

TAXING ISSUES: REEXAMINING THE REGULATION OF ISSUE ADVOCACY BY TAX-EXEMPT ORGANIZATIONS THROUGH THE INTERNAL REVENUE CODE

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Recent elections show that more than just good ideas are needed to win: candidates also need money. More than thirty years ago, Congress sought to limit the amount of money that flowed in and out of federal campaigns through a comprehensive set of amendments to the Federal Election Campaign Act (FECA) of 1971. In Buckley v. Valeo, the U.S. Supreme Court held that only campaign legislation that regulated a vague category of activity called “express advocacy” would be tolerated under the First Amendment. Since that decision, candidates have sought to identify themselves with particular issues and, in particular, the tax-exempt groups who propagate those issues. Not only are these tax-exempt groups exempt from income tax, but they also have been used to avoid the restrictions of the FECA. The most recent incarnation of loophole generating tax-exempt organizations elected tax-exempt status under section 527 of the Internal Revenue Code (the Code). These so-called “stealth PACs” successfully avoided most federal regulation, including federal disclosure requirements under the FECA. That same year, Congress put an end to the practice by mandating that such groups disclose the sources of their funding. In this Note, David S. Karp addresses some of the problems raised by these disclosure amendments. Karp argues that the persistent use of the Code to remedy loopholes in the campaign-finance law is dangerous because it traps otherwise law-abiding tax-exempt organizations between two separate regimes, with different goals in mind, regulating the same subject matter. After canvassing the history of the involvement of tax-exempt organizations in politics since Buckley, Karp concludes by arguing that the problem of the “stealth PACs” could be solved by limiting section 527 status to organizations that engage in express advocacy.

INTRODUCTION

The Internal Revenue Code (Tax Code or the Code) subjects nonprofit, or tax-exempt organizations,¹ to a wide array of regulation

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¹ This Note will use the terms “tax-exempt organization” and “nonprofit” interchangeably to refer to organizations listed under § 501(c) of the Internal Revenue Code (I.R.C. or the Code) of 1986, as amended. All § 501(c) organizations are exempt from taxation under

to ensure fiscal responsibility. The Tax Code, however, generally does not require tax-exempt organizations to disclose the identities of their contributors.² It is, therefore, often difficult to determine the sources of the private funding to these organizations, and this difficulty is a matter of concern in light of the increasing significance of tax-exempt organizations in American politics.³ More and more tax-exempt organizations are engaging in lobbying and issue advocacy,⁴ leading some to fear that garden-variety nonprofits are becoming indistinguishable from political action committees (PACs).⁵

On July 1, 2000, Congress reacted to this concern by closing a loophole in the then-existing federal campaign-finance regime.⁶ The

I.R.C. § 501(a) (2001). Other parts of the Code, however, also bestow exempt status on other categories not listed in § 501(c). Political organizations, for instance, described in § 527, are exempt under the Code. Their exemption, however, is more limited than § 501(c) organizations.

There are a total of twenty-eight different categories of exemption listed under § 501(c). Of those twenty-eight categories, this Note focuses exclusively on charities, described in § 501(c)(3), and social welfare organizations, described in § 501(c)(4), and does not address the nuances that other nonprofit organizations introduce. See *infra* Part II.B (describing rise of tax-exempt organization participation in federal elections). Generally speaking, however, the same rules that apply to social welfare organizations also apply to the other exemptions listed under § 501(c). See *infra* note 30.

² See *infra* notes 55-56 and accompanying text (discussing general rule of nondisclosure governing nonprofit tax return information).

³ See, e.g., 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, 579-85 (1990) (tracing origins of tax-exempt think tanks and their growing influence on national politics); Frances R. Hill, *Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle*, 86 Tax Notes 387, 389-90 (2000) (identifying loopholes in tax and election law leading to increased political participation by tax-exempt organizations); Note, *The Political Activity of Think Tanks: The Case for Mandatory Contributor Disclosure*, 115 Harv. L. Rev. 1502, 1502-09 (2002) (describing tax-exempt think tanks and events that led to greater scrutiny of their activities).

⁴ See *infra* notes 83-88, 104-109 and accompanying text (describing origins of issue advocacy and cataloguing increased use of tax-exempt organizations as vehicles for issue-advocacy advertising); see also, e.g., Robert C. DeGaudenzi, *Tax-Exempt Public Charities: Increasing Accountability and Compliance*, 36 Cath. Law. 203, 204-06 (1995) (highlighting recent scandals involving § 501(c)(3) organizations that have led to increased scrutiny).

⁵ The term political action committee (PAC) refers to the legal term "political committee." Federal election law defines "political committee" as "any committee, club, association, or other group of persons" that receives contributions, or makes expenditures of more than \$1000 in a calendar year. 2 U.S.C. § 431(4)(A) (2001).

⁶ See Gail Russell Chaddock, *Congress Moves to Curb 'Stealth PACs'*, *Christian Sci. Monitor*, June 29, 2000, at 4 (discussing passage of bipartisan measure by House); Eric Schmitt with John M. Broder, *Senate Votes to Open Books of Nonprofit Political Groups*, *N.Y. Times*, June 30, 2000, at A1 (reporting Senate's approval of bipartisan measure introduced in House and statement by then-President William J. Clinton that he would sign bill).

loophole had its origins in several private letter rulings⁷ issued by the Internal Revenue Service (IRS) from 1996 to 1999 that interpreted section 527 of the Code.⁸ This rather obscure section addressed the tax status of contributions to political organizations and previously had received little attention. The rulings allowed certain groups operating under the section 527 exemption—some with innocuous-sounding names such as “Citizens for Better Medicare”⁹ and “Republicans for Clean Air”¹⁰—to engage in substantial electioneering without any

⁷ Private letter rulings are determinations of tax liability made by the Internal Revenue Service (IRS) in response to specific, fact-intensive requests. The Code classifies these documents as “written determinations” that must be disclosed to the public after they are properly sanitized of private information. See I.R.C. § 6110(a)-(c) (2001). Although they are useful guidance to practitioners who may face similar tax inquiries, they may not be cited or used as precedent. See § 6110(k)(3).

⁸ See *infra* Part I.A.3 (discussing tax exemption for political organizations).

⁹ Citizens for Better Medicare (CBM) is a nonprofit group that ran advertisements critical of then-President Clinton’s plan to offer prescription drug benefits to everyone on Medicare. See John M. Broder, *Clinton’s Drug Plan Attacked by Industry*, N.Y. Times, June 28, 2000, at A22. The organization made its first appearance in 1999 with a series of highly successful advertisements featuring a “silver-haired senior citizen called Flo.” Dan Morgan, *Drugmakers Launch Campaign on Medicare; Industry Wary of Prescription Cost Controls*, Wash. Post, July 28, 1999, at A4; see also Owen Ullman, ‘Flo’ to Clinton: Stay Out of My Medicine Cabinet; Drug Companies Begin Folksy Attack Against Plan for Prescription Benefit Under Medicare, USA Today, Aug. 6, 1999, at 10A (reprinting text of CBM advertisement in full).

Because the group limited itself to discussion of issues, it was not subject to the disclosure requirements of federal election law. Broder, *supra*; see also *infra* Part II.A (contrasting differences in tax and federal election law). A study released by Public Citizen in 2000 revealed that the group was in fact funded by many pharmaceutical companies who stood to lose if Congress passed Medicare reform legislation. See generally Public Citizen, *Congress Watch, Citizens for Better Medicare: The Truth Behind the Drug Industry’s Deception of America’s Seniors*, <http://www.citizen.org/congress/drugs/factshts/cbmstudy.pdf> (June 2000). According to a study released by the Annenberg Public Policy Center, Citizens for Better Medicare spent roughly \$65,000,000 during the 1999-2000 election cycle. Kathleen Hall Jamieson et al., *Annenberg Pub. Policy Ctr., Issue Advertising in the 1999-2000 Election Cycle*, 4 chart 1, <http://www.appcpenn.org/issueads/1999-2000issueadvocacy.pdf> [hereinafter *Annenberg 1999-2000 Issue Advertising Report*]. The organization was the third highest spender, beat only by the Democratic National Committee, at approximately \$78,400,000, and the Republican National Committee, at approximately \$83,500,000. *Id.*; see also *id.* at 18-20 (detailing sponsorship of issue advertisements). Following the passage of the reform legislation discussed *infra* in Part II.C, CBM changed its tax status in order to avoid disclosure. Susan Schmidt, *Political Groups Change Status to Avoid Disclosure*, Wash. Post, Sept. 15, 2000, at A1.

¹⁰ Republicans for Clean Air was established by Texas billionaire Sam Wyly. John Mintz, *Texan Aired ‘Clean Air’ Ads; Bush’s Campaign Not Involved, Billionaire Says*, Wash. Post, Mar. 4, 2000, at A6. The group financed \$2,100,000 of advertisements attacking Senator John McCain’s votes opposing alternate energy sources. *Id.* The identity of Sam Wyly as the financial backer of the advertisements was only revealed because he came forward and revealed himself. *Id.* During the Republican primary, McCain used the episode as an illustration of why campaign-finance reform was needed. Adam Nagourney & Frank Bruni, *Bush and McCain Battle for Support on Tuesday in High-Stakes Territory*, N.Y. Times, Mar. 4, 2000, at A10. McCain even filed a complaint with the Federal Election

significant restrictions on their activity or disclosure obligations because they advocated *issues* rather than *candidates*.¹¹ Although the news media sometimes uncovered some of the funding sources for these groups, revealing the identity of contributors proved to be impossible.¹²

Responding to public outcry that these rulings effectively allowed the creation of “stealth PACs,”¹³ Congress hastily passed a modification to the Code¹⁴ which requires tax-exempt organizations that accumulate over \$25,000,¹⁵ regardless of whether they advocate issues or candidates or both, to register with the IRS,¹⁶ report the names of donors contributing an aggregate amount of \$200 or more,¹⁷ and file annual tax returns.¹⁸

In the past two-and-a-half years, this disclosure law has engendered more problems than it has solved. A number of state and local campaign committees and interest groups covered by the new law have urged that the law be amended to exempt those groups that are already required to make substantial disclosures to state election boards.¹⁹ A significant number of state and local campaign commit-

Commission (FEC) and asked television stations not to air the advertisements. T. Christian Miller & Janet Wilson, *McCain Blasts Pro-Bush TV Ad Campaign Financed by Texans*, L.A. Times, Mar. 4, 2000, at A16.

¹¹ Under current Supreme Court doctrine, if an organization does not directly advocate the election or defeat of specifically identified candidates, they cannot be subject to the disclosure requirements of the Federal Election Campaign Act (FECA) of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1972) (codified as amended at 2 U.S.C. §§ 431-455 (2001)). See *infra* notes 81-88 (discussing “express advocacy” standard).

¹² See *infra* notes 114-119 and accompanying text (discussing press coverage of § 527 organizations in early 2000).

¹³ The term “stealth PAC” refers to organizations exempt from taxation under § 527 that are not required to disclose to the FEC. See *Recent Legislation*, 114 Harv. L. Rev. 2209, 2210 & n.17 (2001) (citing 146 Cong. Rec. S5995 (2000) (statement of Sen. Lieberman)); see also Richard L. Hasen, *The Surprisingly Complex Case for Disclosure of Contributions and Expenditures Funding Sham Issue Advocacy*, 48 UCLA L. Rev. 265, 268 (2000).

¹⁴ Pub. L. No. 106-230, 114 Stat. 477 (2000) (codified in scattered sections of I.R.C.). For a discussion on the technical disclosure requirements, see *infra* Part II.C.

When signing the new § 527 disclosure legislation into law, President Clinton remarked that the § 527 disclosure bill “will stop special interests from using 527 status to hide their political spending behind a tax-exempt front group. It will help clean up the system by forcing organizations to come clean about their donors.” *Remarks on Departure for Camp David, Maryland, and an Exchange With Reporters*, 36 Wkly. Comp. Pres. Doc. 1579-80 (July 10, 2000).

¹⁵ § 1(a), 114 Stat. at 478 (codified at I.R.C. § 527(i)).

¹⁶ § 1(a), 114 Stat. at 477.

¹⁷ § 2(a), 114 Stat. at 479-80 (codified at I.R.C. § 527(j)).

¹⁸ § 3, 114 Stat. at 482 (amending scattered sections of I.R.C.).

¹⁹ See, e.g., Alison Bennett, *ASAE Urges Thomas to Ease Disclosure for Section 527 Political Organizations*, Daily Tax Rep. (BNA), Dec. 31, 2001, at G-3 (“The law ‘lacks a key provision to avoid the senseless duplication of efforts on the part of traditional state

tees face a potential tax liability in the hundreds of thousands of dollars for failing to comply with the law's mandates.²⁰ The law also has sparked a lawsuit challenging its constitutionality.²¹ In the midst of this cacophony, the IRS has struggled to put all the paperwork it re-

and local political action committees that are already subject to disclosure requirements at the state and local level[.]” (quoting letter from Michael Olson, President, ASAE, to House Ways and Means Committee Chairman Bill Thomas)); Lance Gay, Campaign Finance Law Misses Target, Catches Small-Town Politicians in Net, *Wash. Times*, Aug. 25, 2000, at A8; Letter from Jan Witold Baran, Wiley, Rein & Fielding, to Judith E. Kindall, IRS 5-6 (Sept. 8, 2000) (“The burden of duplicative reporting on these committees is significant. These committees already report on time schedules that are dictated by state law tied to state elections and that are slightly different than the schedule in § 527.”), <http://www.brook.edu/dybdocroot/gs/cf/NABPACLetter.pdf>.

²⁰ See Fred Stokeld, Some State and Local Campaign Committees Not Registering with IRS, *Official Says*, *Tax Notes Today*, Feb. 26, 2002, LEXIS (stating belief by unnamed IRS official that state and local campaign committees have not filed form indicating notice of existence because they are unaware of requirement, “despite IRS efforts to inform exempt organizations about the law”). The issue has risen to national prominence with the gubernatorial campaign of U.S. Representative Van Hilleary. See Andrew M. Ballard, “Huge Problem” Said Facing IRS over State Campaign Fund Reporting, *Daily Tax Rep. (BNA)*, Feb. 25, 2002, at G-1. Public Law 106-230 imposes the highest corporate tax rate—currently thirty-five percent—on organizations failing to comply with the law’s disclosure requirements. § 1(c), 114 Stat. at 479 (codified at I.R.C. § 6652). Hilleary’s campaign is one of many that recently discovered it had failed to register under the new law as a nonprofit political organization. See Ballard, *supra*. His campaign could end up owing as much as \$700,000 to the IRS for failing to register. *Id.* Interestingly, Hilleary voted for the law of which his campaign now claims ignorance. *Id.*; see also 146 Cong. Rec. H5289 (daily ed. June 27, 2000) (recording vote).

²¹ See Kenneth P. Doyle, Republican Group Launches Challenge to New Law on Section 527 Organizations, *Daily Tax Rep. (BNA)*, Sept. 1, 2000, at G-4 (describing lawsuit filed on August 21, 2000, by National Federation of Republican Assemblies in U.S. District Court for the Southern District of Alabama, seeking to declare Public Law 106-230 unconstitutional). The complaint alleges, *inter alia*, that Public Law 106-230 “violates the First Amendment rights of the Plaintiffs by heavily burdening core First Amendment expression, limiting the speech of the Plaintiffs, and abridging their free expression[.]” *Compl. ¶ 19*, *Nat’l Fed’n of Republican Assemblies v. United States*, (S.D. Ala. filed Aug. 28, 2000) (No. 00-759-RV-C), <http://www.brook.edu/dybdocroot/gs/cf/headlines/527complaint.pdf>. The complaint also alleges that the law violates the Tenth Amendment by unconstitutionally giving the IRS broad and unchecked authority over political activities and expression of associations and individuals involved solely in state and local issues. *Id.* ¶ 20.

Since the case was filed, the district court has issued two opinions. The first was issued on May 31, 2001, in response to the government’s motion to dismiss. *Nat’l Fed’n of Republican Assemblies v. United States (Republican Assemblies I)*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001). Significantly, in that opinion, the district court ruled that the plaintiffs’ suit could go forward because the Code’s Anti-Injunction Act did not apply to suits against penalties. *Id.* at 1283. The second opinion ruled on cross motions for summary judgment. In a partial victory for the plaintiffs, District Judge Richard Vollmer held that the disclosure provision contained in § 527(j) infringed on free speech to the extent that it required disclosure of expenditures for federal electoral advocacy and to the extent that it required disclosure of either expenditures or contributions in connection with state or local advocacy. *Nat’l Fed’n of Republican Assemblies v. United States (Republican Assemblies II)*, 218 F. Supp. 2d 1300, 1354-55 (S.D. Ala. 2002). In response to the government’s request for clarification of judgment, Judge Vollmer subsequently issued a revised order enjoining

ceives online for public view.²² In light of all these difficulties associated with the legislation, the IRS has suspended enforcement of the law on several occasions.²³

Much of this confusion has its origins in the distinctions drawn by the Supreme Court in *Buckley v. Valeo*.²⁴ In *Buckley*, the Court, evaluating the constitutionality of a comprehensive set of amendments to federal election law enacted by Congress in 1974,²⁵ drew a sharp line between two categories of political speech—"express advocacy," which Congress may regulate, and the discussion of issues, the extent to which Congress may regulate is unclear.²⁶ The Federal Election Campaign Act (FECA) and *Buckley* have, therefore, for better or for worse, established a regime that seeks to serve the public interest by assuring disclosure of information related only to express advocacy.²⁷ As discussed above, in 2000 Congress sidestepped this regime by creating a threshold of \$25,000 to distinguish between groups that have to disclose and groups that do not have to disclose.²⁸ If an organization

enforcement of the law only as against the parties to the case. Nat'l Fed'n of Republican Assemblies v. United States, Order of September 17, 2002, 2002 U.S. Dist. LEXIS 20845.

For a critical discussion of the constitutional arguments raised by the plaintiffs in the *Republican Assemblies* case, see generally Richard Kornylak, Note, *Disclosing the Election-Related Activities of Interest Groups Through § 527 of the Tax Code*, 87 Cornell L. Rev. 230 (2001). After considering the constitutional challenges raised by the plaintiffs in the case, the Note concludes that the legislation should pass constitutional muster under prevailing precedent. *Id.* at 249-53.

²² A recent report, Public Citizen, Congress Watch, Congressional Leaders' Soft Money Accounts Show Need for Campaign Finance Reform Bills 28-29 (2002), <http://www.citizen.org/documents/ACF45A.PDF>, criticized "flaws in the disclosure system" of the IRS searchable website, stating that "[t]he limited search functions do not allow the possibility of aggregating contributions to determine the total amount of money flowing into § 527 groups. It is also impossible to determine how many groups are influencing federal elections, as opposed to state and local races without opening every record." *Id.* Some have argued that "[t]imely disclosure, especially just before an election, is crucial," and that "it may have been a mistake for Congress to give this disclosure function to IRS, which has a tradition of handling taxpayer filings in strict secrecy." Kenneth P. Doyle, *Some Reports from 527 Groups Online; IRS Says Others Not Immediately Available*, Daily Tax Rep. (BNA), Oct. 30, 2000, at G-4 (quoting Kent Cooper, former FEC official, and reporting criticism of IRS's "slow pace in making reports available" because "much of the information in the reports will be of little value after the election").

²³ See, e.g., IRS Announces Voluntary Compliance Program to Promote Disclosure by Political Organizations, I.R.S. Notice 2002-34, 2002-21 I.R.B. 990 (May 28, 2002) (announcing enforcement moratoria until July 15, 2002, in order to allow political organizations to file and/or correct errors in forms already filed).

²⁴ 424 U.S. 1 (1976) (per curiam).

²⁵ FECA Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263.

²⁶ See *infra* notes 80-88 and accompanying text for a discussion of the distinction between express advocacy and issue advocacy.

²⁷ See *infra* note 86 (discussing "express advocacy" standard and citing cases).

²⁸ See *supra* notes 14-18 and accompanying text for a discussion of the creation of the \$25,000 threshold.

meets this threshold, it must disclose regardless of whether its activities can be characterized as express or issue advocacy.

This Note argues that Congress has only created a new loophole that will give rise to the same concerns it tried to address in the 2000 legislation. Now the organizations that sought to avoid disclosure under section 527 will likely try to protect the anonymity of their donors by taking advantage of other exemptions under the Code.²⁹ In order to remedy this problem, section 527 should be limited to organizations engaged in express advocacy. Limiting section 527 to express advocacy is sensible because modern campaign-finance law has always aimed at having the financial supporters of this activity disclosed. Moreover, this would enable groups that engage in genuine issue advocacy to seek anonymity under other parts of the Code.

Part I of this Note canvasses the Code's regulation of the political activity of nonprofits. Part II describes the developments in politics and the law that gave rise to section 527 "stealth PACs" and the rush to a legislative solution that has proved unworkable. Part III examines the costs and benefits of some of the remedial measures currently being considered. This Note concludes by suggesting how the definition of "political organization" should be amended to conform to congressional intent as it existed in 1974—namely, the section should apply only to partisan organizations.

I

ELECTIONEERING, NONPROFITS, AND THE CODE

Most, if not all, political activity conducted by tax-exempt organizations is carried out by three categories of nonprofit groups:³⁰ chari-

²⁹ Cheryl Bolen, *Senate Passes Section 527 Disclosure Bill; Opponents Predict Shift to Section 501(c)(4)*, Daily Tax Rep. (BNA), June 30, 2000, at GG-1-GG-2 (describing remarks made by GOP source about how § 527 organizations will change to § 501(c)(4) organizations); John M. Broder, *Finding Another Loophole, a New Secretive Group Springs Up*, N.Y. Times, Aug. 11, 2000, at A14 (describing how group that was leading supporter of Vice President Al Gore quietly chartered under § 501(c)(4) to avoid disclosure); Schmidt, *supra* note 9 ("[I]nstead of complying with the new law, a number of groups are . . . reconstituting themselves under other provisions of the tax code that do not force them to reveal their donors and require far less—and less frequent—reporting overall.").

³⁰ The Code also exempts from tax certain other organizations that engage in political activity and lobbying to further their ends. E.g., I.R.C. § 501(c)(5) (2001) (labor organizations); § 501(c)(6) (business leagues); § 501(c)(7) (social clubs); § 501(c)(8) (fraternal organizations). Generally, with respect to these organizations, the IRS has held that in the absence of a specific statutory prohibition on political activity, political intervention is permissible. E.g., Rev. Rul. 68-266, 1968-1 C.B. 270 (holding that organization whose entire membership is either affiliated with particular political party or interested in political party's affairs may qualify for exemption under § 501(c)(7)); Rev. Rul. 61-177, 1961-2 C.B. 117 (concluding that organization whose primary activity was promoting legislation favorable to its members still qualified for § 501(c)(6) exemption). Generally, the IRS has

ties (described in section 501(c)(3)), social welfare organizations (described in section 501(c)(4)), and political organizations (described in section 527). Section A of this Part describes the distinctions the Code draws between these groups and the different standards and obligations that apply to each. Under certain circumstances, all three nonprofit categories have to comply with federal election law, and these obligations are discussed briefly in section B.

A. *The Code's Regulation of Nonprofit Political Activity*

1. *Charities*

Most tax-exempt organizations are charities.³¹ Section 501(c)(3) describes charities as “[c]orporations . . . organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes”³² The Treasury Regulations further provide that this statutory list of charitable purposes is not exhaustive, allowing organizations with an even wider array of purposes to incorporate under this section, as long as the purposes fit within a generally accepted definition of “charity.”³³

For politically active groups, charitable status comes with both benefits and burdens. The major benefit of charitable status is that the Code allows donors to deduct contributions to such organizations from federal income,³⁴ estate,³⁵ and gift taxes.³⁶ Accordingly, charitable status provides donors with a strong incentive to contribute to such organizations. However, in exchange for this benefit, the Code restricts charities’ participation in political campaigns and elections. Specifically, the Code prohibits charities from “participat[ing] in, or

concluded that if the primary activity of an organization qualifies it for exemption from tax, then any incidental involvement with political campaigns will not jeopardize the exemption. Gen. Couns. Mem. 34,233 (Dec. 30, 1969). A discussion of the Code’s regulation of the political activity of these organizations is beyond the scope of this Note.

³¹ According to the IRS, 865,096 of the 1,567,580 tax-exempt organizations in the United States claimed charity status in 2001. U.S. Dep’t of Treasury, Pub. No. 55B, IRS Data Book 2001, at 24 tbl.22, <http://www.irs.gov/pub/irs-soi/01databk.pdf> [hereinafter 2001 Data Book].

³² § 501(c)(3).

³³ Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 1990) (“‘[C]haritable’ . . . [is] not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of ‘charity’ as developed by judicial definitions.”).

³⁴ § 170(a)(1) (allowing income tax deductions for charitable contribution made within taxable year); § 170(c)(2)(D) (defining “charitable contribution” as, inter alia, donation to organizations “which is not disqualified for tax exemption under section 501(c)(3)”).

³⁵ § 2055(a)(2) (allowing estate tax deduction for transfer to charitable institution); § 2106(a)(2)(A)(ii) (allowing transfers to charitable institutions to be deducted from gross estate for estate tax purposes).

³⁶ § 2522(a)(2) (allowing gift tax deduction for transfer to charitable institution).

interven[ing] in . . . any political campaign on behalf of (or in opposition to) any candidate for public office.”³⁷ Any charity that violates this restriction exposes itself to excise taxes,³⁸ an injunction against further violations,³⁹ or, even worse, loss or denial of charitable status.⁴⁰

³⁷ § 501(c)(3). Although the regulations clearly prohibit express advocacy of a candidate, they appear to permit organizations to engage in voter education or nonpartisan analysis. See, e.g., Rev. Rul. 78-248, 1978-1 C.B. 154 (“[C]ertain ‘voter education’ activities . . . may not constitute prohibited political activity.”). The regulations, for example, define “educational” as “[t]he instruction of the public on subjects useful to the individual and beneficial to the community.” Treas. Reg. § 1.501(c)(3)-(1)(d)(3)(i)(b). An organization may qualify as 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.” *Id.* The “mere presentation of unsupported opinion,” however, is not recognized as an educational purpose. *Id.* Nonpartisan voter-registration drives, for example, are valid activities for a tax-exempt charity. I.R.C. § 4945(f). Such drives are nonpartisan for tax purposes if contributions . . . [to fund the] drives are not subject to conditions that they may be used only in specified States, possessions of the United States, or political subdivisions or other areas of any of the foregoing, or the District of Columbia, or that they may be used in only one specific election period.

§ 4945(f)(5); accord Treas. Reg. § 53.4955-1(c)(2)(iii) (as amended in 1995). Similarly, the Service has found the targeting of certain constituencies (such as minorities) in voter-registration efforts to be consistent with the term “educational.” See, e.g., Priv. Ltr. Rul. 95-40-044 (Jul. 6, 1995) (authorizing charity’s intention to register “large numbers of female voters, particularly in minority communities,” as properly exempt activity); see also *supra* note 7 (explaining IRS’s practice of issuing private letter rulings).

Although beyond the scope of this Note, it should be noted that the IRS’s rulings and positions in the area of voter education generally lack lucidity. The “full and fair exposition” test, codified in Treasury Regulation § 1.501(c)(3)-1(d)(3)(i)(b) and discussed *supra*, has been held unconstitutionally vague. In *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030 (D.C. Cir. 1980), the D.C. Circuit held that the IRS’s definition of “educational” was void for vagueness not only because its “full and fair exposition” requirement was incapable of principled application, *id.* at 1038, but also because it failed to delineate clearly enough which organizations are subject to the requirement. *Id.* at 1036. The D.C. Circuit largely reversed its stance in *Big Mama Rag*, however, in *National Alliance v. United States*, 710 F.2d 868 (D.C. Cir. 1983).

³⁸ See I.R.C. § 4955(a)(1) (imposing ten percent excise tax on § 501(c)(3) organizations for each political expenditure); § 4955(b)(1) (imposing additional one-hundred percent excise tax on § 501(c)(3) organization for each political expenditure previously taxed and not corrected within the taxable period). The term “political expenditure” in § 4955 tracks the language of the prohibition in § 501(c)(3). § 4955(d)(1).

³⁹ See § 7409 (granting IRS authority to seek injunction against § 501(c)(3) organization that flagrantly violates political campaign prohibition to prevent further political expenditures by organization).

⁴⁰ § 6852(a)(1)(B) (granting IRS authority to revoke § 501(c)(3) status for “flagrant violation of the prohibition against making political expenditures”). If the IRS denies or revokes the organization’s tax-exempt status, the organization may seek a declaratory judgment. See § 7428(a). In recent years, the IRS has increasingly enforced the prohibition against political campaign activity. See, e.g., *Branch Ministries v. Rossotti*, 211 F.3d 137, 139 (D.C. Cir. 2000) (affirming district court’s order upholding IRS’s revocation of church’s § 501(c)(3) status for publication of full-page advertisements in two newspapers urging Christians not to vote for then-presidential candidate Bill Clinton); *Ass’n of the Bar*

Not all political activity, however, is prohibited.⁴¹ Charities, for example, are free to engage in lobbying to influence legislation,⁴² so long as such activity does not comprise a “substantial” part of the organization’s work.⁴³

2. *Social Welfare Organizations*

In contrast to charities, the Code merely requires social welfare organizations, which are exempt from taxation under section

of N.Y. v. Comm’r, 858 F.2d 876 (2d Cir. 1988) (upholding denial of § 501(c)(3) status to Bar Association due to ratings of candidates for state judicial elections). But cf. Gen. Couns. Mem. 34,267 (Feb. 20, 1970) (suggesting that editorials in magazine published by exempt organization that questioned whether John F. Kennedy’s adherence to Catholic religion would affect his fitness to be President approached “absolute limit of permissible activity in the political area”).

Depending on the circumstances—including the nature of the organization’s political intervention and any steps it may have taken to prevent a repetition of such a violation—the IRS may decide to impose the excise tax penalty (described in note 38, *supra*) instead of revoking the organization’s exempt status. See Political Expenditures By Section 501(c)(3) Organizations, 60 Fed. Reg. 62,209, 62,209-13 (1995) (discussing comments to proposed treasury regulations implementing § 4955 excise tax and affirmatively stating that IRS has discretion to pursue excise taxes over revocation of § 501(c)(3) status depending on severity of violation by charity).

⁴¹ See Treas. Reg. § 1.501(c)(3)-1(c)(3) (as amended in 1990). While the regulations deny “action” organizations 501(c)(3) status, they define “action” organizations quite narrowly, thus excluding only a subset of political activity from tax exemption. See § 1.501(c)(3)-1(c)(3)(ii)-(iv).

⁴² With regards to action organizations, the regulations define “legislation” as “action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure.” § 1.501(c)(3)-1(c)(3)(ii)(b). A charity can advocate social change or take positions on broad public issues consistently with the terms of § 501(c)(3). § 1.501(c)(3)-1(d)(2).

⁴³ As the text of § 501(c)(3) indicates, an exempt organization violates the prohibition against attempting to influence legislation only when the attempts comprise a “substantial part” of the organization’s activities. I.R.C. § 501(c)(3). Although courts have not carefully defined the quantum of activity necessary to constitute a “substantial part,” substantiality appears to fall somewhere between five and sixteen percent of an organization’s total activities. Compare *Haswell v. United States*, 500 F.2d 1133, 1146-47 (Ct. Cl. 1974) (holding that organization violated substantial part limitation when it directed sixteen to seventeen percent of annual budgetary expenditures toward influencing legislation), with *Seasongood v. Comm’r*, 227 F.2d 907, 912 (6th Cir. 1955) (finding less than five percent of organization’s activities to be insubstantial). An exempt organization that fails this substantial part test automatically loses its tax-exempt status. See § 170(c)(2)(D); see also Treas. Reg. § 1.501(c)(3)-1(c). *De minimis* infractions, however, may be ignored. Gen. Couns. Mem. 33,682 (Nov. 9, 1967) (“[S]ituations might arise in which an organization . . . engaged in political activity but on such a small scale that it would not be feasible from an administrative standpoint to either withhold or revoke the group’s 501(c)(3) status because of it.”); see also *St. Louis Union Trust Co. v. United States*, 374 F.2d 427, 431-32 (8th Cir. 1967) (“[A] slight and comparatively unimportant deviation from the narrow furrow of tax approved activity is not fatal.”). But see Gen. Couns. Mem. 39,441 (Nov. 7, 1985) (stating that *de minimis* exception would not apply to organization that annually rates large number of candidates).

501(c)(4), to be “operated exclusively for the promotion of social welfare,” meaning that “the net earnings of [the organizations] are devoted exclusively to charitable, educational, or recreational purposes.”⁴⁴ Because the requirements for organizations seeking to qualify for tax-exempt status under section 501(c)(4) are less specific and less burdensome than the requirements for charities,⁴⁵ donors to social welfare organizations do not receive the tax deduction benefits granted charities.⁴⁶ Although “[t]he promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office,”⁴⁷ social welfare organizations may engage in legislative activities,⁴⁸ and even certain political campaign activities,⁴⁹ so long as the principal purpose of the organization is to advance social welfare.⁵⁰ Stated differently, social welfare organizations may pursue political campaign activities so long as such activities (1) are germane to a recognized social welfare purpose and (2) fall short of being the organizations’ primary activity.⁵¹

⁴⁴ I.R.C. § 501(c)(4).

⁴⁵ The Treasury Regulations state that an organization that fails to qualify for exemption under § 501(c)(3) due to the fact that it violates the prohibition against participation in a political campaign or engages in excessive lobbying “may nevertheless qualify as a social welfare organization.” § 1.501(c)(3)-1(c)(3)(v).

⁴⁶ See I.R.C. § 170(a)(1) (allowing, as general rule, income tax deductions only for charitable contributions); § 170(c) (defining charitable contribution).

⁴⁷ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (1990).

⁴⁸ An organization that is organized and operated to inform the public by educational methods on a subject of public interest and concern may be exempt under section 501(c)(4) of the Code even though the subject evokes controversy and even though the organization advocates a particular viewpoint and seeks changes in law to reflect such viewpoint. The education of the public on such a subject is deemed beneficial to the community because society benefits from an informed citizenry. Rev. Rul. 68-656, 1968-2 C.B. 216.

⁴⁹ E.g., Rev. Rul. 81-95, 1981-1 C.B. 332 (“Although the promotion of social welfare . . . does not include political campaign activities, the regulations do not impose a complete ban on such activities for section 501(c)(4) organizations.”). But see, e.g., Rev. Rul. 67-368, 1967-2 C.B. 194 (holding that nonpartisan rating of candidates constitutes participation in political campaign and thus does not come within definition of social welfare).

⁵⁰ The Code does not define “social welfare.” In the Revenue Act of 1924, Congress specifically defined these groups as “organizations engaged in promoting the welfare of mankind, other than organizations ‘exempt under the so-called charitable clause.’” Gen. Couns. Mem. 33,495 (Apr. 27, 1967) (quoting Revenue Act of 1924, reg. 65, art. 519). The Treasury Regulations broadly define the pursuit of social welfare as being “primarily engaged in promoting in some way the common good and general welfare of the people of the community.” § 1.501(c)(4)-1(a)(2)(i).

⁵¹ Gen. Couns. Mem. 33,495 (Apr. 27, 1967); cf. Gen. Couns. Mem. 36,286 (May 22, 1975) (holding that political activities are permissible, even if substantial, so long as exempt purposes remain primary).

It is not clear how the IRS would measure the proportion of political activity. In parallel circumstances, the IRS has been disinclined to look purely at the fraction of an organization’s budget that goes into a particular activity. See, e.g., League of Women Vot-

The political activities of social welfare organizations, however, are subject to certain limitations. First, the Code taxes campaign expenditures.⁵² Second, the Code imposes gift tax on all transfers of money or property above \$10,000 (adjusted for inflation).⁵³ Third, any political campaign activity of a section 501(c)(4) organization must comply with the dictates of federal election law.⁵⁴

Important for the purposes of this Note, though, the Code protects the names and addresses of contributors to social welfare organizations and charities from disclosure,⁵⁵ thus guaranteeing contributors' anonymity.⁵⁶

3. *Political Organizations*

The Code provides a tax exemption under section 527 for "political organizations,"⁵⁷ that is, for organizations engaging primarily or

ers v. United States, 180 F. Supp. 379, 383 (Ct. Cl.) (finding volunteer time at organization devoted to issue advocacy and indirectly influencing legislation "substantial," and holding gifts to organization nondeductible, despite lack of direct evidence that funds were diverted to that purpose), cert. denied, 364 U.S. 822 (1960).

⁵² See I.R.C. § 527(f)(1) (requiring that any political campaign expenditure of organization claiming tax exemption under § 501(a) be "subject to tax . . . as if it constituted political organization taxable income"); Treas. Reg. § 1.527-6(a) (1980) (stating that if organization described in § 501(c) makes political expenditures, it may be subject to tax on lesser of organization's net investment income for taxable year or aggregate political expenditures made during taxable year); see also *infra* note 69 and accompanying text (noting that some gross income of political organizations is taxable).

⁵³ In Revenue Ruling 82-216, 1982-2 C.B. 220, the Service made clear that gifts to § 501(c) organizations remain subject to gift tax. See I.R.C. § 2501(a) (imposing gift tax on transfers of property by gift); § 2502 (computing rate of tax); § 2503(b)(1) (excluding first \$10,000 of gifts to person from gift tax); § 2503(b)(2) (adjusting exclusion contained in § 2503(b)(1) for inflation).

⁵⁴ See *infra* Part I.B (discussing impact of FECA on tax-exempt organizations); see also Gen. Couns. Mem. 38,215 (Dec. 31, 1979) ("[I]f some of the activities of [a social welfare] organization are illegal, that is, if they violate a Federal or State [election] law—we believe these activities would disqualify the organization from recognition of exemption under section 501(c)(4).").

⁵⁵ § 6104(d)(3)(A) (providing that § 501(c) organizations need not disclose name or address of any contributor thereto).

⁵⁶ Cf. Note, *supra* note 3, at 1502-09 (arguing that "think tanks" electing charitable tax status should be required to disclose their contributor lists to IRS if they are involved in educating public on political issues).

⁵⁷ Congress responded to uncertainty regarding whether contributions to political campaigns should be treated as income in 1974 with the enactment of § 527 and a simultaneous amendment to the gift tax. Pub. L. No. 93-625, § 10(a), 88 Stat. 2108, 2116-19 (1975). See Milton Cerny & Frances R. Hill, *The Tax Treatment of Political Organizations*, 71 *Tax Notes* 651, 652-53, and Marcus S. Owens & Lloyd H. Mayer, *Congress Requires Disclosure by Section 527 Organizations*, 12 *J. Tax'n Exempt Orgs.* 91, 91 & nn.1 & 2 (2000), for a description of the tax treatment of political organizations before Congress enacted § 527. The Senate Finance Committee appended § 527 to a bill to amend the Tariff Schedule of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty. See H.R. 421, 93d Cong. (1974); see also S.

directly in electioneering activities. A “political organization” can be “a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for any exempt function”⁵⁸ such as “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.”⁵⁹ The Treasury Regulations define a political organization in much the same way.⁶⁰

The burdens imposed on political organizations are generally less stringent than those imposed on social welfare organizations. In particular, contributions to political organizations are exempt from the Code’s gift tax.⁶¹ And, because Congress believed that only political parties and candidate committees would use section 527, the congressional reports associated with section 527 make no mention of a politi-

Rep. No. 93-1357, at 25-26 (1974), reprinted in 1974 U.S.C.C.A.N. 7478, 7501-02. Congressional debate over H.R. 421 fills a scant seven pages in the Congressional Record. 120 Cong. Rec. 41,815-22 (1974).

⁵⁸ I.R.C. § 527(e)(1).

⁵⁹ § 527(e)(2).

⁶⁰ Treas. Reg. § 1.527-2(a)(1) (as amended in 1985) (defining “political organization” as “a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures for an exempt function activity”). A political organization does not need to be established as a corporation, trust, association, or other legal entity to be eligible for exemption under § 527. See § 1.527-2(a)(2). When there are no formal organizational documents, consideration is given to statements of the members of the organization at the time the organization is formed that they intend to operate the organization primarily to carry on exempt-function activities. See § 1.527-2(a)(2)-(3) (outlining organizational and operational tests for “political organization” status).

The Treasury Regulations exempt a broad class of political activities, “includ[ing] all activities that are directly related to and support the process of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to public office or office in a political organization.” § 1.527-2(c)(1). To qualify as election-related, and therefore nontaxable, the activities need not involve a declared candidate or bear a close temporal relationship to an election: “An activity engaged in between elections which is directly related to, and supports, the process of selection, nomination, or election of an individual in the next applicable political campaign is an exempt function activity.” *Id.* Thus, the IRS is able to reach (and protect) a far broader range of political activity than the FECA is permitted to regulate at present. See *infra* Part II.A.

Not all political activities, however, qualify as § 527 exempt functions. Amounts used in connection with initiatives, referenda, or votes on constitutional amendments and other ballot measures generally will not qualify as exempt-function expenditures. S. Rep. No. 1357, at 27 (1974), reprinted in 1974 U.S.C.C.A.N. 7478, 7503; Tech. Adv. Mem. 92-44-003 (Apr. 15, 1992); Priv. Ltr. Rul. 80-01-061 (Oct. 12, 1979). Additionally, any amounts expended that inure to the benefit of a private individual, including a candidate for office, are not expended for an exempt function. § 1.527-5(a)(1). Finally, any illegal expenditures are not exempt-function expenditures. §§ 1.527-2(c)(4), 5(a)(2).

⁶¹ I.R.C. § 2501(a)(5) (exempting transfers of money or other property to political organizations for such organization’s use from gift tax).

cal organization's obligations under federal election law.⁶² Such silence suggests that legislators assumed that federal election law would cover all the political activity of section 527 organizations, and thus Congress did not need to discuss additional, independent disclosure requirements. This assumption by Congress finds support in language of the Senate committee report accompanying the legislation indicating Congress's belief that other tax-exempt organizations that were prohibited from campaigning would form section 527 organizations to carry out that function.⁶³ Under the law prior to 2000, therefore, political organizations did not have any reporting or disclosure requirements, other than a duty to annually report their net non-exempt function income (i.e., income from investment activities) if it exceeded \$100.⁶⁴

Correspondingly, the benefits given to political organizations under the Code are less. Indeed, to call a political organization a tax-exempt organization is something of a misnomer.⁶⁵ As one commentator has stated, "[m]ost aspects of Section 527 status relate more to

⁶² See Hill, *supra* note 3, at 390 ("One explanation for the minimal requirements for exemption under section 527 is that it was assumed that all section 527 organizations would be subject to the limitation under the FECA, which would have made further elaboration of limitations or positive requirements redundant." (footnote omitted)).

⁶³ According to the Senate Finance Committee Report:

The Committee expects that, generally, 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.

S. Rep. No. 93-1357, at 30 (1974), reprinted in 1974 U.S.C.C.A.N. 7478, 7506. Charities, however, may not escape the prohibition against participation or intervention in campaigns by forming an affiliated § 527. See Treas. Reg. § 1.527-6(f) (as amended in 1980) ("[A]n organization described in section 501(c) . . . may, if it is consistent with its exempt status, establish and maintain . . . a separate segregated fund to receive contributions and make expenditures in a political campaign . . ."); S. Rep. No. 93-1357, at 30 (1974), (noting that section 527 "is not intended to affect in any way the prohibition against certain exempt organizations (e.g., sec. 501(c)(3)) engaging in 'electioneering'"), reprinted in 1974 U.S.C.C.A.N. at 7506.

⁶⁴ Prior to 2000, a political organization was required to report any taxable income on Form 1120-POL. I.R.C. § 6012(a)(6) (1994); Treas. Reg. § 1.6012-6 (as amended in 1978). Organizations having less than \$100 in taxable income were exempt from making this filing. S. Rep. No. 93-1357, at 29 (1974), reprinted in 1974 U.S.C.C.A.N. at 7505. When required, Form 1120-POL had to be filed by the fifteenth day of the third month after the end of the political organization's taxable year. I.R.C. § 6072(b); Treas. Reg. § 1.527-8(c).

⁶⁵ According to the IRS, § 527 is not an elective provision. Field Serv. Adv. 2000-37-040 (Sept. 15, 2000). Whether an organization is a § 527 organization "is determined by whether it is in fact organized and operated in the manner described in § 527(e)." *Id.* Thus, § 527 differs from organizations exempt under § 501(a) in that groups wishing to avail themselves of that status generally must request recognition from the IRS. Although

the world of taxable organizations than to the tax-exempt sector.”⁶⁶ A political organization is generally subject to income tax as a corporation.⁶⁷ Except for revenues put toward those particular political activities specified under section 527,⁶⁸ most forms of income accruing to political organizations are taxable at the highest corporate rate.⁶⁹ Moreover, political organizations do not receive the additional exclusions from income taxation that section 501(c) nonprofits typically enjoy.⁷⁰ Additionally, the Code historically has treated contributions to political organizations as nondeductible, either by individuals or as business expenses.⁷¹ In short, “[a]ll that the enactment of Section 527 actually accomplished was to broaden slightly the definition of ‘exempt function income’ beyond gifts to cover other traditional revenues—i.e., dues, political-event proceeds, and bingo.”⁷²

B. Tax-Exempt Organizations and Federal Election Law

In addition to those obligations imposed by the Code, tax-exempt organizations that engage in any form of political advocacy also must comply with the dictates of federal election law as set out in the FECA.⁷³ Congress amended the FECA in 1974 in response to the campaign abuses disclosed in the aftermath of the Watergate scandal and the other reports of financial abuse in President Richard M.

the IRS has not yet sought to force organizations into § 527, it would create an interesting constitutional question that is beyond the scope of this Note.

⁶⁶ Gregory L. Colvin, *How Well Does the Tax Code Work in Regulating Politics?*, 12 *J. Tax'n Exempt Orgs.* 66, 68 (2000).

⁶⁷ See *id.* (“In essence, political organizations are taxable entities with a statutory carve-out for the customary methods of political fundraising that occur outside of the commercial realm.”).

⁶⁸ See § 1.527-3(a)(1) (defining “exempt function income” in terms of amounts received as monetary or property contributions, membership dues, or proceeds from entertainment event or sale of campaign materials); see also I.R.C. § 527(c)(3) (same).

⁶⁹ See § 527(b). The highest corporate rate bracket as of this writing is thirty-five percent. See § 11(b) (determining corporate tax rate).

⁷⁰ See Colvin, *supra* note 66, at 68 (“Section 527 entities are taxable not only on their investment income, but also their unrelated business income without any exceptions, modifications, or exclusions.”).

⁷¹ See, e.g., § 162(e) (restricting deductibility of lobbying expenses related to taxpayer’s trade or business); § 271 (denying any deduction for worthless debts owed by political parties); § 276 (denying any deduction for certain indirect political contributions, principally advertising in convention programs, tickets for dinners and programs, and inaugural events).

⁷² Colvin, *supra* note 66, at 68.

⁷³ FECA of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1972) (codified as amended at 2 U.S.C. §§ 431-455 (2001)).

Nixon's 1972 presidential reelection campaign.⁷⁴ The 1974 amendments capped an individual's campaign contributions to a candidate to \$1000 for a single election (provided that no one person could contribute more than \$25,000 in any election cycle);⁷⁵ prescribed limits for spending by candidates and political parties;⁷⁶ and limited an individual's expenditures "relative to a clearly identified candidate" to \$1000 per year.⁷⁷

Furthermore, the 1974 amendments strengthened the FECA's disclosure provisions. The 1974 amendments required "[e]very person (other than a political committee or candidate) who makes contributions or expenditures, other than by contribution to a political committee or candidate . . . [to] file . . . a statement containing the [same] information" required of political committees and candidates.⁷⁸ The amendments also broadened the definitions of "contribution" and "expenditure" to include anything of value made for the purpose of influencing the nomination for election, or the election of, any person to federal office.⁷⁹

II

THE ATMOSPHERE FOR REFORM LEGISLATION

This Part will discuss how tax-exempt organizations came to participate significantly in political campaigns. There exists incongruence in what political activity is regulated under campaign-finance laws and what is regulated for tax-exempt organizations under the Code. Section A discusses how this disjuncture has made nonprofits increasingly attractive for electioneering purposes. Section B then describes how, in particular, nonprofits organized under section 527, the so-called "stealth PACs," became a popular vehicle for tax-exempt organizations to engage in political activity while shielding themselves from the FECA's disclosure requirements. Section C explains both the

⁷⁴ For a review of the Watergate scandal and the financial improprieties of the 1972 Nixon presidential campaign, see Herbert E. Alexander, *Financing the 1972 Election* 39-76 (1976).

⁷⁵ FECA Amendments of 1974, Pub. L. No. 93-443, § 101(a), 88 Stat. 1263, 1263 (codified as amended at 2 U.S.C. § 441a(a)(1)-(3) (2001)).

⁷⁶ § 101(a), 88 Stat. at 1264, repealed by FECA Amendments of 1976, Pub. L. No. 94-283, § 202(a), 90 Stat. 475, 496.

⁷⁷ § 101(a), 88 Stat. at 1265, repealed by FECA Amendments of 1976, § 202(a), 90 Stat. at 496.

⁷⁸ § 204(c), 88 Stat. at 1278 (codified as amended at 2 U.S.C. § 434(c) (2001)), amended by FECA Amendments of 1976, Pub. L. No. 94-283, § 104(d), 90 Stat. at 481.

⁷⁹ §§ 201(a)(4), (5), 88 Stat. at 1272-73 (codified as amended at 2 U.S.C. §§ 431(8), (9) (2001)).

steps Congress took to address the problem and the legal problems that remain.

A. Differing Standards

Campaign-finance law currently addresses only a subset of political activity that the Code permits as an “exempt purpose” under section 527.⁸⁰ The narrower focus of campaign-finance law is a result of the law’s scope—it is limited to *federal* election activity—and the line drawn by the Supreme Court between conduct that Congress can and cannot constitutionally regulate under the FECA. The Court, in the landmark decision of *Buckley v. Valeo*,⁸¹ held that only activity that constitutes “express advocacy” may be regulated; all other political activity is protected under the First Amendment.⁸²

“Express advocacy,” according to the *Buckley* Court, amounts to those “communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office.”⁸³ The Court tried to give further guidance by noting that, “[s]o long as persons and groups eschew expenditures that in express terms advocate the election or defeat of a clearly identified candidate, they are free to spend as much as they want to promote the candidate and his views.”⁸⁴ Furthermore, in a footnote that has become famous throughout the campaign-finance literature, the Court gave several examples of magic words that would trigger advocacy that could constitutionally be regulated: “‘vote for,’ ‘elect,’ ‘support,’ ‘cast your ballot for,’ ‘Smith for Congress,’ ‘vote against,’ ‘defeat,’ [or] ‘reject.’”⁸⁵

⁸⁰ Compare I.R.C. § 527(e)(1) (2001) (defining political organization as incorporated or unincorporated organization, committee, association, or fund), § 527(e)(2) (describing exempt function as “influencing or attempting to influence the . . . election . . . of any individual to any . . . public office”), and Treas. Reg. § 1.527-2(c)(1) (as amended in 1985) (noting that § 527 covers expenditures in support of individual who is not, and who never becomes, declared candidate), with 2 U.S.C. § 431(4) (defining political committee as unincorporated group of persons, committee, club, or association, separate segregated fund, or local committee of political party), § 431(9)(A)(i) (defining expenditure under FECA as “anything of value, made by any person for the purpose of influencing any election for Federal office”), and *FEC v. Fla. for Kennedy Comm.*, 681 F.2d 1281, 1287-88 (11th Cir. 1982) (holding that unauthorized group seeking to draft candidate is not “political committee” within FECA).

⁸¹ 424 U.S. 1 (1976) (per curiam).

⁸² U.S. Const. amend. I (“Congress shall make no law . . . abridging the freedom of speech . . . or the right of the people peaceably to assemble . . .”); see also *Buckley*, 424 U.S. at 39-59 (holding that FECA’s independent expenditure ceiling, its limitation on candidates’ expenditures from own personal funds, and its ceilings on overall expenditures violate First Amendment since they place direct and substantial restrictions on ability of candidates, citizens, and associations to engage in protected political expression).

⁸³ *Buckley*, 424 U.S. at 44.

⁸⁴ *Id.* at 45.

⁸⁵ *Id.* at 44 n.52.

Political speech that does not fall within this definition of express advocacy, according to the Court, cannot constitutionally be regulated by Congress.⁸⁶

While it is clear that advertisements using the “magic words” constitute express advocacy, the precise line between what constitutes express advocacy and issue advocacy is blurry at best.⁸⁷ For the purpose

⁸⁶ The Court did not even deem the interest in preventing actual or apparent corruption of candidates as adequate to justify regulation of issue advocacy. The Court rejected this interest even though it was recognized that issue advocacy could potentially be abused to obtain improper benefits from candidates. *Id.* at 45-47; see also *id.* at 80 (holding that regulations seeking to regulate more than explicit words of advocacy of election or defeat of clearly identified candidates are “impermissibly broad” under First Amendment).

The line separating “express” from “issue” advocacy is a subject of ongoing judicial debate. Compare *Furgatch*, 807 F.2d 857, 864 (9th Cir. 1987) (holding that implied meaning of advertisement can form basis to find express advocacy), with *Faucher v. FEC*, 928 F.2d 468, 470-71 (1st Cir. 1991) (adopting *Buckley*’s bright-line express advocacy test).

Although the FEC has adopted regulations defining express advocacy consistent both with *Buckley*’s express advocacy test, 11 C.F.R. § 100.22(a) (2001) as well as a “reasonable person” standard, § 100.22(b), the vast majority of appellate courts have required express words of advocacy before allowing government regulation of speech. See, e.g., *Citizens for Responsible Gov’t State PAC v. Davidson*, 236 F.3d 1174, 1187 (10th Cir. 2000); *Vt. Right to Life Comm. v. Sorrell*, 221 F.3d 376, 386 (2d Cir. 2000); *Iowa Right to Life Comm. v. Williams*, 187 F.3d 963, 969-70 (8th Cir. 1999); *Brownsburg Area Patrons Affecting Change v. Baldwin*, 137 F.3d 503, 505-06 (7th Cir. 1998); *Faucher*, 928 F.2d at 471-72; *Fla. Right to Life v. Mortham*, No. 98-770-CIV-ORL-19A, 1998 WL 1735137, at *3 n.5, *4 n.8 (M.D. Fla. Sep. 30, 1998), *aff’d per curiam sub nom.*, *Fla. Right to Life v. Lamar*, 238 F.3d 1288, 1289 (11th Cir. 2001).

The Ninth Circuit is the sole exception: In contrast to all other circuits, it has held that a court can find express advocacy without any of the words listed in *Buckley*, so long as the speech, “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.” *Furgatch*, 807 F.2d at 864; *State ex rel. Crumpton v. Keisling*, 982 P.2d 3, 10-11 (Or. Ct. App. 1999) (requiring disclosure under state law analogous to FECA for ads meeting a definition “somewhat less restrictive” than in *Furgatch*, in part because of absence of criminal penalties), review denied, 994 P.2d 132 (Or. 2000).

⁸⁷ In an indirect admission that the express advocacy standard might be confusing in practice, the Court noted that

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.

Buckley, 424 U.S. at 42.

For a discussion of the distinction between express advocacy and issue advocacy, see generally Lillian R. BeVier, *The Issue of Issue Advocacy: An Economic, Political, and Constitutional Analysis*, 85 Va. L. Rev. 1761, 1766-71 (1999) (discussing *Buckley* decision and emerging “define-and-regulate” strategies); Richard Briffault, *Issue Advocacy: Redrawing the Elections/Politics Line*, 77 Tex. L. Rev. 1751, 1756-63 (1999) (comparing majority view of very restrictive definitions of express advocacy with minority view of mostly broadening definition of express advocacy); Anthony Corrado, *On the Issue of Issue Advocacy: A Comment*, 85 Va. L. Rev. 1803, 1807-09 (1999) (describing “absurdity” of

of this Note, it is only important to be aware that there exists a species of political activity, issue advocacy, which Congress cannot directly regulate.⁸⁸ By contrast, as the following discussion demonstrates, under the Code, the IRS may reach a broader range of political activity to both promote and prohibit such conduct by tax-exempt organizations.

The Code addresses political campaign activity in two places—section 501(c)(3) and section 527. Section 501(c)(3) expressly prohibits charities from participating or intervening in any political campaign.⁸⁹ In evaluating whether a particular activity constitutes verboten “political activity” for section 501(c)(3) organizations, the IRS does not invoke the “express advocacy” standard used under federal election law. Instead, the agency’s more liberal test asks whether support for, or opposition to, a candidate is indicated by a particular label used as a stand-in for a candidate. In applying this test, which looks at all the facts and circumstances surrounding political activity, the IRS has ruled that even “jargon and catch phrases contained in an organization’s fund raising letters may demonstrate evidence of bias and constitute improper political campaign intervention, even if . . . contributions received in response to the letters were used only to finance nonpartisan, educational activities.”⁹⁰

The IRS also applies this broader definition of political activity to section 527 organizations but to different ends. Whereas the IRS’s definition tells section 501(c)(3) organizations what they cannot do, it instructs section 527 organizations as to what they can do. More specifically, it gives further guidance as to the “exempt functions” a section 527 organization may carry out tax free.⁹¹

Although the Supreme Court has not had occasion to rule on the constitutionality of the IRS’s practice, precedent appears to support it. The Court, in *Regan v. Taxation With Representation*,⁹² took the posi-

narrow “magic words” distinction in practice and detrimental effects of current law regarding issue advocacy with respect to accountability of electoral system and competence of electorate).

⁸⁸ The Court reaffirmed *Buckley*’s “express advocacy” standard in *Nixon v. Shrink Montana Government PAC*, 528 U.S. 377 (2000).

⁸⁹ I.R.C. § 501(c)(3) (2001). See supra notes 37-40 and accompanying text (discussing extent of § 501(c)(3) prohibition).

⁹⁰ Priv. Ltr. Rul. 2000-44-038 (July 24, 2000).

⁹¹ See supra notes 58-59 and accompanying text (defining “exempt function” for purposes of § 527).

⁹² 461 U.S. 540 (1983). In *Taxation With Representation*, Taxpayers for Representation of Washington (TRW), a group organized to represent the taxpayer’s public interest in Washington D.C., was denied § 501(c)(3) status because it proposed to engage in substantial lobbying activities. *Id.* at 541-42. TRW argued that affording tax deductible contributions to the substantial lobbying activities of veterans groups electing exemption from tax

tion that a conditional tax exemption constitutes a form of government subsidy, and that Congress only is required to act rationally when it decides which activities it chooses to subsidize.⁹³ Only when the government denies access to a tax subsidy simply because the taxpayer engages in speech is the scrutiny of the First Amendment invoked.⁹⁴ The Court rejected the “‘notion that First Amendment activities are not fully realized unless they are subsidized by the State.’”⁹⁵

Congress’s decisions about conditioning tax exemptions and deductions, therefore, essentially appear to be spending decisions, over which Congress has wide latitude:⁹⁶

Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual’s contributions.⁹⁷

Concurring, Justice Blackmun, joined by Justices Brennan and Marshall, took the position that the lobbying restrictions imposed on section 501(c)(3) groups did not infringe impermissibly upon TRW’s First Amendment freedoms. Standing alone, noted Justice Blackmun, “[s]ection 501(c)(3) does not merely deny a subsidy for lobbying activities . . . [.] it deprives an otherwise eligible organization of its tax-exempt status and its eligibility to receive tax-deductible contributions for all its activities, whenever one of those activities is ‘substantial lob-

under § 501(c)(19), which are allowed to engage in substantial lobbying activities at state or federal levels, while denying such benefits to charitable organizations involved in similar activities, was unconstitutional discrimination. *Id.* at 546-49.

⁹³ Writing for the Court, then-Justice William H. Rehnquist held

The Code does not deny TWR the right to receive deductible contributions to support its non-lobbying 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.

Id. at 545.

⁹⁴ See, e.g., *Perry v. Sindermann*, 408 U.S. 593, 597 (1972) (“[I]f the government could deny a benefit to a person because of his constitutionally protected speech or associations, his exercise of those freedoms would in effect be penalized and inhibited.”); *Speiser v. Randall*, 357 U.S. 513, 518 (1958) (“[T]o deny an exemption to claimants who engage in certain forms of speech is in effect to penalize them for such speech.”).

⁹⁵ *Taxation With Representation*, 461 U.S. at 546 (quoting *Cammarano v. United States*, 358 U.S. 498, 515 (1959) (Douglas, J., concurring) (citation omitted)).

⁹⁶ Cf. *Bob Jones Univ. v. United States*, 461 U.S. 574, 595 (1983) (upholding IRS interpretation of § 170 and § 501(c)(3) that racial discrimination is “wholly incompatible with the concepts underlying tax exemption”).

⁹⁷ *Taxation With Representation*, 461 U.S. at 544.

bying.”⁹⁸ Section 501(c)(3), however, was saved by the fact that a section 501(c)(3) group could form a section 501(c)(4) affiliate to conduct substantial lobbying.⁹⁹ “Should the IRS attempt to limit the control these organizations exercise over the lobbying of their § 501(c)(4) affiliates,” Justice Blackmun wrote, “the First Amendment problems would be insurmountable.”¹⁰⁰

The fact that section 527 organizations may reap tax benefits from engaging in conduct that, in a *Buckley* world, federal election law cannot regulate creates an incentive to use nonprofit organizations to conduct “express advocacy” on the local or state level because the Federal Election Commission (FEC), the agency responsible for enforcing the FECA, may only regulate such expenditures for federal campaigns.¹⁰¹ An inducement even is created, albeit to a lesser extent, for political parties and interest groups to use section 501(c)(3) organizations, which may engage in election-related activity so long as the organizations’ activities do not cross the hazy threshold above which campaign participation becomes a “substantial part of [their] activities.”¹⁰²

B. Expansive Interpretation of Section 527 and the Rise of “Stealth PACs”

Available empirical data suggest that political parties and interest groups took full advantage of this legal loophole.¹⁰³ According to a study by the Annenberg Public Policy Center, in the 1998 election, at least seventy-seven organizations spent an estimated \$275 to \$340 million on 423 issue advertisements broadcast via television or radio, more than twice the estimated spending by the twenty-seven organizations that engaged in this practice during the 1996 election.¹⁰⁴ While

⁹⁸ *Id.* at 552 (Blackmun, J., concurring); see also *id.* at 545 (“[T]he government may not deny a benefit to a person because he exercises a constitutional right.”).

⁹⁹ *Id.* at 552-53 (Blackmun, J., concurring).

¹⁰⁰ *Id.* at 553 (Blackmun, J., concurring).

¹⁰¹ See *supra* note 80 (noting limited reach of FECA into federal electioneering only).

¹⁰² I.R.C. § 501(c)(3) (2001); see also *supra* notes 37-43 and accompanying text (describing contours of § 501(c)(3)’s prohibitions).

¹⁰³ See Andrew B. Kratenstein, Recent Legislation: Campaign Finance Reform, 36 *Harv. J. on Legis.* 219, 221-22 (1999) (“Independent groups such as the AFL-CIO, the National Rifle Association, the Sierra Club, and the Christian Action Network climbed aboard to spend collectively an estimated \$2.2 billion [during the 1996 campaign cycle] without having to report a dime under federal law.”).

¹⁰⁴ Jeffrey D. Stanger & Douglas G. Rivlin, Annenberg Pub. Policy Ctr., Issue Advocacy During the 1997-1998 Election Cycle (1998), <http://www.appcpenn.org/issueads/REPORT.HTM>. The study also found that sixty-one percent of the ads asked the audience member to “call” or “tell” something to an elected official or candidate, about sixteen percent urged a call to the advocacy organization to obtain more information on an issue, and over eighteen percent contained no call to action. *Id.*

these interest groups took advantage of their section 501(c) status, others investigated different options, including section 527.¹⁰⁵

Beginning in 1996, the IRS issued several private letter rulings¹⁰⁶ delineating what these tax-exempt organizations could do without triggering FECA obligations that apply to “express advocacy.”¹⁰⁷ The organizations wanted to engage in “voter education activities” intended to influence the outcome of an election, but they did not plan to expressly advocate the election of a particular candidate. After canvassing section 527, its regulations, and the major interpretative rulings, the IRS concluded that the activities were political under the Code and therefore entitled to tax exemption, but failed to rise to the level of “express advocacy” under the FECA.¹⁰⁸ Of particular significance to the IRS decision was that the FEC regulations permitted the preparation, publication, and distribution of congressional voting records and voter guides on elected federal officials and candidates.¹⁰⁹

It did not take long for section 527 organizations to attract congressional attention. On January 28, 2000, the Staff of the Joint Committee on Taxation released a three-volume report analyzing taxpayer confidentiality and disclosure under the Code.¹¹⁰ The Joint Committee recommended that section 527 organizations be required to disclose to the IRS and the public far more information about its activities and funding than required under the Code.¹¹¹ The Joint Committee justified its recommendations by pointing to the fact that,

¹⁰⁵ See Hill, *supra* note 3, at 389 (“The widespread use of section 501(c)(4) organizations as campaign-finance vehicles in the 1996 election established that deductibility of political contributions by directing political money through section 501(c)(3) would be sacrificed, if necessary, to the goal of avoiding FEC limitations and reporting.” (internal footnotes omitted)); see also Richard Briffault, *The Political Parties and Campaign Finance Reform*, 100 *Colum. L. Rev.* 620, 630-31 (2000) (noting that 390 individuals or organizations donated \$100,000 or more each in 1997-1998).

¹⁰⁶ For a brief explanation of private letter rulings, see *supra* note 7.

¹⁰⁷ See *Priv. Ltr. Rul.* 99-25-051 (Mar. 29, 1999); *Priv. Ltr. Rul.* 98-08-037 (Nov. 21, 1997); *Priv. Ltr. Rul.* 97-25-036 (Mar. 24, 1997); *Priv. Ltr. Rul.* 96-52-026 (Oct. 1, 1996).

¹⁰⁸ For an excellent analysis of the private letter rulings and other legal developments that created the “stealth PAC” phenomenon, see generally Hill, *supra* note 3, at 390-94.

¹⁰⁹ See 11 *C.F.R.* §§ 114.4(c)(4), (c)(5) (2001).

¹¹⁰ See generally 1-3 *Joint Committee on Taxation, Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998* (2000) [hereinafter *Joint Committee Study*].

¹¹¹ According to the Joint Committee:

The Joint Committee staff believes that the special status accorded to section 527 political organizations under present law justifies this disclosure. The Joint Committee staff believes it is in the public’s interest to receive information concerning the activities of such organizations, particularly because the Federal election law disclosure requirements do not apply to some section 527 political organizations.

2 *id.* at 95; see also *supra* note 64 (describing § 527 filing requirements under prior law).

because these organizations agreed to refrain from express advocacy, they would not be subject to the disclosure obligations under the FECA.¹¹² Since the Code contained no requirements for section 527 organizations to publicly disclose any information regarding their activities, the organizations' political activity could be paid for with corporate money, from unlimited donations or foreign sources, and without any disclosure of the contributions received and expenditures made.¹¹³

The organizations also picked up some attention from citizen watchdog groups and the press. On April 7, 2000, Common Cause released a report recommending that all section 527 organizations be required to register as political committees with the FEC, and that, at a minimum, Congress require disclosure of each section 527 organization's existence, officers, and major contributors.¹¹⁴ A *New York Times* article published in March of 2000 stated that "[s]ection 527 has become the loophole of choice this year for groups large and small, left and right, to spread their messages without revealing the sources of their income or the objects of their spending."¹¹⁵ Among the groups discussed in the article was "Republicans for Clean Air," a section 527 organization established by Sam Wyly, which ran several broadcast advertisements critical of Senator John McCain in key states during the Republican presidential primaries.¹¹⁶

Another article published in *Newsweek* gave examples of Republicans and Democrats alike being upset over attack ads by tax-exempt groups with nebulous and elusive names like "Americans for Job Security," "Shape the Debate," or the "Coalition to Protect Americans Now."¹¹⁷ The author of the *Newsweek* article remarked that "these groups [took] advantage of loopholes in the campaign and tax laws that allow them to legally raise millions from individuals and corpora-

¹¹² Joint Committee Study, *supra* note 110, at 95.

¹¹³ Hill, *supra* note 3 at 378-88.

¹¹⁴ Common Cause, Under the Radar: The Attack of the "Stealth PACs" on Our Nation's Elections 6, <http://www.commoncause.org/publications/utr/stealth.pdf> (last visited Aug. 18, 2002).

¹¹⁵ John M. Broder & Raymond Bonner, A Political Voice, Without Strings, *N.Y. Times*, Mar. 29, 2000, at A1.

¹¹⁶ See *id.*; see also *supra* note 10 (describing reports of "Republicans for Clean Air"). Senator McCain, appearing on Meet the Press on April 2, 2000, after conceding the primary to then-Governor George W. Bush, spoke out against the advertisements ran by Sam Wyly and other § 527 organizations. "It took a very zealous and professional media to uncover that the Wyl[y] brothers were the ones who actually paid for [the advertisements]. Unfortunately, that's not the case in many other campaigns [W]e've got to start with full disclosure" Meet the Press (NBC television broadcast, Apr. 2, 2000), LEXIS, News Library, Transcripts file.

¹¹⁷ Michael Isikoff, The Secret Money Chase, *Newsweek*, June 5, 2000, at 22, 23-24.

tions for openly partisan purposes—without revealing where the money [came] from.”¹¹⁸ According to the author, “[a]bout two dozen” such groups were in existence at the time.¹¹⁹

C. Closing the Loophole

The increasing use of section 527 to avoid the FECA, particularly its disclosure provisions, ultimately proved to be too much for Congress.¹²⁰ In a process that began on June 8, 2000, and ended July 1, 2000, Congress added Subsections 527(i) and 527(j) to the Code.¹²¹ These two new subsections require section 527 political organizations to register and disclose their contributions and expenditures. Through political maneuvering, this solution was enacted in lieu of the one suggested by The House Ways and Means Subcommittee on Oversight. Believing that “the use of tax-exempt organizations generally to engage in political activities is substantial and increasing,”¹²² the Committee had recommended the passage of a bill that would have

¹¹⁸ *Id.* at 23.

¹¹⁹ *Id.*

¹²⁰ See 146 Cong. Rec. H2018 (daily ed. Apr. 11, 2000) (remarks of Rep. Doggett) ([A] 527 is not a bird or some new model of aircraft, but it is the Superman or super weapon of this political season [T]hese new political groups can spew out hate over the airwaves and fill our mailboxes with misinformation. These new political groups can take unlimited amounts of money, and they can take unlimited amounts of foreign money. The Iraqis, the Cubans, the Chinese can pour money into these secret Swiss accounts of the political season and use it to spew out more hate over the airwaves.);

Id. at H5287 (daily ed. June 27, 2000) (remarks of Rep. Barrett) (“Sincere advocates of campaign-finance reform have named 527 organizations Public Enemy number One—and with good reason. 527s illustrate everything that has gone wrong in America’s political campaign financing system.”); *id.* at S6047 (daily ed. June 29, 2000) (remarks of Sen. Lieberman) (“Individuals, corporations, and associations can give unlimited amounts to 527 organizations, and those contributions are absolutely secret, unknown to the public. The contributors then audaciously enjoy a tax benefit for those contributions.”).

¹²¹ Pub. L. No. 106-230, 114 Stat. 477 (2000). An almost identical version of this law was introduced in the Senate as an amendment to the Department of Defense authorization bill in early June 2000. 146 Cong. Rec. S4715 (daily ed. June 7, 2000) (proposing Amendment No. 3214 to S. 2549, 106th Cong. (2000)). The main difference between this bill and the law eventually passed was that the earlier version would have eliminated the tax exemption of a non-disclosing political organization rather than imposing a penalty under § 527(j). *Id.* at S6047 (daily ed. June 29, 2000) (statement of Sen. Reed).

The measure was abandoned due to concerns that, at least technically, the amendment should originate in the House of Representatives as a revenue measure. *Id.* at S4782 (daily ed. June 8, 2000) (statement of Sen. Levin). Ironically, however, the Congressional Record is replete with references not to revenue raising, but to campaign-finance reform. See, e.g., *id.* at S4778 (daily ed. June 8, 2000) (statement of Sen. Lieberman) (“This is about political freedom, about electoral reform, about disclosure to the public. It is hardly at all, if at all, a revenue measure.”); *id.* at S6046 (daily ed. June 29, 2000) (statement of Sen. McCain) (“This is a vote for campaign finance reform.”).

¹²² H.R. Rep. No. 106-702, at 13 (2000).

required substantial disclosure not only from section 527 organizations but also other categories of nonprofits.¹²³ Prior to presenting that proposed disclosure bill to the House for a vote, however, the substitute bill, applying limited disclosure only to section 527 organizations, was submitted in its place.¹²⁴

1. Notice and Reporting Requirements

The section 527 disclosure legislation creates two new obligations for political organizations: notice and reporting. First, Subsection 527(i) requires written and electronic notice to the IRS within twenty-four hours after formation of any organization that intends to be treated as a section 527 political organization.¹²⁵ Contributions to any

¹²³ During the House Subcommittee hearings, a number of those testifying expressed concern that reform of § 527 should focus on the activity sought to be curbed, i.e., partisan advertising masquerading as issue advocacy. See Disclosure of Political Activities of Tax-Exempt Organizations: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 106th Cong. 17 (2000) [hereinafter Hearing on Disclosure of Political Activities of Tax-Exempt Organizations] (statement of Rep. Michael N. Castle) (“If reform focuses only on the 527 designation, these groups may shift to another tax designation and continue to pay for campaign ads while avoiding the current inadequate federal disclosure requirements.”); *id.* at 4 (statement of House Oversight Chairman Rep. Amo Houghton) (“[W]hen 501(c) groups intervene in the political process, they also should disclose what they are doing and who is paying.”); *id.* at 63 (statement of Glenn J. Maramarco, Senior Attorney, Brennan Center for Justice, New York University School of Law) (“In my view, public disclosure should not turn on whether a group is registered as a 501(c)(4), (c)(5), or (c)(6) organization; rather it should turn on the specific activities in which the group is engaged.”). The Subcommittee report, generally, was in accord with these views:

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 organization 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.

H.R. Rep. No. 106-702, at 13-14 (2000). Given the tax benefits provided to political organizations, social welfare organizations, labor unions, and business associations, the House Subcommittee determined that “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.” *Id.* at 14. Further, the report justified disclosure by arguing that “[p]ublic disclosure of information enables the general public to provide oversight of the political activities of these organizations.” *Id.*

¹²⁴ H.R. 4762 was introduced in the House of Representatives and was passed, late in the evening, under suspension of the rules, on June 27, 2000. 146 Cong. Rec. H5282-90 (daily ed. June 27, 2000). The bill passed the Senate without amendment on June 29, 2000, *id.* at S6041-47 (daily ed. June 29, 2000), and was signed by the President on July 1, 2000. The bill was not reported by any committee of the House of Representatives or the Senate. The bill, therefore, does not have any formal legislative history.

¹²⁵ I.R.C. § 527(i) (2001).

organization that fails to file the required notice become immediately taxable until such notice is given.¹²⁶

Second, Subsection 527(j) requires covered organizations to make periodic reports disclosing recipients of political expenditures of \$500 or more, including the occupation and employer of individuals to whom payment is made.¹²⁷ Subsection 527(j) also requires covered organizations to disclose the name and address of contributors of \$200 or more, along with the occupation and employer of individual contributors.¹²⁸ For purposes of triggering disclosure, the statute provides that “a person shall be treated as having made an expenditure or contribution if the person has contracted or is otherwise obligated to make the expenditure or contribution.”¹²⁹ Failure to act in accordance with the requirements of section 527(j) subjects the noncomplying political organization to a penalty¹³⁰ “equal to the rate of tax specified in subsection (b)(1) multiplied by the amount to which the failure relates.”¹³¹

2. Exemptions from These Notice and Reporting Requirements

The notice and reporting requirements do not apply to any political organization that reasonably anticipates gross receipts of less than \$25,000 for any taxable year.¹³² Additionally, nonprofits organized under other sections of the Code generally are not affected.¹³³

The law also exempts political organizations that are otherwise required to report political expenditures under the FECA.¹³⁴ Political

¹²⁶ § 527(i)(4).

¹²⁷ § 527(j)(3)(A).

¹²⁸ § 527(j)(3)(B).

¹²⁹ § 527(j)(4).

¹³⁰ In *Republican Assemblies I*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001), the district court noted that the subsection heading of § 527(i) and (j) refers to this exaction as a “penalty.” In considering the government’s motion to dismiss, the district court noted that the Code’s Anti-Injunction Act, I.R.C. § 7421 (2001) and the Declaratory Judgment Act, 28 U.S.C. § 2201 (2001), did not bar the plaintiff’s challenge to the disclosure requirements of § 527(j), as the thirty-five percent tax on income imposed upon organizations that fail to disclose requisite information constituted a penalty rather than a tax. *Republican Assemblies I*, 148 F. Supp. 2d at 1277 n.4, 1283.

¹³¹ § 527(j)(1). “This can result in a double taxation. If an organization fails to report a contribution, and then fails to report the expenditure funded by that contribution, it will owe tax both on the amount of the contribution and on the amount of the expenditure.” *Owens & Mayer*, supra note 57, at 98.

¹³² § 527(j)(5)(C).

¹³³ A § 501(c) organization can fall under § 527 if it (1) is subject to taxation under § 527(f), see supra note 52, or (2) maintains a separate segregated fund within the meaning of § 527(f)(3). A separate segregated fund of a § 501(c) organization is treated as a separate § 527 organization and thus would be subject to the notice and reporting requirements, although the § 501(c) organization itself would not be.

¹³⁴ § 527(j)(5)(A).

committees of a state or local candidate, including political committees of state or local officeholders, are not required to file the periodic disclosures, but they are required to comply with the notice requirements.¹³⁵

Organizations subject to either the notice or the reporting requirements, or both, must make these filings periodically according to a calendar that is keyed to federal election years, regardless of whether the regulated organization participates in federal elections.¹³⁶

III

RE-EXAMINING THE SECTION 527 DISCLOSURE REGIME

The section 527 disclosure legislation, meant to deal with the funding and spending of organizations engaged in political activity not subject to the disclosure provisions of the FECA, is unlikely to adequately address the problem for a number of reasons. First, section 527 is only one avenue under the Code that an interest group can take to obtain tax benefits while engaging in election-related issue advocacy. Some tax-exempt organizations, therefore, can shift activities to a non-section 527 nonprofit to avoid disclosure obligations.¹³⁷

¹³⁵ Compare § 527(j)(5)(B) (exempting state and local political committees from disclosure requirements), with § 527(i)(5) (making no mention of exemption for notice requirement) and Rev. Rul. 2000-49, 2000-2 I.R.B. 430, 430 (reiterating IRS's position that § 527 does not exempt state and local political organizations from notice requirement).

¹³⁶ § 527(j)(2), (3); see also, e.g., § 6012(a)(6) (requiring § 527 organizations to file tax return); § 6104(a)(1)(A) (providing for public inspection of application for exemption "together with any papers submitted in support of such application or notice, and any letter or other document issued by the [IRS] with respect to such application or notice"); § 6104(b) (providing for public inspection of tax returns); I.R.C. § 6033(g) (detailing information to be included in tax return).

¹³⁷ *Supra* note 29 (predicting shift from § 527 to § 501(c) status); see also *supra* Parts I.A.1, I.A.2 (describing limits on political participation by charities and social welfare organizations). But see Schmidt, *supra* note 9 (discussing interview with election lawyer and former head of FEC enforcement Kenneth A. Gross as stating that new law will reveal some previously unknown political activity because not all groups will seek to change status); Josh Goldstein, *New Law Shows Vote Ad Donors; Groups Seek Loophole for 'Stealth' Backers*, *Pittsburgh Post-Gazette*, Aug. 20, 2000, at A-8 ("While the law has ensnared many who are were [sic] arguably not the concern of this legislation, it has left on the table possibly millions of dollars of political activity that the reformers are still interested in seeing." (quoting Kenneth A. Gross)).

Although the enforcement regime has been rather ineffectual, see *infra* notes 139-143, the IRS appears to have taken the stance that the obligations imposed by § 527 may not be escaped so easily. See *supra* note 65 (noting IRS's position that § 527 is not elective provision); see also Kenneth P. Doyle, *Political Organizations May Not Qualify for 501(c)(4) Status*, *IRS Official Says*, *Daily Tax Rep. (BNA)*, Nov. 29, 2001, at G-4 (observing that political organization "could face heavy penalties if it tries to avoid disclosure requirements by organizing as a social welfare organization under Section 501(c)(4) of the tax code"). But see *id.* (noting that in January 2001 IRS approved CBM's application for

Second, the section 527 disclosure legislation only impacts disclosure of those political organizations that value nontaxable contributions more than anonymity. Some groups, therefore, may still keep their electioneering anonymous by eschewing the benefits of non-profit status altogether. In fact, many interest groups relinquish valuable tax subsidies in order to realize the opportunity of playing a larger role in campaigns.¹³⁸

Third, according to a recent government study of the disclosure law's first two years, the

IRS's oversight of Section 527 organizations' compliance with the law's filing and reporting requirements has been very limited and has included checks on whether some of the reported data is correct and little proactive effort to determine whether all filings are timely and all organizations that should file have done so.¹³⁹

The IRS audits less than one percent of nonprofit organizations every year,¹⁴⁰ and, until recently, there were many indications that the IRS had become less aggressive in its scrutiny of potential tax abuses.¹⁴¹

§ 501(c)(4) status, despite fact that CBM was most prominent "stealth PAC" noted by reformers).

¹³⁸ Hill, *supra* note 3, at 389 ("The widespread use of section 501(c)(4) organizations as campaign finance vehicles in the 1996 election established that deductibility of political contributions . . . would be sacrificed, if necessary, to the goal of avoiding FEC limitations and reporting." (footnote omitted)).

¹³⁹ U.S. Gen. Accounting Office, Report to the Honorable Bill Thomas, Chairman, Committee on Ways and Means, House of Representatives, Political Organizations: Data Disclosure and IRS's Oversight of Organizations Should Be Improved, 14 (2002), <http://www.gao.gov/new.items/d02444.pdf> [hereinafter GAO Report].

¹⁴⁰ In 2000, the IRS processed 872,210 exempt organization returns. Of those, revenue agents examined only 2642 of them. 2001 Data Book, *supra* note 31, at 20 tbls.14 & 15; see also GAO Report, *supra* note 139, at 18 ("Between July 2000 and March 2002, IRS only audited [section 527 organizations] in two situations—as part of an investigation of an allegation submitted to IRS or an audit of other tax-exempt organizations during which a Section 527 issue arose."); David Cay Johnston, Rate of All IRS Audits Falls; Poor Face Particular Scrutiny, *N.Y. Times*, Feb. 16, 2001, at A1. Despite the concerns of hidden corruption that prompted Congress to enact the § 527 disclosure legislation, the IRS examined only seven returns of political organizations in 2001. See 2001 Data Book, *supra* note 31, at 20 tbl.15.

¹⁴¹ From 1995 to 2001, the IRS revoked the tax-exempt status of only 188 exempt organizations total, and only 114 charities and 45 social welfare organizations in particular. See GAO Report, *supra* note 139, at 52 tbl.9; cf. David Cay Johnston, Affluent Avoid Scrutiny on Taxes Even as IRS Warns of Cheating, *N.Y. Times*, Apr. 7, 2002, at A1 ("The government looks for tax cheating by wage earners far more carefully than it looks for cheating by people whose money comes from their own businesses, investments, partnerships and trusts," despite fact that "cheating is becoming far more common among affluent Americans"); Mark O'Keefe, Cheating the IRS: Americans Do It to the Tune of \$195 Billion Per Year, *Dallas Morning News*, Apr. 8, 2001, at J1 (stating that average American's chance of being audited by IRS has dropped from 1.28% in 1997 to 0.49% in 2000).

The IRS has indicated that it intends to step up its enforcement of the tax laws over the next few years in order to "reverse a decline in taxpayer scrutiny that officials fear is

The available data on the effectiveness of the disclosure legislation indicates that the IRS serves as little more than a clearinghouse for the additional paperwork generated by the law.¹⁴² Moreover, the IRS's inability to post the reports of political organizations in a timely manner has been attributed in large part to the IRS's lack of resources and personnel.¹⁴³

Moreover, the enforcement of section 527's new disclosure provisions asks the IRS—an organization whose acquired expertise lies in keeping data private¹⁴⁴—to become experts in disclosure.¹⁴⁵ Finally, at the time the law was passed, the media estimated that only twenty-four or so “stealth PACs” existed.¹⁴⁶ The result of the law has been to require tens of thousands of organizations to submit paperwork, often duplicative, that no doubt buries the disclosures of the true stealth organizations.¹⁴⁷

fueling an epidemic of tax cheating.” Kathy M. Kristof, *IRS to Increase Number of Audits*, L.A. Times, Mar. 1, 2002, at C1; see also David Cay Johnston, *I.R.S. Vows to Focus More Effort on the Rich*, N.Y. Times, Sept. 13, 2002, at A2. According to the IRS, tax cheating costs the U.S. Treasury an estimated \$250 billion annually. Kristof, *supra*, at C2. The number of audits conducted in 2001 was 731,756, which approximates to 0.6% of all taxpayers. *Id.*

¹⁴² For instance, the

IRS does not fully check whether all required data are included on the Forms 8871 and 8872 it receives and that the data is correct. Also, IRS performs limited checks on the timeliness of filings and does not perform checks to determine whether all Section 527 organizations that should file have done so.

GAO Report, *supra* note 139, at 15; see also *id.* at 16 tbls.1 & 2 (noting IRS's failure to check for completeness of data on forms).

¹⁴³ See *id.* at 20 (“In 2001, IRS staffing for the exempt function totaled 811.”); Kenneth P. Doyle, *Some Reports from 527 Groups Online; IRS Says Others Not Immediately Available*, Daily Tax Rep. (BNA), Oct. 30, 2000, at G-4 (criticizing IRS's “slow pace in making reports available, indicating that much of the information in the reports will be of little value after the election”); Owens & Mayer, *supra* note 57, at 102 (“Unlike the FEC, the EO Division also has to enforce numerous other types of requirements and restrictions. Given the already low incidence of audits of tax-exempt organizations, it is unlikely that the IRS will aggressively search for non-compliance or even respond quickly to complaints that are filed.” (footnote omitted)).

¹⁴⁴ See I.R.C. § 6103 (2001) (“Returns and return information shall be confidential”); § 7431(a) (providing taxpayer with civil remedy against any person, whether or not U.S. government employee, who “knowingly, or by reason of negligence, inspects or discloses any return or return information with respect to a taxpayer in violation of any provision of section 6103”).

¹⁴⁵ Owens & Mayer, *supra* note 57, at 101 (“Congress clearly intended that reports be reviewed and available very quickly, as is the case with filings with the FEC. Unlike the FEC, though, the IRS is not experienced in providing such speedy action”).

¹⁴⁶ Isikoff, *supra* note 117, at 23.

¹⁴⁷ GAO Report, *supra* note 139, at 17. According to the GAO Report, the “IRS's procedures do not include checks to determine whether it receives both electronic and paper versions of the Forms 8871 as Public Law 106-230 requires.” *Id.*

A whirlwind of legislative proposals have surfaced to address these and other concerns. Section A of this Part will discuss the two proposals that have received the most attention. One proposal seeks to remedy the law's overinclusiveness by giving a blanket exemption to state and local political committees. The other, embodied in the sweeping campaign reform legislation that President George W. Bush recently signed into law,¹⁴⁸ is favored by those who wish to remedy underinclusiveness in election law generally and advocates regulation of speech rather than the forced disclosure of the speaker's identity. Section B then argues that Congress and the Bush Administration could go a long way toward redressing the problems by harmonizing section 527's definition of "political organization" and "political committee" with definitions of these terms under the FECA.

A. Current Proposals for Reforming Section 527

1. Exempting State and Local Parties and Candidate Committees

Even before President Clinton's signature on the section 527 disclosure law was dry, state and local political organizations already subject to disclosure regimes at the state and local level clamored for an exemption.¹⁴⁹ These groups argue that the law is unnecessary as applied to them since they are already required to make similar disclosures under state law.¹⁵⁰ In response, a number of senators and representatives have introduced proposals aimed at easing the burden of duplicative reporting.¹⁵¹ One such proposal came to the House floor for a vote on April 10, 2002.¹⁵²

The proposed amendment, attached as part of the Taxpayer Protection and IRS Accountability Act of 2002, would have exempted certain state and local political organizations from the notification and

¹⁴⁸ Bipartisan Campaign Reform Act of 2002, Pub. L. 107-155, 116 Stat. 81.

¹⁴⁹ See *supra* note 20 (describing problems faced by some state and local campaigns and political organizations).

¹⁵⁰ See *supra* notes 19-20 (describing crisis facing smaller campaigns that were unaware of obligations under new disclosure law and duplicative reporting).

¹⁵¹ See, e.g., H.R. 3993, 107th Cong. (2002) (amending § 527 to eliminate reporting and return requirements for state and local candidate committees); H.R. 4180, 107th Cong. (2002) (amending § 527 to eliminate notification and return requirements for all state and local political committees and candidate committees, and to eliminate duplicative reporting by these organizations); S. 2078, 107th Cong. (2002) (same); S. 744, 107th Cong. (2001) (same); S. 3193, 106th Cong. (2000) (amending § 527 to exempt state and local political committees from notification requirements); H.R. 5277, 106th Cong. (2000) (amending § 527 to eliminate duplicative reporting of information of certain qualifying political organizations); H.R. 5625, 106th Cong. (2000) (amending § 527 to exempt state and local political committees from notification and reporting requirements).

¹⁵² See Taxpayer Protection and IRS Accountability Act of 2002, H.R. 3991, 107th Cong. §§ 701-703.

reporting requirements.¹⁵³ Organizations would be exempt from reporting under section 527(j) if they (1) did not “engage in any exempt function other than to influence or to attempt to influence” state or local elections,¹⁵⁴ (2) were subject to state or local reporting requirements “substantially similar” to the information required by section 527(j),¹⁵⁵ and (3) were required by state law to make this information available for public inspection.¹⁵⁶ The bill also would have exempted certain state and local organizations from filing returns.¹⁵⁷ Finally, the bill gave the IRS the discretionary power not to require an organization to file a return when “not necessary to the efficient administration of the internal revenue laws,”¹⁵⁸ and the discretionary power to waive “all or any portion” of the taxes or penalties imposed for failure to meet the notice and reporting requirements “on a showing that such failure was due to reasonable cause and not due to willful neglect.”¹⁵⁹ The Ways and Means Committee Report accompanying the bill urged Congress to approve the change because “compliance with the political organization notification, reporting, and return requirements is in some cases needlessly burdensome, duplicative, or unnecessary.”¹⁶⁰

At first glance, this exemption makes sense. Federal election law should not reach into the domain of state and local politics.¹⁶¹ By way of analogy, securities law, another field governed by extensive public-disclosure requirements, exempts from federal registration and disclosure requirements those securities offerings that are made purely to in-state residents and that already are subject to the disclosure provisions of that state’s securities laws.¹⁶² Thus, the reach of section 527 disclosure raises some federalism concerns that the exemption would ameliorate.

Moreover, such a modification appears to comport with congressional intent behind the section 527 disclosure legislation. On July 25, 2000, twenty-one members of Congress, identifying themselves as

¹⁵³ § 701(b).

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ § 701(c).

¹⁵⁸ *Id.*

¹⁵⁹ § 701(d).

¹⁶⁰ H. Rep. No. 107-394, at 80 (2002).

¹⁶¹ See, e.g., *Republican Assemblies II*, 218 F. Supp. 2d 1300, 1345-46 (S.D. Ala. 2002) (drawing on *Gregory v. Ashcroft*, 501 U.S. 452, 461-64 (1991), to conclude that establishing regulations governing electoral advocacy in connection with selection of state officeholders is but one step removed from selecting officeholders themselves, which Congress cannot regulate pursuant to Tenth Amendment).

¹⁶² See 17 C.F.R. § 230.504 (2001).

drafters of the legislation, sent a letter to then-IRS Commissioner Charles O. Rossotti stating that the law “was intended to put a stop to the shameful practice of self-proclaimed election-related organizations taking the public subsidy of tax exemption under section 527 of the tax code while claiming a right to hide from public view all information about their election-related activities.”¹⁶³ Groups that already disclose this information pursuant to state or local law certainly could not be said to be hiding from public view.

The measure, however, has several drawbacks. First, it does not provide any clear mechanism for designating who will determine whether disclosures are adequate under state or local law. Second, if the state and/or local disclosure laws are inadequate or untimely, an exemption would eliminate the requirement for tax-exempt political organizations at the state level to complete annual, publicly disclosed returns providing basic information—such as organizations’ names, addresses, statements of purpose, and yearly disbursements—that is essential to the public mission of ensuring the tax exemption is not abused. Third, it creates an incentive to funnel large amounts of money into state and local parties and candidate committees.¹⁶⁴ These funds then might be used indirectly to benefit federal campaigns and candidates.

These concerns no doubt contributed to the rejection of this proposal when it recently came up for a vote on the floor of the House of Representatives. The press attacked the amendment with vitriolic prose, calling this a “new and arrogant assault on campaign disclosure” and a “travesty of a bill” that would “weaken the requirement that secret campaign slush funds disclose their donors.”¹⁶⁵ As one member of Congress suggested, the recent debate and passage of the campaign reform legislation may have made Congress wary of tinker-

¹⁶³ Letter from U.S. Senator Joseph Lieberman, et al., to Charles O. Rossotti, Commissioner, IRS (July 25, 2000), reprinted in Congressional Finance Reformers’ Letter to IRS on 527 Legislation, Tax Notes Today, July 27, 2000, LEXIS, 2000 TNT 145-15.

¹⁶⁴ According to a report by the watchdog organization Public Citizen, released on April 9, 2002, the top twenty-five § 527 groups raised over \$67,300,000 in the eighteen months since the disclosure legislation went into effect. Public Citizen, *Déjà Vu Soft Money: Outlawed Contributions Likely to Flow to Shadowy 527 Groups that Skirt Flawed Disclosure System* (2002), <http://www.citizen.org/documents/ACF8D5.PDF>. The report also notes that these groups are highly partisan and could be potential vehicles for the nonfederal money banned by the recent campaign reform legislation.

¹⁶⁵ Editorial, *Campaign Reform Farce*, N.Y. Times, Apr. 9, 2002, at A24; see also Editorial, *Sunshine in the House*, Wash. Post, Apr. 9, 2002, at A18 (“[C]ritics see the language opening a significant loophole, allowing some organizations to substitute lax state reporting requirements for more extensive reporting to the IRS.”); Editorial, *Hidden Agendas*, Buff. News, Jan. 2, 2002, at C6 (warning that efforts to “loosen disclosure requirements . . . should be looked upon suspiciously”).

ing with things.¹⁶⁶ The reform measure was defeated in the House by a vote of 219 to 205.¹⁶⁷

As this Note was going to press, Senators announced that they had reached an agreement to include language dealing with section 527 political organizations as a managers' amendment to the Care Act of 2002.¹⁶⁸ The managers' amendment is similar to the proposal embodied in H.R. 3991 in that it exempts state and local candidates from some of the reporting requirements under section 527.¹⁶⁹ Instead of exempting state and local political organizations that filed "substantially similar" information as required under section 527, the measure creates a category of "exempt State or local political organizations"¹⁷⁰ which are exempt from filing under section 527. A virtually identical measure¹⁷¹ passed the House on October 16, 2002,¹⁷² and the Senate on October 17, 2002,¹⁷³ and was signed into law on November 2, 2002.¹⁷⁴

2. *Extending Disclosure Beyond Section 527*

a. Encompassing Section 501(c) Organizations Within the Disclosure Regime In order to remedy concerns about the under-inclusiveness of the section 527 disclosure legislation, others have advocated for a disclosure regime that encompasses the electioneering activity of other politically active nonprofits, mainly those organized under section 501(c).¹⁷⁵ The passage of the section 527 disclosure legislation generally did not affect these organizations.¹⁷⁶ While the

¹⁶⁶ See Juliet Eilperin, House Votes Against Diluting New Campaign Finance Law, Wash. Post, Apr. 11, 2002, at A6 (quoting Representative Thomas M. Reynolds).

¹⁶⁷ Id.; see also 148 Cong. Rec. H1180-81 (daily ed. Apr. 10, 2002) (recording vote).

¹⁶⁸ H.R. 7, 107th Cong. 1st Sess. (2001) (expanding tax incentives for charitable giving).

¹⁶⁹ See 148 Cong. Rec. S9167-68 (daily ed. Sept. 24, 2002); id. at H8010 (daily ed. Oct. 16, 2002) (statement of Rep. Dogget). The amendment integrated an earlier bill, S. 2078, 107th Cong. (2002), into the Care Act of 2002.

¹⁷⁰ An "exempt state or local political organization" is one which conducts exempt functions solely for state or local purposes, S. 2078, §2, 107th Cong., and which is subject to state law reporting requirements regarding expenditures from and contributions to the organization, id., and the person who makes such a contribution or receives such an expenditure. Id.

¹⁷¹ See H.R. 5596, 107th Cong. (2002).

¹⁷² 148 Cong. Rec. H8010 (daily ed. Oct. 16, 2002).

¹⁷³ Id. at S10,779 (daily ed. Oct. 17, 2002).

¹⁷⁴ Pub. L. No. 107-276, 116 Stat. 1929 (2002).

¹⁷⁵ Because charities are prohibited from engaging in any partisan electoral activity, see *supra* notes 37-40, they have generally been excluded from these proposals.

¹⁷⁶ The Code already had required these affected tax-exempt organizations to publicly disclose unredacted annual returns, I.R.C. § 6104(d)(1)(A)(i) (2001), and approved applications for tax-exempt status. See § 6104(d)(1)(A)(ii); see also § 6104(a)(1)(A) (allowing for public inspection of tax returns of tax-exempt organizations entitled to exemption under § 501(a)). Public Law 106-230 amended this section in 2000 by adding organizations

Code obligates non-section 527 nonprofits to make some minor disclosures under the Code, their donor lists remain protected from disclosure. This has prompted calls for additional reform.¹⁷⁷

There are problems with subjecting section 501(c) organizations to such disclosure requirements. First, though section 501(c) nonprofits (with the exception of charities) are permitted to engage in or sponsor some partisan electoral communications, they are explicitly barred from being exclusively political.¹⁷⁸ Organizations with an exclusively election-related purpose must, by statute, qualify as section 527 organizations.¹⁷⁹ In other words, the political activity of non-section 527 organizations must be *secondary* to a fundamentally nonpolitical purpose.¹⁸⁰ Such nonprofit organizations with a primary purpose unrelated to electioneering are the perfect vehicles for constitutionally protected issue advocacy and therefore should not be subject to potentially chilling disclosure obligations.

For example, a university professor might reasonably fear stigma—or worse—if the fact that he made substantial contributions to a section 501(c) organization with a primary purpose of supporting or opposing abortion becomes publicly known. Public revelation of a factory worker's financial donation to anti-union groups might yield similar concerns.¹⁸¹ While these concerns exist with regard to contributors to political organizations, the donor at least knows he or she is contributing to an organization pursuing a political purpose, while with a section 501(c)(4) organization, that is not often so clear. Thus, extending disclosure requirements to such organizations might dis-

exempt under § 527 to the catalogue. Pub. L. No. 106-230, § 1(b)(1)(A), 114 Stat. 477, 478 (2000). See *supra* Part II.C for a discussion of the disclosure requirements for political organizations under Public Law 106-230.

¹⁷⁷ See *supra* note 55 and accompanying text.

¹⁷⁸ See *supra* notes 37-40 and accompanying text (stating prohibition and discussing consequences of violation).

¹⁷⁹ See *supra* notes 58-59 and accompanying text (discussing statutory definition of § 527 organizations).

¹⁸⁰ See *supra* notes 30, 51 and accompanying text (citing sources standing for proposition that § 501(c) organizations other than charities may carry on political campaign activity so long as it does not become organization's primary purpose).

¹⁸¹ See Hearing on Disclosure of Political Activities of Tax-Exempt Organizations, *supra* note 123, at 60 (statement of Independent Sector) (

[I]n sharp contrast to section 527 organizations, for section 501(c)(4) organizations, involvement in the electoral process must be secondary to a fundamentally non-electoral purpose. Moreover, this non-electoral purpose—allowing groups of concerned citizens to speak with one voice on a public issue of common concern—lies at the very core of the First Amendment protections of association, speech, and privacy.)

suade contributions,¹⁸² significantly limiting their ability to pursue an issue agenda that is wholly permissible within the scope of their tax exemption.

b. The Bipartisan Campaign Reform Act The Bipartisan Campaign Reform Act (BCRA) that passed the House on March 20, 2002, and that President Bush signed into law one week later, would impose disclosure requirements on any entity, regardless of its tax-exempt status, engaged in certain categories of communications.¹⁸³ Specifically, the BCRA regulates “federal election activity” of political parties which includes, *inter alia*, “voter registration activity . . . 120 days before the date a regularly scheduled Federal election is held,”¹⁸⁴ “voter identification [activity] . . . conducted in connection with an election in which a candidate for Federal office appears on the ballot (regardless of whether a candidate for State or local office also appears on the ballot),”¹⁸⁵ and “a public communication that refers to a clearly identified candidate for Federal office . . . and that promotes or supports a candidate for that office (regardless of whether the communication expressly advocates a vote for or against a candidate).”¹⁸⁶

In an effort to curtail sham issue advertising, the BCRA creates a class of communications—termed “electioneering communications”—that are subject to the FECA. These communications 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 runoff election for the office sought by the candidate; or
 - (bb) 30 days before a primary . . . or a convention or caucus of a political party that has authority to nominate a candidate¹⁸⁷

¹⁸² See William McGeveran, *The Privacy Costs of Political Contribution Disclosure* (Sept. 2002) (manuscript at 30, on file with the *New York University Law Review*) (“The disclosure needed to squeeze this small information out of contributions imposes privacy costs on all donors, including those who have nothing to do with such marginally informative patterns.”).

¹⁸³ Bipartisan Campaign Reform Act (BCRA) of 2002, Pub. L. No. 107-155, 116 Stat. 81 (2002) (codified as amended at 2 U.S.C. §§ 431-455).

¹⁸⁴ § 101(b)(20)(A)(i) (amending 2 U.S.C. § 431).

¹⁸⁵ § 101(b)(20)(A)(ii) (amending 2 U.S.C. § 431).

¹⁸⁶ § 101(b)(20)(A)(iii) (amending 2 U.S.C. § 431).

¹⁸⁷ § 201(a)(f)(3)(A)(i) (amending 2 U.S.C. § 434). The BCRA also includes an alternate definition of “electioneering communication,” which defined it 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

Those paying for electioneering communications cannot use funds from national banks, corporations, foreign nationals, or labor organizations to pay for electioneering communications,¹⁸⁸ and must meet the FECA's disclosure requirements. The law appears to permit individuals and, possibly, certain PACs, to make electioneering communications so long as they do so without using funds provided by corporations or unions and comply with the FECA's disclosure requirements.¹⁸⁹

These categories of communication that trigger reporting obligations are far too broad. The net effect of these provisions would be to ban many important national issue advocacy groups and their affiliates from funding TV or radio ads that even mention the name of a local member of Congress for thirty days before a state's congressional primary or runoff and for another sixty days before the general election.

Moreover, several provisions affecting tax-exempt organizations other than section 527s further limit the ability of these groups to participate through voter registration, candidate forums, and other non-partisan activities. Under the BCRA, corporate and union funds may not be used to pay for electioneering communications.¹⁹⁰ This ban extends to electioneering communications by tax-exempt organizations if the organizations' communications are "targeted."¹⁹¹ Because most broadcast communications will be targeted within the meaning of the BCRA, the ability of tax-exempt organizations to participate in lobbying, public education, and electoral activities will be affected regardless of whether the organization receives support from businesses or unions. Moreover, it is unclear whether the BCRA leaves open the safety-valve recognized by the *Taxation With Representation* Court—that is, establishing a separate political committee under section 527 to carry out electioneering communications using only contributions from individuals.¹⁹²

against a candidate) and which also is suggestive of no plausible meaning other than an exhortation to vote for or against a specific candidate.

§ 201(a)(f)(3)(A)(ii) (amending 2 U.S.C. § 434).

¹⁸⁸ § 204 (amending 2 U.S.C. §§ 441b(b)(2), 441e(a)(2)).

¹⁸⁹ See 2 U.S.C. § 434(f).

¹⁹⁰ § 203(a) (amending 2 U.S.C. § 441(b)(2)).

¹⁹¹ § 204 (amending 2 U.S.C. § 441(b)).

¹⁹² On September 26, 2002, the FEC approved final regulations clarifying the definition of "electioneering communications." The final regulations, codified at 11 C.F.R. § 100.29, exempt charities from restrictions on electioneering communications. § 100.29(c)(6). The FEC reasoned that the Code and the IRS already prohibit § 501(c)(3) organizations from engaging in political campaign activity; thus, additional regulations were not necessary. According to the narrative accompanying the final rules, "the purpose of BCRA is not served by discouraging such charitable organizations from participating in what the public

B. Confronting the Taxing Issue

1. Adopting the "Express Advocacy" Standard

What should be done to address the gap that allows some section 527 political activity to go unregulated by the FECA or state and local disclosure laws? A possible answer comes from the Senate Finance Committee's deliberations when section 527 was originally adopted twenty-five years ago.¹⁹³ The Committee suggested that any and all organizations desiring tax subsidies for campaign advocacy be required to invoke section 527, and that section 527 activities be limited to express advocacy.¹⁹⁴ In 2000, the House Ways and Means Subcommittee on Oversight hinted at the advantage of this approach when it suggested that non-section 501(c)(3) nonprofits should be able to avoid the obligations proposed in its version of the disclosure legislation¹⁹⁵ simply by forming a section 527 segregated fund.¹⁹⁶ In other words, in order to take advantage of the section 527 tax exemption, organizations would have to restrict themselves to the express advocacy which is covered by the FECA. Issue advocacy then would be the sole province of section 501(c) organizations and would be subject to few disclosure requirements.

2. Redefining "Political Committee"

In order to limit section 527 activity to express advocacy, Congress should harmonize section 527's definition of "political committee" with the FECA's definition of "political organization." This proposal briefly surfaced in May and June 2000 as Senate Bill 2582. This proposal, introduced by Senator Joseph Lieberman, would have required most section 527 organizations to be political committees under the FECA.¹⁹⁷ It effectively would nullify the effect of the pri-

considers highly desirable and beneficial activity, simply to foreclose a theoretical threat from organizations that has not been manifested, and which such organizations, by their very nature, do not do." *Id.* at 65,200.

¹⁹³ See *supra* note 63 (expressing Congress's legislative expectation that organizations whose exemption was defined under § 501(c) would establish separate organization to engage in partisan activity).

¹⁹⁴ See *supra* note 63 (quoting from Senate Finance Committee report at length).

¹⁹⁵ See *supra* Part II.C (describing § 527 notice and reporting requirements and exemptions).

¹⁹⁶ H.R. Rep. No. 106-702, at 10 (2000).

¹⁹⁷ S. 2582, 106th Cong. § 1 (2000). The amendment proposed to § 527 by the Senate Bill would have defined "political organization" as

a party, committee, association, fund, or other organization (whether or not incorporated)—

(i) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function, and

vate letter rulings that led to the exploitation of section 527 status in the first place.¹⁹⁸ Section 527 status then would only be available for organizations that to some extent expressly advocate the election or defeat of clearly identified candidates for federal office.¹⁹⁹

Such a solution also should be coupled with amendments to the Code that would require section 501(c)(3) and (c)(4) organizations that make political expenditures exceeding a certain amount to file under section 527. Under this Note's suggested scheme, this speech would, of course, be express advocacy.²⁰⁰

Such a scheme would be consistent with the constitutional scheme laid down by the U.S. Supreme Court in *Buckley* and *Taxation With Representation*.²⁰¹ As the Court emphasized in *Taxation With Representation*, directing campaign advocacy away from certain tax-exempt forms or organizations towards another tax-exempt form or organization (possibly even a section 527 organization) does not im-

(ii) which is a political committee described in section 301(4) of the Federal Election Campaign Act of 1971 (2 U.S.C. 431(4)).

Id.

¹⁹⁸ See supra Part II.B (discussing expansive interpretation of "exempt function" under § 527).

¹⁹⁹ The FEC twice considered rulemakings aimed at amending 11 C.F.R. § 100.5 (as amended in 1996) to encompass § 527 organizations. The first time was in May 2000. See Memorandum from Commissioner Karl Sandstrom to FEC, Agenda Document No. 00-51, <http://www.fec.gov/agenda/agendas2000/agenda05182000.pdf>. This proposal, in brief, would have amended the FEC's definitions of "contribution" and "expenditure" to include more objective criteria, including § 527 organizations. The FEC commissioners did not even bring this proposal to vote. See Amy Keller, FEC Won't 'Change the Rules' on 527s, Roll Call, May 29, 2000, 2000, WL 8734513. A similar rulemaking began almost a year later. See Definition of Political Committee, 66 Fed. Reg. 13,681 (Mar. 7, 2001). As of the publication of this Note, this rulemaking has been held in abeyance. See Recent and Ongoing Rulemakings, <http://www.fec.gov/register.htm> (last visited Sept. 26, 2002).

²⁰⁰ Of course, express advocacy constitutes verboten activity for charities. See supra notes 37-40 and accompanying text (quoting prohibition in § 501(c)(3) and describing litany of punishments IRS can levy on misbehaving charities). Charities, however, often engage in activity that arguably constitutes express advocacy, or at least comes close, by characterizing their activities as "educational." See supra notes 37, 41-43 and accompanying text. Although a detailed solution to this problem is beyond the scope of this Note, it should be noted that the problem posed by § 501(c)(3) organizations participating in electioneering activity is not as serious as the problems that § 501(c)(4) and § 527 pose. First, contributions to § 501(c)(3) organizations are subject to the gift tax. See supra note 53 (noting that IRS has taken position that contributions to all § 501(c) organizations remain subject to gift tax). Second, the legal contortionism that charities engage in to fit political activity into the murky definition of "educational" could be alleviated by allowing charities to set up a separate § 527 fund that would have to make disclosures. Third, as discussed in supra notes 139-141, enforcement appears to be the main obstacle to making sure § 501(c)(3) activities fit into the statutory definition.

²⁰¹ See supra Part II.A (discussing standards set forth by Court in *Buckley* and *Taxation With Representation*).

permissibly bar electoral advocates from expressing their views through other outlets.²⁰²

This proposed reform also alleviates the concerns raised by the *Republican Assemblies II* court. After determining that *Buckley* and its progeny provided the proper analytical framework, the district court held that the disclosure provisions of section 527 were not narrowly tailored because the statute, as drafted, required disclosure of contributions and expenditures that went beyond the express advocacy threshold.²⁰³ Moreover, such a bright-line approach abolishes the need to rely on cumbersome and constitutionally suspect “penalties” and other such regulation through the Code.²⁰⁴

Finally, this proposal ensures predictability in the law. The current legal framework essentially establishes two different legal regimes to oversee a common problem—preventing actual and potential corruption in the political process. These two legal regimes could, and most likely will, diverge in their interpretation of common issues, as the goals underlying the tax law are different than the goals underlying election law. After all, the general rule in election law is one of disclosure—“[p]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”²⁰⁵ In contrast, the general rule in tax law is one of privacy.²⁰⁶ Allowing these two systems to generate divergent precedents on the same issues with different goals in mind engenders unpredictability in the law.²⁰⁷

CONCLUSION

This Note demonstrates the failings of a system that seeks to regulate the political activity of tax-exempt organizations through the Tax Code, instead of through election law. While regulation of campaign advocacy ideally should be left entirely to election law, such a method appears to be constitutionally impossible so long as *Buckley* and its progeny remain the law. Given these constraints, the proposal suggested by this Note harmonizes election law and the Tax Code so that

²⁰² *Regan v. Taxation With Representation*, 461 U.S. 540 (1983).

²⁰³ *Republican Assemblies II*, 218 F. Supp. 2d 1300, 1336 (S.D. Ala. 2002).

²⁰⁴ See *Republican Assemblies I*, 148 F. Supp. 2d 1273, 1278-81 (S.D. Ala. 2001) (determining § 527(j) to be penalty rather than tax); see also *Republican Assemblies II*, 218 F. Supp. 2d at 1349.

²⁰⁵ *Buckley v. Valeo*, 424 U.S. 1, 67 n.80 (1976) (quoting Louis D. Brandeis, *Other People's Money, And How the Bankers Use It* 62 (Nat'l Home Library Found. ed. 1933)).

²⁰⁶ See *supra* note 144 (describing general rule of nondisclosure in Tax Code).

²⁰⁷ Moreover, federal election law would seem to require a certain level of consistency. See, e.g., 2 U.S.C. § 438(f) (requiring IRS and FEC to work together to promulgate rules that are mutually consistent).

they work together toward the common purpose of a better electoral process.²⁰⁸

²⁰⁸ The proposal suggested by this Note leaves open two issues. The first is whether disclosure is an effective means of regulating campaign finance. Although beyond the scope of this Note, the author finds persuasive the emerging scholarship suggesting that disclosure regimes aimed at the individual contributor may violate the constitution. For a more in-depth analysis of the constitutionality of contributor-based disclosure, see generally McGeveran, *supra* note 182, which argues that contributor-based disclosure regimes, such as the section 527 legislation examined in this Note, are at odds with emerging Supreme Court precedent. A second issue left open by this Note is how to treat organizations that engage in issue advocacy but do not qualify under §§ 501(c)(3) or (c)(4). One proposal is to channel such activity into a new category of organization under the Code, termed a "political corporation." See Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 *Ga. L. Rev.* (forthcoming winter 2003) (manuscript at 69-73, on file with the *New York University Law Review*).