IRS has no obligation to take account of such communications in any way.

The outcome of IRS examinations are not public. In consequence, other section 501(c)(3) organizations learn nothing about the standards being applied by the IRS and voters have no information about the contributions to or expenditures by section 501(c)(3) organizations that participate or intervene in election campaigns.

V. Reliance on a PASO Standard Would Undermine the Legitimate Purposes of Both Election Law and Tax Law

Modification of the exemption for section 501(c)(3) organizations would add complexity without achieving clarity in this area. If PASO were defined as broadly permissive, adding a PASO exception to the exemption would facilitate the diversion of a section 501(c)(3) organization's resources from exempt activity to prohibited participation or intervention in a political campaign. Candidates would then have a green light from the FEC to offer their contributors a tax-deductible channel for political contributions. If PASO were defined as broadly restrictive, it would add a second level of limitations to the exempt and permissible purposes of section 501(c)(3) organizations.

However the FEC might define PASO, this standard could not be used for federal income tax purposes. BCRA states explicitly that the "[n]othing in this subsection may be construed to establish, modify, or otherwise affect the definition of political activities or electioneering

activities (including the definition of participating in, intervening in, or influencing or attempting to influence a political campaign on behalf of or in opposition to any candidate for public office) for purposes of the Internal Revenue Code of 1986." 2 U.S.C. § 434(f)(7),

VI. An Exemption Limited to Section 501(c)(3) Organizations Controlled by Federal Candidates of Officeholders Does Not Address the Problems Arising from the Exemption

The NPRM suggests in passing limiting the exemption for section 501(c)(3) organizations to organizations that are not directly or indirectly established, maintained or controlled by a Federal candidate or officeholder. 70 Fed. Reg. At 49511.

I oppose retaining a section 501(c)(3) exemption even with this limitation. Such a limitation does not address the problems that any exemption for any section 501(c)(3) organizations creates under both the Code and FECA. Like an exemption limited by a PASO test, an exemption limited by an officeholder or candidate test would not address the core issue of diversion of resources from exempt purposes.

The question of the role of Federal (or state or local) candidates or officeholders is a significant issue for tax law and one of the many issues that the IRS has not addressed. For tax law it is an issue that requires careful analysis on its own terms. It is not the kind of issue that is constructively addressed as a secondary issue addressed for the sole purpose of saving the exemption for section 501(c)(3) organizations.

VII. Conclusions

For the reasons set forth above, I urge the FEC to eliminate the regulatory exemption from the electioneering communications provisions it crafted for section 501(c)(3) organizations.

I appreciate the opportunity to submit these comments.

Sincerely,

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