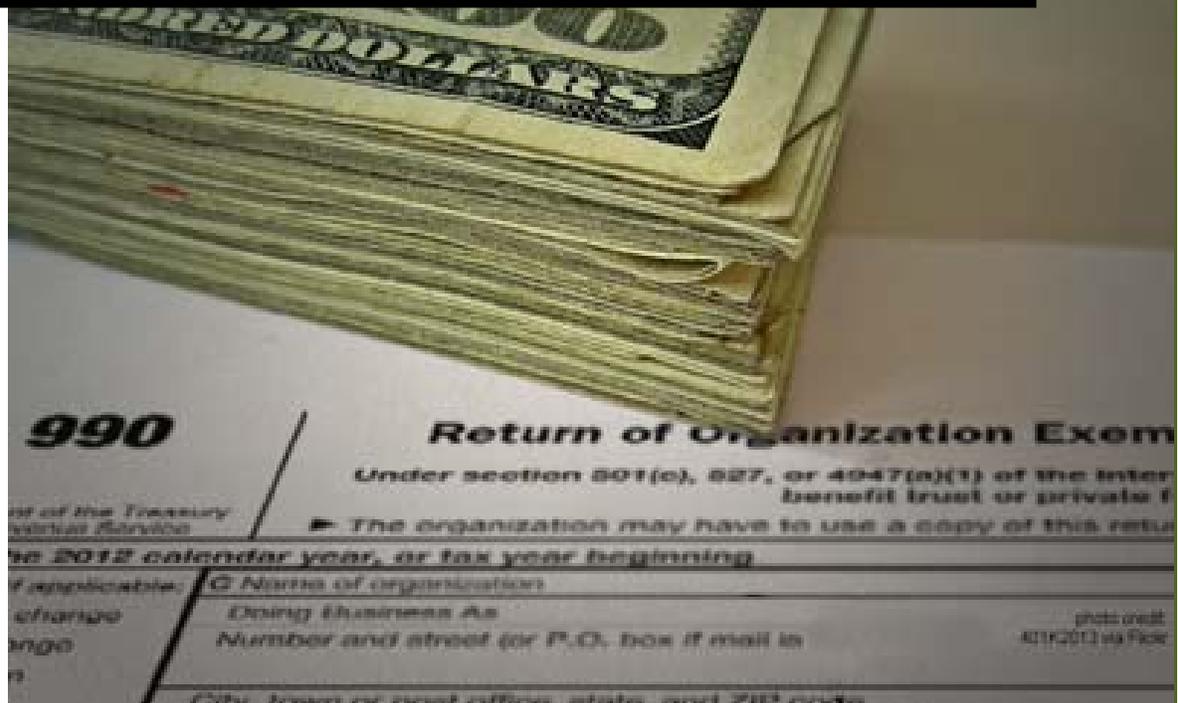


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Responses to
Arguments Against
Reforming IRS
Treatment of
501(c) Groups

The Dark Money Debate



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Political activity by tax-exempt organizations has increased sharply in the last several election cycles, and is certain to continue growing. This development largely is due to Supreme Court decisions allowing these groups to conduct unlimited independent campaign spending, coupled with tax and campaign finance laws that let them keep their donors anonymous. Members of Congress and good government advocates have responded by proposing legislative and regulatory steps to rein in the secretly-funded political activity. In addition, the IRS recently said it may revisit regulations that allow much of the spending. The same forces that brought about *Citizens United*, however, are now mounting a defense of the new system, and some are trying to unleash even more campaign spending by all kinds of tax-exempt groups, including charities and religious groups currently banned from politics.

This paper first describes the basic legal background regarding political activity by tax-exempt organizations. Next, it reviews and responds to the main arguments raised by those who oppose reforming how the IRS currently treats political activity by social welfare groups organized under section 501(c)(4) of the tax code. The paper then reviews and addresses claims the First Amendment undermines any restrictions on political activity by either section 501(c)(4) groups or section 501(c)(3) churches and charities. Finally, it discusses what is likely to be the next step in dark money spending – using section 501(c)(6) business leagues instead of section 501(c)(4) social welfare groups.

Background

Under the IRS's current interpretation of the law, several types of tax-exempt organizations are permitted to conduct some political activity. Section 501(c)(4) of the tax code provides a tax exemption for “civic leagues or organizations not organized for profit but *operated exclusively* for the promotion of social welfare.”¹ Notwithstanding this language, IRS regulations promulgated in 1959 provide that “an organization is operated exclusively for the promotion of social welfare if it is *primarily engaged* in promoting in some way the common good and general welfare of the community.”² The regulations further exclude “direct or indirect participation in political campaigns on behalf of or in opposition to any candidate for public office.”³ Neither the tax code nor any IRS authority defines “primarily” with any specificity, and the IRS instead uses a vague test that considers all the “facts and circumstances.”⁴ Many tax law practitioners interpret the regulation to mean a section 501(c)(4) group may spend up to half of its total expenditures on campaign activities, and the IRS made the same assertion in training materials.⁵

Section 501(c)(5) of the tax code provides a tax exemption for “labor, agricultural, or horticultural organizations,” and section 501(c)(6) provides one for “business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues.”⁶ Unlike

¹ 26 U.S.C. § 501(c)(4) (emphasis added).

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

³ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

⁴ Rev. Rul. 68-45, 1968-1 C.B. 259.

⁵ ABA Section on Taxation, Comments of the Individual Members of the Exempt Organizations Committee's Task Force on Section 501(c)(4) and Politics, 37 (2004), available at <http://www.abanet.org/tax/pubpolicy/2004/040525exo.pdf>; Exempt Organizations Determinations Unit 2, Student Guide, Training 29450-002 (Rev. 9-2009), at 7-19, available at [http://www.taxanalysts.com/www/freefiles.nsf/Files/EO%204.pdf/\\$file/EO%204.pdf](http://www.taxanalysts.com/www/freefiles.nsf/Files/EO%204.pdf/$file/EO%204.pdf).

⁶ 26 U.S.C. §§ 501(c)(5), (6).

section 501(c)(4), these statutory provisions do not use the term “exclusively.” The IRS, through widely-accepted guidance, has applied the “primarily” standard to section 501(c)(5) and section 501(c)(6) groups.⁷

In addition, section 501(c)(3) provides a tax exemption for organizations “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . , or for the prevention of cruelty to children or animals.”⁸ Under the statute, these groups may not “participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”⁹

Following the Supreme Court’s 2010 decision in *Citizens United v. Federal Election Commission* allowing corporations, including non-profit corporations, and labor unions to spend general treasury funds for independent expenditures and electioneering communications in political campaigns,¹⁰ campaign spending by section 501(c)(4) groups exploded. These groups spent more than \$92 million on the 2010 elections, and more than \$256 million in the 2012 cycle.¹¹

Members of Congress and good government advocates have responded in several ways. Based on the discrepancy between the statute, which requires section 501(c)(4) organizations to be operated “exclusively” for social welfare purposes, and the IRS’s regulations allowing them to be only “primarily” engaged in those activities, several groups filed petitions with the IRS requesting a rulemaking that would harmonize the regulations with the statute, and sued the IRS when it failed to act.¹² After the lawsuits were filed, the IRS announced it would conduct a rulemaking on its section 501(c)(4) regulations, but the rulemaking is focused on what activities qualify as “political” for section 501(c)(4) groups.¹³ The IRS also asked for comments on whether it should change the “primarily” standard and how much section 501(c)(4) groups should be allowed to spend on activities that do not promote social welfare, but did not commit to taking any action.¹⁴

In addition, several members of Congress and others have proposed or introduced bills to address “dark money” spending. One bill would eliminate the IRS’s interpretation of the statute by explicitly adding to section 501(c)(4) the language from section 501(c)(3) banning political activity.¹⁵ Another would cap political spending by section 501(c)(4) groups at the lesser of 10

⁷ G.C.M. 34233.

⁸ 26 U.S.C. § 501(c)(3).

⁹ *Id.*

¹⁰ 558 U.S. 310 (2010). An independent expenditure is spending by a group that expressly advocates the election or defeat of a clearly identified candidate and is not coordinated with the candidate’s campaign. 2 U.S.C. § 431(17). An electioneering communication is an advertisement broadcast within 60 days of a general election or 30 days of a primary election that clearly identifies a candidate and is targeted to the candidate’s electorate. 2 U.S.C. § 434(f).

¹¹ Open Secrets, *Political Nonprofits*, available at http://www.opensecrets.org/outsidespending/nonprof_summ.php.

¹² See *Citizens for Responsibility and Ethics in Washington v. U.S. Dep’t of the Treasury Internal Revenue Service, et al.*, Civil Action No. 13-0732 (JDB) (D.D.C.); *Van Hollen, et al. v. Internal Revenue Service, et al.*, Civil Action No. 13-1276 (JDB) (D.D.C.).

¹³ Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71535 (proposed Nov. 29, 2013).

¹⁴ *Id.* at 71537-38.

¹⁵ 501(c)(4) Reform Act of 2013, H.R. 2520 (2013).

percent of their total expenditures or \$10 million.¹⁶ Addressing the issue more broadly, another proposal would cap political spending for *all* section 501(c) groups at the lesser of 10 percent or \$100,000.¹⁷

Characteristics of Key Types of Tax-Exempt Organizations					
Tax code section	501(c)(3)	501(c)(4)	501(c)(5)	501(c)(6)	527
Type of organization	Charitable = for religious, charitable, scientific, or educational purposes ¹⁸	Social welfare organization	Labor union	Business league, trade association, chamber of commerce	Political organization
Tax exempt?	Yes	Yes	Yes	Yes	Yes
Contributions deductible?	Yes	No	No	No	No
Political campaign activities?	No	Statute: No Regulations: Yes	Yes	Yes	Yes
Limit on political campaign activities	None allowed	Statute: None allowed Regulations: Must be primarily engaged in tax-exempt activity = up to half on other activity, including politics	Must be primarily engaged in tax-exempt activity = up to half on other activity, including politics	Must be primarily engaged in tax-exempt activity = up to half on other activity, including politics	Unlimited
Outside spending on 2012 federal elections	None	\$256.2 million ¹⁹	\$23.9 million	\$55.3 million	\$864.7 million (parties + super PACs)
Outside spending on 2010 federal elections	None	\$92.2 million	\$30.2 million	\$46.6 million	\$250.2 million (parties + super PACs)
Donor disclosure?	Only if private foundation	No	No	No	Yes
Lobbying?	Yes, but only non-substantial	Yes, unlimited	Yes, unlimited	Yes, unlimited	Only to influence candidate selection

¹⁶ Openness in Political Expenditures Now Act, H.R. 2670 (2013).

¹⁷ Greg Colvin, *A Silver Bullet That Would End Secret Tax-Exempt Money in Elections*, Campaign for America's Future website, April 11, 2012, available at http://ourfuture.org/20120411/A_Silver_Bullet_That_Would_End_Secret_Tax-Exempt_Money_in_Elections.

¹⁸ Also testing for public safety or literary purposes, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

¹⁹ Campaign finance data from Open Secrets.

Arguments raised by opponents of reforming political activity by section 501(c)(4) groups, and responses

Opponents of regulatory and legislative responses to the upsurge in dark money spending have advanced several non-frivolous arguments for leaving the current system as it is. Each is addressed below.

The IRS's interpretation warrants deference

One practitioner who represents tax-exempt organizations has argued that under principles of agency authority to interpret ambiguous statutes, the IRS's interpretation of section 501(c)(4) warrants deference.²⁰ This claim notes section 501(c)(4) does not refer specifically to political activity, in contrast to section 501(c)(3), which explicitly bans political activity. According to this view, Congress knows how to ban political activity and did not do so in section 501(c)(4). Therefore, the IRS has the authority to interpret the statute to allow it.

It is true that in general, courts defer to agency interpretations of ambiguous laws, especially in the area of tax law.²¹ Courts look first, however, to whether the agency has the discretion to interpret the statute, asking if “Congress has directly spoken to the precise question at issue.”²² If Congress's intent is clear, “that is the end of the matter.”²³ The plain meaning of the word “exclusively” is clear and unambiguous – it means “solely” or excluding everything else.²⁴ In using it, Congress provided explicitly that section 501(c)(4) organizations must be engaged solely in the promotion of social welfare. Given the unambiguous word choice Congress made, there is no basis for the IRS to interpret “exclusively” as meaning “primarily.” In addition, the law is not made ambiguous simply because Congress used more specific language addressing political activity in section 501(c)(3) than it did in section 501(c)(4).

Court decisions support the IRS's interpretation

A related set of arguments contends court decisions support the IRS's interpretation of the statute.²⁵ While it is true that several cases involving section 501(c)(4) organizations equate “exclusively” with “primarily,” courts cannot override the plain meaning of a statute except in rare circumstances in which applying the plain meaning would produce absurd results or results demonstrably at odds with the intent of the drafters.²⁶ These cases do not claim applying the

²⁰ Barnaby Zall, “The Tie Goes To The Speaker, Not The Censor.” – Proposals to Change Definitions of Permissible Political Activities by Section 501(c)(4) Organizations, at 16, paper presented to the American Bar Association Section of Taxation Committee on Exempt Organizations, September 20, 2013, available at <http://meetings.abanet.org/meeting/tax/FALL13/media/jt-ao-cpg-helping-zall-paper.pdf>.

²¹ *Chevron USA v. Natural Resources Defense Council*, 467 U.S. 837, 842-43 (1984); *Mayo Found. For Med. Educ. v. United States*, 131 S. Ct. 704, 713 (2011).

²² *Chevron USA*, 467 U.S. at 462.

²³ *Id.*

²⁴ See, e.g., Merriam-Webster's Collegiate Dictionary 436 (11th ed. 2006) (defining “exclusive” as “SINGLE, SOLE <exclusive jurisdiction>”).

²⁵ Zall, *supra*, at 18-19; Bruce R. Hopkins, *The Law of Tax-Exempt Organizations* 72 (10th ed. 2010).

²⁶ *Barnhart v. Sigmon Coal Co., Inc.*, 534 U.S. 438, 459 (2002); *United States v. Ron Pair Enters.*, 489 U.S. 235, 242 (1989).

plain meaning of “exclusively” would produce such results, and are based on misinterpretations of prior opinions.

Just a few years before Congress first passed the predecessor to section 501(c)(4), the Supreme Court explicitly held the word “exclusive” means “sole” or not including anything else. Interpreting the term as it was used in a contract, the Court held:

The term “exclusive” is so plain that little additional light can be gained by resort to the lexicons. If we turn to the Century Dictionary we find it defined to mean “Appertaining to the subject alone; not including, admitting or pertaining to any other or others; undivided; sole; as, an exclusive right or privilege; exclusive jurisdiction.”²⁷

To give the word a meaning other than “a sole and undivided privilege . . . would do violence to the plain words of the contract,” the Court concluded.²⁸ That plain meaning has not changed since.²⁹

The decisions equating “exclusively” and “primarily” misconstrue earlier cases concluding nonprofit organizations engaged in activities that did not advance their tax-exempt purposes could retain their status only if those activities were incidental and not substantial.³⁰ In the key earlier case, *Better Business Bureau of Washington v. United States*, the Supreme Court held the plaintiff was not organized and operated “exclusively” for scientific or educational purposes, and thus not exempt from Social Security taxes, because some of its activities were intended to promote a profitable business community.³¹ The Court refused to sanction “unusual or tortured meanings unjustified by legislative intent,” and made clear that being exclusively devoted to educational purposes “plainly means that the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes.”³² In effect, the Court held an organization is operating exclusively for exempt purposes only if its non-exempt activity is insubstantial.

In the years after the IRS issued its section 501(c)(4) regulations in 1959, a handful of courts misread *Better Business Bureau* and other decisions and conflated them with the language of the regulation to interpret “exclusively” to mean “primarily.”³³ One decision relied on by proponents of this argument, for example, asserted “the word ‘exclusively’ has not been interpreted to mean ‘solely,’ or ‘absolutely without exception,’” and concluded a statute’s requirement that an organization be “‘organized and operated exclusively’ for the qualifying purposes demands that all its primary activity be so devoted.”³⁴ None of the cases this decision

²⁷ *Vicksburg v. Vicksburg Waterworks Co.*, 202 U.S. 453, 470-71 (1906).

²⁸ *Id.* at 471.

²⁹ *See, e.g., Mississippi v. Louisiana*, 506 U.S. 73, 7-78 (1992) (plain meaning of “exclusive” jurisdiction “necessarily denies jurisdiction of such cases to any other federal court”). *See also* Merriam-Webster’s Collegiate Dictionary 436.

³⁰ Other cases simply rely on the IRS regulation in applying the “primarily” standard.

³¹ 326 U.S. 279, 283 (1945).

³² *Id.*

³³ *See, e.g., People’s Educational Camp Society, Inc. v. Commissioner*, 331 F.2d 923, 931 (2d Cir. 1964).

³⁴ *St. Louis Trust Co. v. United States*, 374 F.2d 427, 431 (8th Cir. 1967). This case involved a section of the tax code similar to section 501(c)(3), not section 501(c)(4). *Id.* at 430.

relies on, however, equate “exclusively” and “primarily,” and the court did not address whether the organization’s primary activity was non-exempt.³⁵ Rather, the opinion turned to the *Better Business Bureau* test, asserted non-exempt activity will not result in the organization losing its tax exemption if the activity “is only incidental and less than substantial,” and applied that test to the facts.³⁶ Several other courts similarly have confused “exclusively,” “primarily,” and “incidental and less than substantial.”³⁷

Some proponents of this view also point to *Federal Election Commission v. Beaumont*, where the Supreme Court said in a footnote, “[a]n organization ‘may carry on lawful political activities and remain exempt under section 501(c)(4) as long as it is primarily engaged in activities that promote social welfare.’”³⁸ *Beaumont*, however, did not consider or address the IRS’s interpretation of section 501(c)(4). Instead, it merely echoed the IRS’s interpretation, quoting a Revenue Ruling. A court does not adopt a point of law simply by referring to it.³⁹

In sum, courts decisions do not support the regulation equating “exclusively” with “primarily.” At most, they permit interpreting the statute to mean section 501(c)(4) organizations can engage in “incidental and less than substantial” political activity. Even this is questionable, however, as courts do not have the authority to change the plain meaning of statutes.

Legislative history

Some supporters of the IRS’s interpretation of section 501(c)(4) also argue the legislative history of another tax law provision, section 527, demonstrates Congress intended section 501(c)(4) groups to be permitted to engage in political activity.⁴⁰ In 1975, Congress passed section 527 of the tax code to address uncertainty about the tax status of political organizations such as parties and campaign committees. The Senate report on the bill addressed “exempt organizations which are not political organizations” under the new provisions, and noted “[u]nder present law, certain tax-exempt organizations (such as sec. 501(c)(4) organizations) may engage in political campaign activities.”⁴¹

This passing reference sheds no light on Congress’ original intent in enacting section 501(c)(4) and has little value under principles of statutory interpretation. The forerunner to section 501(c)(4) was originally passed in 1913, and its scant legislative history contains no

³⁵ *Id.* (citing *Hammerstein v. Kelley*, 349 F.2d 928, 930 (8th Cir. 1965); *Stevens Bros. Foundation, Inc. v. Commissioner*, 324 F.2d 633, 638 (8th Cir. 1963); *Duffy v. Birmingham*, 190 F.2d 738 (8th Cir. 1951); *Better Business Bureau of Washington*, 326 U.S. 279).

³⁶ *Id.* at 432-40.

³⁷ *People’s Educational Camp Society, Inc.*, for example, similarly equated “exclusively” and “primarily” by relying on a case that does not use the word “primarily,” then immediately said those words were the *Better Business Bureau* test “stated another way.” 331 F.2d at 931 (citing *Debs Memorial Radio Fund, Inc. v. Commissioner*, 148 F.2d 948, 952 (2d Cir. 1945)). See also *New Dynamics Found. v. United States*, 70 Fed. Cl. 782, 799 (Fed. Cl. 2006); *Easter House v. United States*, 12 Cl. Ct. 476, 483 (Cl. Ct. 1987).

³⁸ 539 U.S. 146, 150 n.1 (2003) (quoting Rev. Rul. 81-95); Zall, *supra*, at 18-19.

³⁹ Other cases similarly have involved section 501(c)(4) organizations engaged in some political activity, but none of them have directly addressed whether these groups could engage in campaign activity in the first instance. See, e.g., *Federal Election Comm’n v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238 (1986) (“*MCFL*”).

⁴⁰ Zall, *supra*, at 14-15.

⁴¹ S. Rep. No. 93-1357 (1975), reprinted at 1975-1 C.B. 517.

suggestion Congress expected or intended social welfare groups to engage in political activity.⁴² The IRS began interpreting “exclusively” to mean “primarily” in 1959, and immediately encountered difficulty applying the new language to political activities.⁴³ Although the discrepancy between the statute and the regulation was still being debated within the IRS as of 1975,⁴⁴ by that time the IRS’s position was that section 501(c)(4) permits at least some political activity. The comments in the Senate report merely reflect that position. Moreover, under principles of statutory interpretation, subsequent legislative history has very little value.⁴⁵ As a result, the Senate’s 1975 characterization of the statute is irrelevant to Congress’s intent in passing section 501(c)(4) in 1913.

Even if the language quoted from Senate report had some interpretive value, additional statements in the report severely undercut the allegation Congress intended section 501(c)(4) groups to be able to conduct political activities and not disclose their donors. The Senate committee made clear it expected section 501(c) organizations engaged in politics to do so through separate political organizations required to disclose their donors:

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 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 of both the organization and the administration of the tax laws.⁴⁶

Politics is social welfare

Some opponents of disclosing dark money argue political activity actually promotes social welfare.⁴⁷ They note section 501(c)(4) does not refer specifically to political activity or define “social welfare,” and claim the term includes political activity.⁴⁸ Some proponents of this

⁴² John Francis Reilly, Carter C. Hull, and Barbara A. Braig Allen, *IRC 501(c)(4) Organizations*, 2003 EO CPE Text, at I-2, available at <http://www.irs.gov/pub/irs-tege/eotopici03.pdf>.

⁴³ G.C.M. 32394; G.C.M. 32395.

⁴⁴ G.C.M. 38215.

⁴⁵ See, e.g., *Pension Benefit Guar. Corp. v. LTV Corp.*, 496 U.S. 633, 650 (1990) (“subsequent legislative history is a ‘hazardous basis for inferring the intent of an earlier’ Congress”) (citation omitted); *Sullivan v. Finklestein*, 496 U.S. 617, 632 (1990) (Scalia, J., concurring in part) (“Arguments based on subsequent legislative history . . . should not be taken seriously, not even in a footnote.”).

⁴⁶ S. Rep. No. 93-1357 (1975), reprinted at 1975-1 C.B. 517. At that time, section 527 did not require donors to be disclosed, but federal campaign law required contributors to be disclosed by political committees such as those the Senate report envisioned would carry out the political activity of section 501(c) groups. *Mobile Republican Assembly v. United States*, 353 F.3d 1357, 1359-60 (11th Cir. 2003). In 2000, after some groups took advantage of the difference between how the IRS and the FEC defined political activity to spend millions of dollars on campaigns without disclosing their donors, Congress amended section 527 to require disclosure by political organizations.

⁴⁷ See, e.g., Bradley Smith, *The Latest IRS Power Grab*, *Wall Street Journal*, December 8, 2013; Bradley Smith, *The IRS Attack on Political Speech*, *Wall Street Journal*, August 5, 2013; Center for Competitive Politics, Comments on IRS NPRM, REG-134417-13, at 2, December 5, 2013; Hans von Spakovsky, *Silencing Conservatives – The Administration’s Latest Attempt to Censor Political Speech*, *Human Events*, December 18, 2013; Eric Wang, *Prohibiting Politics as Public Service*, *The Hill*, March 11, 2013 (giving “exclusively” its plain meaning “requires us to believe that political advocacy – in fact, politics itself – cannot promote better government and, therefore, social welfare”).

⁴⁸ Smith, *Wall Street Journal*, Dec. 8, 2013; Smith, *Wall Street Journal*, Aug. 5, 2013.

view contend political activity promotes social welfare by educating the public.⁴⁹ Others claim because political change can bring societal change, political activity can promote social welfare.⁵⁰ One noted, for example, groups like the NAACP have used section 501(c)(4) entities to run political advertisements, and claim this shows politics is social welfare.⁵¹ Some also contend electing candidates who support a section 501(c)(4) organization's principles may be the only way the group can achieve its social welfare purpose.⁵²

Some of the claims are simply incorrect. One proponent asserted the statute leaves it to the IRS to define "social welfare," and "for half a century the agency has defined it to include political-campaign activity."⁵³ In fact, since 1959 the IRS's regulation has defined "social welfare" to *exclude* political activity, not include it.⁵⁴ The regulation allows section 501(c)(4) groups to engage in activities that do not promote social welfare as long as those are not their primary activities, but this does not mean the IRS believes political activity promotes social welfare.

Further, even though the statute does not specially define social welfare, courts and the IRS have described it as requiring promotion of the common good and the general welfare of the "community as a whole."⁵⁵ By contrast, campaign activity to support or oppose a candidate for elected office is designed to benefit the supported candidate, not the community as a whole.⁵⁶ At a minimum, political activity that advocates voting for a candidate does not benefit either the opposing candidate or the opposing candidate's supporters.

In the context of commenting on the IRS's proposed rules, some proponents of the view that political activity promotes social welfare have tried to muddle their argument by claiming some activities the IRS is proposing to sweep into the proposed rules, such as "nonpartisan get-out-the-vote drives, voter registration, voter education, and meet-the-candidate nights," support social welfare and thus are not political.⁵⁷ Some truly nonpartisan activity related to political participation does benefit the community as a whole,⁵⁸ but it is spurious to argue the \$256 million section 501(c)(4) groups spent on independent expenditures and electioneering communications in 2012 does so. Nevertheless, some advocates attempt to conflate these radically different sorts of activities.

⁴⁹ Center for Competitive Politics, *supra*, at 2; Zall, *supra*, at 17.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² David B. Rivkin and Lee A. Casey, The True Lesson of the IRS Scandal, *Wall Street Journal*, August 22, 2013.

⁵³ Smith, *Wall Street Journal*, Dec. 8, 2013.

⁵⁴ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

⁵⁵ *Commissioner v. Lake Forest, Inc.*, 305 F.2d 814, 818-19 (4th Cir. 1962). See also *Mutual Aid Assoc. of Church of the Brethren v. United States*, 759 F.2d 792, 795 (10th Cir. 1985); *People's Educational Camp Society, Inc.*, 331 F.2d at 931; Treas. Reg. 65, Art. 519, T.D. 3640, 26 Treas. Dec. Int. Rev. 745, 897 (1924) (early IRS regulation on social welfare organizations, limiting tax exemption to organizations "operated exclusively for purposes beneficial to the community as a whole") (emphasis added). This is a core principle for determining whether any activity, regardless of whether it involves politics, promotes social welfare. Hopkins, *supra*, at 361.

⁵⁶ See, e.g., Priv. Ltr. Rul. 201221025 (activities conducted for "the benefit of a political party and a private group of individuals, rather than the community as a whole," are not social welfare).

⁵⁷ See, e.g., Bradley A. Smith, Silenced by the Taxman, *National Review Online*, November 30, 2013; Smith, *Wall Street Journal*, Dec. 8, 2013. See also Janine Turner, Interview: Brad Smith, December 12, 2013, available at <http://www.campaignfreedom.org/2013/12/12/in-the-new-janine-turner-interview-brad-smith/>.

⁵⁸ Priv. Ltr. Rul. 201221025.

Efforts to obfuscate the difference between nonpartisan and partisan political activities do not change the principle that partisan activity does not promote the welfare of the community as a whole.

Fixing the regulations will force section 501(c)(4) groups to disclose all of their donors

Some opponents of disclosure contend that giving “exclusively” its plain meaning and clarifying what activities are political will force section 501(c)(4) groups engaged in politics to register with the Federal Election Commission or the IRS as political action committees and reveal the identities of their donors.

This is false. Fixing the regulations will not result in disclosure of *all* donors to section 501(c)(4) groups, only those giving money to engage in politics. Section 501(c)(4) groups would not be permitted to engage in political activity themselves, but they could establish separate affiliates or funds to do so.⁵⁹ In fact, as discussed earlier, Congress intended that tax-exempt groups would engage in political activity through separate affiliates or funds when it passed section 527 of the tax code. The contributors to such entities would be disclosed, but the donors supporting valid social welfare activities would not.

Fixing the regulations is an attempt to use the tax code to do what the Supreme Court prohibits

A related argument is that correcting the regulations is an attempt to use the tax code to indirectly require disclosure that the Supreme Court has rebuffed in consideration of campaign finance laws.⁶⁰ According to this theory, the Supreme Court has held people have a right to engage in anonymous political activity, and the government cannot force private organizations – except groups controlled by political parties or candidates, or those that have the primary purpose of engaging in political campaigns – to disclose their donors.⁶¹

This claim overstates the Supreme Court’s decisions on disclosure, and misconstrues the effect of fixing the regulations. Giving “exclusively” its plain meaning and clarifying what activities are treated as political would not force social welfare groups to disclose all their donors or their membership. Rather, as discussed above, section 501(c)(4) groups would be permitted to establish separate affiliates or funds for political activity. Only the identities of those who contributed to an affiliated political group or fund would be disclosed.

Further, the Court has not prohibited requiring disclosure of donors’ identities. In *Buckley v. Valeo*, the Supreme Court considered whether specific language in the Federal Election Campaign Act (“FECA”) requiring extensive reporting and disclosure by political committees was too vague.⁶² Finding that the language of the statute could be interpreted to cover groups “engaged purely in issue discussion,” the Court held that under the FECA, groups could be treated as political committees only if their “major purpose” was political activity.⁶³ While this means the FECA, as written, cannot require groups whose “major purpose” is not

⁵⁹ Separate segregated funds are treated as separate organizations under section 527. 26 U.S.C. § 527(f)(3).

⁶⁰ Smith, *Wall Street Journal*, Dec. 8, 2013; Smith, *National Review Online*, Nov. 30, 2013.

⁶¹ See, e.g., Smith, *Wall Street Journal*, Dec. 8, 2013 (citing *Buckley v. Valeo*).

⁶² *Buckley v. Valeo*, 424 U.S. 1, 79 (1976).

⁶³ *Id.*

political activity to disclose their donors, the opinion does not apply to other statutes and provisions that are not vague.

Several lower courts, for example, have since read *Buckley* as applying only to the FECA, and upheld state campaign finance laws requiring groups to register as political committees even when politics is not their major or primary purpose.⁶⁴ In addition, in *Buckley* itself the Court upheld a provision of FECA requiring disclosure of donors who gave money for the purpose of influencing of federal elections to groups that made independent expenditures but whose major purpose was not politics.⁶⁵ The Court similarly upheld disclosure of contributors to groups that spent money on electioneering communications in *Citizens United*.⁶⁶

Amending the IRS's regulation is not an attempt to achieve indirectly what the Supreme Court prohibited. Rather, it would restore the law to what Congress intended when it established section 501(c)(4) groups must be exclusively engaged in social welfare, and require disclosure only of those who contribute to an affiliated political group or fund for the purpose of influencing elections. These are exactly the contributors the Supreme Court held can and should be disclosed.

Giving "exclusively" its plain meaning will make unrelated business tax law meaningless

Others argue "exclusively" cannot be read plainly because doing so would prevent section 501(c)(4) organizations from engaging in unrelated business activities that are authorized by a different section of the tax code, and thus would make those provisions meaningless.⁶⁷ Tax-exempt organizations sometimes earn income from businesses unrelated to their exempt purposes. For example, a tax-exempt university leasing out its football stadium to a professional football team earns unrelated business income, as does a tax-exempt agricultural organization that regularly sells its members' cattle for a commission.⁶⁸ Sections 511-515 of the tax code provide for the treatment of such "unrelated business taxable income" earned by section 501(c) organizations to prevent these organizations from having an unfair advantage over for-profit businesses.⁶⁹

Giving the word "exclusively" its plain meaning would not make the unrelated business income provisions superfluous. Even if section 501(c)(4) organizations are prohibited from engaging in unrelated business because they must be exclusively engaged in social welfare, the

⁶⁴ See *Center for Individual Freedom v. Madigan*, 697 F.3d 464, 487-88 (7th Cir. 2012) (major purpose limitation a "creature of statutory interpretation"); *National Org. for Marriage v. McKee*, 649 F.3d 34, 55-56 (1st Cir. 2011) (*Buckley* holding an "artifact of the Court's construction of a federal statute"); *Human Life of Washington, Inc. v. Brumsickle*, 624 F.3d 990, 1009-10 (9th Cir. 2010). But see *New Mexico Youth Organized v. Herrera*, 611 F.3d 669, 677-78 (10th Cir. 2010); *North Carolina Right to Life, Inc. v. Leake*, 525 F.3d 274, 286-89 (4th Cir. 2008).

⁶⁵ 424 U.S. at 78.

⁶⁶ 558 U.S. at 52-55. Although it would seem these provisions would require disclosure of contributions used by tax-exempt groups for politics, subsequent FEC interpretations of the statutes opened loopholes that the groups exploit. The FEC has interpreted the statutes to mean contributors only need to be disclosed if they earmark their contributions for a specific campaign ad, and the groups easily avoid disclosure by claiming contributions are not earmarked.

⁶⁷ *Hopkins*, *supra*, at 72; see also *Zall*, *supra*, at 15.

⁶⁸ Internal Revenue Service, Tax on Unrelated Business Income of Exempt Organizations, Publication 598 (March 2012).

⁶⁹ 26 U.S.C. §§ 511-15.

unrelated business income provisions still will apply to other tax-exempt groups not required to be exclusively engaged in their exempt activities. Moreover, interpreting “exclusively” to mean “solely” would not have a significant impact on section 501(c)(4) groups engaged in political activity because few of them conduct unrelated business. In fact, none of the section 501(c)(4) organizations that spent the most money on political activity in 2010 and 2012 reported *any* unrelated business income on their most recent tax returns.⁷⁰

In any event, changing the IRS’s interpretation would not prohibit any section 501(c) organization from engaging in unrelated business activities because they still could do so through a for-profit subsidiary, as many tax-exempt groups do.⁷¹ As a result, interpreting “exclusively” to mean “solely” will not prohibit unrelated business activity by section 501(c) organizations.

Claims the First Amendment undermines any restrictions on political spending by section 501(c)(3) and 501(c)(4) groups

For decades, section 501(c)(3)’s prohibition on political activity has come under attack for supposedly violating the First Amendment. This effort largely has been driven by some churches objecting to restraints on their ability to be involved in political campaigns.⁷² *Citizens United* added a new set of arguments to this discussion that some have seized on to claim the restrictions are unconstitutional.⁷³ Prior to *Citizens United*, section 501(c)(4) largely was ignored in this discussion, probably because the IRS interpreted the provision to allow some political activity. Recently, however, some opponents of dark money disclosure have started relying on

⁷⁰ See, e.g., Crossroads GPS, 2010, 2011, and 2012 Form 990s; American Action Network, 2010 and 2011 Form 990s; American Future Fund, 2010, 2011, and 2012 Form 990s.

⁷¹ See Peter Molk, Reforming Nonprofit Exemption Requirements, 17 Fordham J. Corp. & Fin. 475, 478 (2012); Priv. Ltr. Rul. 200405016 (authorizing section 501(c)(6) organization to form for-profit subsidiary). The activities and any income from the for-profit subsidiary are not attributed to the parent organization as non-exempt activity, as long as the subsidiary is organized for a genuine business purpose and the parent does not so control the subsidiary’s operations that it is a mere instrumentality of the parent. G.C.M. 39598 (citing *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 438 (1943); *Britt v. United States*, 431 F.2d 227, 234 (5th Cir. 1970); *Krivo Industrial Supply Co. v. National Distillers and Chemical Corp.*, 438 F.2d 1098 (5th Cir. 1973)). See also J. Patrick Plunkett and Heidi Neff Christianson, The Quest for Cash: Exempt Organizations, Joint Ventures, Taxable Subsidiaries, and Unrelated Business Income, 31 Wm. Mitchell L. Rev. 1, 17-22 (2004).

⁷² The Alliance for Defending Freedom (“ADF”), for example, has organized an annual Pulpit Freedom Sunday for several years encouraging pastors to make explicitly political statements in church. This “strategic litigation plan” is intended to goad the IRS into taking action against these churches so that ADF could bring cases to test the constitutionality of section 501(c)(3)’s political restriction. See ADF website, Pulpit Freedom Sunday frequently asked questions page, available at http://www.adfmedia.org/files/ChurchFAQ_PulpitFreedom.pdf. See also Commission on Accountability and Policy for Religious Organizations, Government Regulation of Speech by Religious and Other Section 501(c)(3) Organizations 27-34 (2013) (recommending amending the tax code to permit more political activity by churches). Academics have debated these issues at length. See, e.g., Laura Brown Chisholm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 Geo. Wash. L. Rev. 308 (1990); Donald B. Tobin, *The Law of Politics: The Role of Law in Advancing Democracy: Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 Geo. L. J. 1313 (2007).

⁷³ See, e.g., Erik W. Stanley, *LBJ, the IRS, and Churches: The Unconstitutionality of the Johnson Amendment in Light of Recent Supreme Court Precedent*, 24 Regent U.L. Rev. 237 (2011-12); Paul Weitzel, *Protecting Speech from the Heart: How Citizens United Strikes Down Political Restrictions on Churches and Charities*, 16 Tex. Rev. L. & Pol. 155 (2011); Brandon S. Boulter, *Expensive Speech: Citizens United v. FEC and the Free Speech Rights of Tax-Exempt Religious Organizations*, 2010 BYU L. Rev. 2243 (2010).

Citizens United and its intersection with other constitutional doctrines to argue section 501(c)(4)'s restraints on political activity violate the First Amendment.⁷⁴

Traditional analysis of restrictions on tax-exempt organizations

To date courts have upheld restrictions on speech by tax-exempt organizations. The law, however, is in a state of flux, and it is unclear how future courts will treat the restrictions.

The key case upholding the tax code's restrictions is *Regan v. Taxation With Representation of Washington* ("TWR").⁷⁵ In that case, the IRS denied a tax policy group's application for section 501(c)(3) status because the organization planned to engage in a substantial amount of lobbying, which is barred by section 501(c)(3).⁷⁶ TWR argued the prohibition on substantial lobbying violated the First Amendment. A unanimous Supreme Court rejected the challenge, holding the First Amendment does not require Congress to subsidize lobbying.⁷⁷ The Court noted section 501(c)(3) provides two subsidies, a tax exemption for the organization and tax deductibility for donors.⁷⁸ The Court then reasoned that although the government may not deny a benefit to a person because he or she exercises a constitutional right, the First Amendment does not mean Congress must provide subsidies to anyone who wishes to exercise a constitutional right.⁷⁹ "Congress has not infringed any First Amendment rights or regulated any First Amendment activity," the Court concluded. "Congress has simply chosen not to pay for TWR's lobbying."⁸⁰

In addition, noting section 501(c)(4) organizations can engage in an unlimited amount of lobbying, the Court said TWR would be able to exercise its right to speak by lobbying if it established a "dual structure," using a section 501(c)(3) organization for its non-lobbying activities and a related section 501(c)(4) organization for its lobbying activities.⁸¹ The section 501(c)(4) affiliate would provide the section 501(c)(3) group an alternative vehicle for exercising its First Amendment rights. As a result, tax-deductible contributions would not be used to support lobbying, but TWR would still receive a subsidy through its tax exemption. In a footnote, the Court added the IRS's requirement that the two related groups be separately incorporated and keep records adequate to show no tax-deductible contributions were used to pay for lobbying was "not unduly burdensome."⁸²

Although the Court sanctioned the dual structure and suggested it was useful, the decision does not rest on a tax-exempt organization having an alternative way to exercise its right to

⁷⁴ Zall, *supra*, at 9-12.

⁷⁵ 461 U.S. 540 (1983).

⁷⁶ *Id.* at 541.

⁷⁷ *Id.* at 546.

⁷⁸ *Id.* at 544 ("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.").

⁷⁹ *TWR*, 461 U.S. at 545.

⁸⁰ *Id.* at 545-46. *See also Cammarano v. United States*, 358 U.S. 498, 513 (1959) (denying First Amendment challenge to IRS regulation that denied business expense deductions for lobbying activities on the grounds that "petitioners are not being denied a tax deduction because they engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own pockets").

⁸¹ *Id.* at 544.

⁸² *Id.* at 544 & n. 6.

speak.⁸³ A three-justice concurrence written by Justice Blackmun, however, focused on this alternative “channel of communication” and said it was a constitutional requirement. Standing alone, section 501(c)(3)’s ban on substantial lobbying would deny TWR a benefit for exercising its constitutional rights, the concurrence asserted, but concluded that “constitutional defect” is avoided because TWR can lobby through a section 501(c)(4) affiliate.⁸⁴ The concurrence added as long as the IRS went no further than requiring separate incorporation and record-keeping, a section 501(c)(3)’s right to speak would not be infringed because it could do so through its section 501(c)(4) affiliate without losing tax benefits for non-lobbying activities.⁸⁵ Any “significant restriction on this channel of communication, however, would negate the saving effort of § 501(c)(4),” according to the concurrence.⁸⁶

Several later Supreme Court decisions adopted Justice Blackmun’s concurring view that an organization’s First Amendment rights are not violated only when it can, without an undue burden, establish an alternative channel to speak.⁸⁷ The Court has not, however, struck down *TWR*, and has relied on its reasoning that Congress may put limits on activity it subsidizes in some recent decisions. In the 2009 *Ysursa v. Pocatello Educational Association* case, for example, the Court relied on the unanimous opinion in *TWR* to hold that under the First Amendment, the government “is not required to assist others in funding the expression of particular ideas, including political ones.”⁸⁸ As a result, this area of law, called the “unconditional conditions” doctrine, is often seen as incoherent, and is notorious for being applied inconsistently.⁸⁹ The Supreme Court’s most recent discussion of *TWR*, for example, first noted the case held Congress had merely chosen not to subsidize lobbying, but added the opinion “highlighted” the alternative channel.⁹⁰

Some opponents of restrictions on political activity by tax-exempt organizations argue *TWR* does not apply because it addressed a restriction on lobbying, while sections 501(c)(3) and (c)(4) involve restrictions on political activity. Both lobbying and political activity, however, are protected under the First Amendment, and there is no reason to distinguish between the two in this context. In *Branch Ministries v. Rossotti*, the District of Columbia Circuit applied the unconstitutional conditions doctrine to uphold section 501(c)(3)’s ban on political activity.⁹¹ In

⁸³ Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, Loyola Law School Legal Studies Paper No. 2010-57, at 13 (Dec. 2010); *Agency for Int’l Dev. v. Alliance for Open Soc’y Int’l*, 133 S. Ct. 2321, 2334 (June 20, 2013) (Scalia, J., dissenting) (asserting *TWR* did not rely on the availability of a separate affiliate).

⁸⁴ *TWR*, 461 U.S. at 552 (Blackmun, J., concurring).

⁸⁵ *Id.* at 553.

⁸⁶ *Id.*

⁸⁷ See, e.g., *FCC v. League of Women Voters*, 468 U.S. 364, 400 (1984) (finding FCC rule unconstitutional banning editorializing by television stations that accept federal funds because “such a station is not able to segregate its activities according to the source of its funding”).

⁸⁸ 555 U.S. 353, 358-60 (2009) (upholding Idaho law banning payroll deductions for local government employees’ union political activities). See also Aprill, *supra*, at 28-32.

⁸⁹ See, e.g., Roger Colinvaux, *The Political Speech of Charities in the Face of Citizens United: A Defense of Prohibition*, 62 Case W. Res. L. Rev. 685, 739 (2012); Aprill, *supra*, at 12; Cass R. Sunstein, *Why the Unconstitutional Conditions Doctrine is an Anachronism*, 70 B.U. L. Rev. 593, 594-95 (1990); Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 Harv. L. Rev. 1413, 1415-16 (1989). See also *Dolan v. City of Tigard*, 512 U.S. 374, 407 n.12 (1994) (Stevens, J., dissenting).

⁹⁰ *Agency for Int’l Dev.*, 133 S. Ct. at 2328-30.

⁹¹ 211 F.3d 137 (D.C. Cir. 2000).

that case, the IRS revoked the section 501(c)(3) status of a church for engaging in political activity, and the church argued section 501(c)(3)'s complete prohibition on political activity violated its First Amendment rights.⁹² Relying on *TWR*'s concurrence, the court rejected the claim, reasoning Branch Ministries had an alternative channel to communicate its political views.⁹³ While a section 501(c)(3) group cannot create its own political action committee ("PAC"), it could establish an affiliated section 501(c)(4) organization, the court concluded, and that group legally could form a PAC "free to participate in political campaigns."⁹⁴

The decisions in *TWR* and *Branch Ministries* are the strongest arguments for the constitutionality of section 501(c)(3)'s ban on political activity and section 501(c)(4)'s limitations. Both directly address bans or significant limits on speech by tax-exempt organizations, and conclude those constraints are constitutional. Language in *Citizens United*, discussed in detail below, threatens the strength of these cases to support the political activity restrictions, especially if the Supreme Court adopts or applies the alternative channel approach of *TWR*'s concurrence.

Tax-exempt status provides a subsidy

Regardless of which approach is applied, a central issue for the constitutionality of section 501(c)(4) is whether social welfare groups receive a subsidy for their political activity that justifies any restrictions on their speech. For section 501(c)(3) organizations, the deductibility of contributions constitutes a subsidy, as the Court held in *TWR*.⁹⁵ The Court also has repeatedly held a tax exemption provides a subsidy.⁹⁶ Some opponents of restrictions on political spending by tax-exempt groups have argued, however, there is no subsidy when an organization is engaged in political activity.⁹⁷ The basis for this claim is the provisions for taxing political activity by section 501(c)(4), (c)(5), and (c)(6) organizations. Despite their general exemption from tax, a provision of section 527 levies a tax on the lesser of (1) the amount an organization spends on political activities, or (2) its investment income.⁹⁸ According to this argument, if a section 501(c)(4) organization pays taxes on its political activities, then there is no subsidy, and the justification for speech restrictions is eliminated.⁹⁹

As a factual matter, however, tax-exempt organizations engaged in politics do not pay much, if any, tax under section 527. The section 501(c)(4) organizations that spent the most money on political activity in 2010 and 2012 reported far less investment income than political activity, meaning they paid tax on the lower amount and thus were subsidized for most of their

⁹² *Id.* at 140.

⁹³ *Id.* at 143.

⁹⁴ *Id.*

⁹⁵ Some commentators, however, have argued the deductibility does not constitute a subsidy. *See, e.g.,* Edward A. Zelinsky, *Are Tax "Benefits" for Religious Institutions Constitutionally Dependent on Benefits for Secular Entities?*, 42 B.C. L. Rev. 805 (2001).

⁹⁶ *See, e.g., Leathers v. Medlock*, 499 U.S. 439, 450 n.3 (1991); *Texas Monthly, Inc. v. Bullock*, 489 U.S. 1, 14 (1989); *TWR*, 461 U.S. at 544.

⁹⁷ Zall, *supra*, at 7.

⁹⁸ 26 U.S.C. § 527(f). The purpose of this provision is to equalize the taxation of tax-exempt organizations engaged in politics with section 527 political organizations, which pay no tax on political activity but the highest corporate rate for other income.

⁹⁹ Zall, *supra*, at 6-7.

political activity. For example, Crossroads GPS reported spending \$74,510,334 on political activity in 2012, and earning no investment income at all.¹⁰⁰ As a result, it did not even file the form on which it would have computed any taxes owed.¹⁰¹ Similarly, the American Action Network reported spending \$5,535,848 on political activity between July 2010 and June 2011, and just \$4 in investment income.¹⁰² The tax exemption did, in fact, provide a subsidy to these groups.

In addition, the claim that section 501(c)(4) organizations do not receive a subsidy through their tax exemption ignores a separate subsidy provided by the exemption from the gift tax for contributions to these groups. Tax law generally imposes a 35 percent tax on gifts greater than \$14,000 per year, but gifts to section 501(c)(3) and section 527 organizations are exempted.¹⁰³ The law does not provide an exemption for gifts to section 501(c)(4) organizations, and the IRS traditionally took the position such gifts are subject to the tax, even if it rarely, if ever, enforced that position.¹⁰⁴ The IRS, however, backed off that position in July 2011, when a controversy erupted after the IRS sent letters to several donors indicating they might be subject to gift taxes for contributions to section 501(c)(4) organizations.¹⁰⁵ The IRS closed all examinations based on gifts to section 501(c)(4) groups, and said it would not open any others until after it reviewed the issue.¹⁰⁶ As the IRS has not issued any further guidance, contributions to section 501(c)(4) organizations are, at least for now, exempted from the gift tax, providing these groups a further subsidy.

At times, this issue is conflated with the question of whether section 501(c)(4) groups get “tax breaks” not provided to political organizations organized under section 527.¹⁰⁷ The question under *TWR*, however, is whether an organization receives a tax subsidy, not whether it is subject to less taxation than another type of organization.

Citizens United challenges

TWR and *Branch Ministries* have long been criticized as violating the First Amendment rights of churches and other charities, and some opposed to limits on political spending have seized on language in *Citizens United* to argue the traditional analysis is no longer viable. These arguments largely relate to applying the alternative channel rationale to the tax code’s political restrictions. As a result, the strength of these claims rests in significant part on whether the unanimous *TWR* opinion or Justice Blackmun’s concurrence is applied.

In *Citizens United*, a section 501(c)(4) group organized as a corporation wanted to make independent expenditures, but was barred from doing so under a federal election law barring

¹⁰⁰ Crossroads GPS, 2012 Form 990, at 1, Schedule C.

¹⁰¹ *Id.* at 27.

¹⁰² American Action Network 2010 Form 990, at 1, 20.

¹⁰³ 26 U.S.C. §§ 2501(a)(4), 2522(a)(2).

¹⁰⁴ Barbara K. Rhomberg, *The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions*, 15 *Tax’n of Exempts* 62, 65 (Sept.-Oct. 2003).

¹⁰⁵ Stephanie Strom, *I.R.S. Drops Audits of Political Donors*, *New York Times*, July 7, 2011.

¹⁰⁶ Steven T. Miller, Deputy Commissioner for Services and Enforcement, Internal Revenue Service, *Guidance for SB, SE Estate and Gift Tax and TE/GE Exempt Organizations*, July 7, 2011.

¹⁰⁷ See, e.g., Smith, *Wall Street Journal*, Dec. 8, 2013; Brad Smith, *Oh Bob!*, Center for Competitive Politics, January 7, 2014, available at <http://www.campaignfreedom.org/2014/01/07/oh-bob/>.

corporations from directly making campaign expenditures.¹⁰⁸ The Court applied “strict scrutiny” to the election law – the most stringent test – and struck it down.¹⁰⁹ In explaining its analysis and decision, the Court characterized First Amendment jurisprudence in ways some have argued show the tax code’s restrictions on political activity also are unconstitutional.

One argument is that the Court’s application of strict scrutiny to campaign laws banning speech is evidence the Court would apply the same high standard to the tax code’s restrictions.¹¹⁰ Courts, however, normally apply far less stringent tests to the tax code.¹¹¹ In *TWR*, for example, the Court rejected applying strict scrutiny to section 501(c)(3).¹¹² Tax laws creating classifications generally are presumed constitutional and are upheld if they bear a “rational relationship to a legitimate governmental purpose,” the Court held.¹¹³ In *Citizens United*, the Court’s application of strict scrutiny was based on the purpose of the law and the penalties for violating it. The campaign finance law at issue was “[e]nacted to control or suppress speech,” and thus the strictest test needed to be applied, the Court held.¹¹⁴ By contrast, sections 501(c)(3) and (c)(4) were created to define which entities are entitled to tax-exempt status.¹¹⁵ The Court in *Citizens United* also pointed to the campaign finance law’s criminal sanctions to justify applying strict scrutiny.¹¹⁶ Under tax law, however, the consequence of violating the restrictions on political activity is, at most, revocation of an organization’s tax-exempt status.¹¹⁷

Second, some have argued *Citizens United* implicitly blocked application of the alternative channel rationale to the tax code’s political restrictions and overturned *Branch Ministries* by holding that while campaign finance law authorizes corporations to establish PACs and make political expenditures through them, this arrangement does not allow corporations themselves to speak because “[a] PAC is a separate association from the corporation.”¹¹⁸ Under the Court’s unanimous opinion in *TWR*, an alternative channel is not necessary for the restriction to be valid, making this statement irrelevant to the analysis.¹¹⁹ Even if the Court applied the reasoning of the *TWR* concurrence, a PAC or separate segregated fund established by a tax-exempt organization to conduct its political activity still may constitute a valid alternative channel. The Court’s holding in *Citizens United* that a PAC does not allow a corporation to speak can be distinguished because the Court was considering a statute that, unlike section 501(c)(3), did not provide a subsidy. The Court itself made this distinction in an earlier decision that addressed applying *TWR* to the same campaign finance law at issue in *Citizens United*.¹²⁰ As a result, the Court’s pronouncement in *Citizens United* may not undermine *TWR*.

¹⁰⁸ *Citizens United v. Federal Election Comm’n*, 558 U.S. 310 (2010).

¹⁰⁹ *Id.* at 340, 365.

¹¹⁰ Stanley, *supra*, at 264-66; Zall, *supra*, at 3-4.

¹¹¹ Aprill, *supra*, 10, 24.

¹¹² *TWR*, 461 U.S. at 547.

¹¹³ *Id.*; see also *Armour v. City of Indianapolis*, 132 S. Ct. 2073, 2080 (2012); Galston, *supra*, at 892-97.

¹¹⁴ *Citizens United*, 558 U.S. at 336.

¹¹⁵ Colinvaux, *supra*, at 710-17.

¹¹⁶ *Citizens United*, 558 U.S. at 337.

¹¹⁷ Colinvaux, *supra*, at 717-21.

¹¹⁸ *Citizens United*, 558 U.S. at 337; Stanley, *supra*, at 270-73; Weitzel, *supra*, at 162-63.

¹¹⁹ Colinvaux, *supra*, at 722.

¹²⁰ *MCFL*, 479 U.S. at 256 n. 9; see Aprill, *supra*, at 82-83.

Citizens United further asserted even if using a PAC allowed a corporation to speak, that option does not alleviate the First Amendment problems because “PACs are burdensome alternatives.”¹²¹ According to the Court, they are “expensive to administer and subject to extensive regulations” because:

every PAC must appoint a treasurer, forward donations to the treasurer promptly, keep detailed records of the identities of the persons making donations, preserve receipts for three years, and file an organization statement and report changes to this information within 10 days. . . . And that is just the beginning. PACs must file detailed monthly reports with the FEC, which are due at different times depending on the type of election that is about to occur.¹²²

Some have argued that under the alternative channel doctrine, *Citizens United* makes the tax code’s restrictions on political activities unconstitutional because the option of establishing a PAC or separate segregated fund is unduly burdensome.¹²³ If the rationale of the unanimous *TWR* opinion is applied, however, the burden of establishing a PAC is irrelevant because of the tax subsidy. Moreover, a condition is not unconstitutional simply because it imposes some burden on the exercise of First Amendment rights. In *Ysursa*, for example, the Court held a statute that caused “substantial difficulties” in collecting funds for political activity did not infringe on political speech.¹²⁴

In addition, while *Citizens United* asserts establishing a PAC is burdensome, it does not suggest it is an *unduly* burdensome alternative for an organization to receive a tax subsidy, the standard set out in *TWR*. The Court has not established what constitutes an undue burden, and the responsibilities of maintaining the dual structure of separate section 501(c)(3) and (c)(4) organizations for lobbying validated in *TWR* may be comparable to administering a PAC or separate segregated fund. The tax code and IRS regulations require tax-exempt entities to keep and maintain records and file annual informational tax returns, and contain special provisions relating to reporting and taxation of lobbying activities.¹²⁵ In addition, there are numerous revenue rulings, revenue procedures, general counsel memoranda, private letter rulings, tax court decisions, and other IRS authority related to tax-exempt organizations that could be relevant to the record-keeping and separate incorporation requirements *TWR* held are not unduly burdensome.¹²⁶

Finally, opponents of political restrictions on tax-exempt organizations contend the statutes violate the First Amendment because they impermissibly disfavor certain speakers.¹²⁷ Some claim the restrictions improperly disfavor section 501(c)(3) organizations as opposed to other tax-exempt groups that may engage in political activity, while others contend they censor organizations that espouse unconventional or unpopular ideas, pointing in part to language in

¹²¹ *Citizens United*, 558 U.S. at 337.

¹²² *Id.* at 337-38 (citations omitted).

¹²³ Zall, *supra*, at 8-11; Stanley, *supra*, at 270-73.

¹²⁴ *Ysursa*, 555 U.S. at 358-59; see Galston, *supra*, at 909-10 (citing *MCFL*, 479 U.S. at 256 & n.9, *American Soc’y for Ass’n Executives v. United States*, 195 F.3d 47, 50-51 (D.C. Cir. 1999) and *Mobile Republican Assembly v. United States*, 353 F.3d 1357, 1362 (11th Cir. 2003)).

¹²⁵ 26 U.S.C. §§ 6001, 6033; Treas. Reg. §§ 1.6001-1(c); 1.6033-2.

¹²⁶ See Treas. Reg. § 601.601.

¹²⁷ Stanley, *supra*, at 267-70; Zall, *supra*, at 10-11.

Citizens United saying: “By suppressing the speech of manifold corporations, both for-profit and nonprofit, the Government prevents their voices and viewpoints from reaching the public and advising voters on which persons or entities are hostile to their interests.”¹²⁸ The restrictions on political activities, however, are not aimed at the “suppression of dangerous ideas.”¹²⁹ They apply equally to all section 501(c)(3) and section 501(c)(4) organizations, regardless of their views, and thus do not disfavor unpopular organizations. Nor do the restrictions improperly disfavor section 501(c)(3) or (c)(4) organizations. As already noted, tax laws creating classifications are generally presumed to be constitutional, and the Court in *TWR* held treating certain types of tax-exempt organizations differently than others does not violate the First Amendment.¹³⁰

Coming next: using section 501(c)(6) organizations for dark money spending

Section 501(c)(4) organizations have been the most politically active nonprofits in the election cycles following *Citizens United*, but it appears likely those interested in secretly spending money on politics may increasingly rely on section 501(c)(6) organizations to do so. Like section 501(c)(4)s, section 501(c)(6) groups can keep their donors secret and spend up to half of their expenditures on political activities, but such groups face even less controls by IRS and states. In response to this emerging issue, CREW recently filed a petition asking the IRS to clarify rules governing the permissible activities in which section 501(c)(6) groups may engage, and there is at least one proposal to limit their political activity.¹³¹

The tax code and IRS regulations lay out several requirements to qualify as tax-exempt under section 501(c)(6). Among other things, these groups must be associations of members with a common business interest and a purpose to promote that common business interest, and must direct their activities to improving business conditions of one or more lines of business.¹³² Unlike sections 501(c)(3) and (c)(4), section 501(c)(6) does not explicitly limit political activities, but the IRS applies the “primarily” test to determine if their activities are promoting their exempt purpose.¹³³

Section 501(c)(6) groups – largely chambers of commerce, trade associations, and business leagues – have long played some role in political activities. Federal campaign spending by section 501(c)(6) organizations has increased over the last three election cycles, from \$27.3 million in 2008 to \$46.6 million in 2010 to \$55.3 million in 2012.¹³⁴ In fact, the U.S. Chamber

¹²⁸ *Citizens United*, 558 U.S. at 354.

¹²⁹ *TWR*, 461 U.S. at 548 (citing *Cammarano*, 358 U.S. at 513).

¹³⁰ *Id.* at 547-50.

¹³¹ See *CREW Calls on IRS to Clarify Rules for 501(c)(6) Groups and Investigate Freedom Partners*, November 5, 2013; Colvin, *A Silver Bullet That Would End Secret Tax-Exempt Money in Elections*, Campaign for America’s Future website, April 11, 2012.

¹³² See, e.g., John Francis Reilly, Carter C. Hull, & Barbara A. Braig Allen, *IRC 501(c)(6) Organizations*, Exempt Organizations-Technical Instruction Program for FY 2003, at K-4 (2003), available at <http://www.irs.gov/pub/irs-tege/eotopick03>.

¹³³ G.C.M. 34233.

¹³⁴ Open Secrets, *Political Nonprofits*, available at http://www.opensecrets.org/outsidespending/nonprof_summ.php. It is unknown how much section 501(c)(6) groups have spent on local and state political activities, but some have been active, for example, in judicial races. See Michigan Campaign Finance Network, *2012 Supreme Court Race Was State’s Most Expensive, Least Transparent Ever*, February 21, 2013 (reported Americans for Job Security, a section 501(c)(6) organization, spent \$1.1 million on television ads in a state trial court election).

of Commerce was the single largest dark money spender in the 2010 election cycle, putting \$33.8 million into federal political activity.¹³⁵

Wealthy groups and individuals recently have turned to section 501(c)(6) business leagues as vehicles to funnel dark money into political activities. One example is Freedom Partners Chamber of Commerce, Inc. (“Freedom Partners”), which originally operated under the name Association for American Innovation, Inc. (“AAI”). Freedom Partners has been linked to the Koch brothers,¹³⁶ who operate a “dark money network of nonprofit corporations.”¹³⁷ In November 2011, Freedom Partners/AAI applied for tax-exempt status under section 501(c)(6) as a business league, describing its anticipated activities as “promot[ing] the common business interests and conditions of its members in order to improve their competitive standing and innovation in various lines of business, industries, etc. in which they are engaged.”¹³⁸ In fact, however, the only activity in which Freedom Partners engaged in 2012 was providing grants totaling \$235,715,250 to 30 different politically active tax-exempt organizations.¹³⁹

Each grant was provided for “general support,” and the grant recipients were prohibited from using the funds for lobbying activities and electioneering purposes.¹⁴⁰ Nevertheless, because Freedom Partners imposed no requirements on how grant recipients must spend the funds and specified no activities on which the funds should be spent, the grants freed up other funds for political activities. Americans for Prosperity, for example, received \$32.3 million from Freedom Partners in 2012, and spent \$36.3 million on federal campaign activity during the 2012 election cycle.¹⁴¹

Another section 501(c)(6) group, Americans for Job Security (“AJS”), has long participated in political campaigns. The group spent \$8.2 million on federal elections in 2010 and \$15.8 million in the 2012 cycle, and has been active in state elections.¹⁴² AJS also has participated in schemes to funnel millions of dollars to groups involved in state ballot initiatives.¹⁴³ CREW and others have filed complaints with the IRS alleging AJS violated its tax-exempt status by spending far too much on political activities and advancing the electoral agenda of the Republican Party, not its members, but the IRS has not taken public action to date.

Section 501(c)(6) has several advantages over section 501(c)(4) for those interested in anonymous political spending. As noted, this section of the tax code does not explicitly require these groups to be exclusively engaged in their exempt purpose. Further, the argument that

¹³⁵ Open Secrets, Political Nonprofits: Top Election Spenders, 2010, available at http://www.opensecrets.org/outsidespending/nonprof_elec.php?cycle=2010.

¹³⁶ See, e.g., Mike Allen and Jim VandeHei, Exclusive: The Koch Brothers’ Secret Bank, *Politico*, September 11, 2013.

¹³⁷ See Press Release, California Fair Political Practices Commission, FPPC Announces Record Settlement in \$11 Million Arizona Contribution Case, October 24, 2013; Matea Gold, Koch-Backed Political Coalition, Designed to Shield Donors, Raised \$400 Million in 2012, *Washington Post*, January 6, 2014.

¹³⁸ AAI Form 1024, Application for Recognition of Exemption Under Section 501(a), Attachment B, at 2.

¹³⁹ AAI 2011 Form 990, Schedule I, Part IV.

¹⁴⁰ *Id.*

¹⁴¹ See <https://www.opensecrets.org/outsidespending/summ.php?cycle=2012&chrt=V&disp=O&type=A>.

¹⁴² *Id.*; <https://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=V&disp=O&type=U>.

¹⁴³ Nicholas Confessore, Group Linked To Kochs Admits To Campaign Finance Violations, *New York Times*, October 24, 2013; Mike McIntire, Hidden Under Tax-Exempt Cloak, Political Dollars Flow, *New York Times*, September 23, 2010.

campaign activity and politically-tinged issue advocacy advance the business interests of a group's members has more appeal than the argument such spending promotes the social welfare of the community as a whole. The IRS has provided very little guidance regarding permissible political activity by section 501(c)(6) groups, what activities promote the common business interest of members of these groups, and whether these groups may transfer funds through general support grants.¹⁴⁴ The IRS's silence provides leeway for groups so inclined to engage in political activity. Organizing under section 501(c)(6) also may make it more difficult for states to regulate the groups. Some state attorneys general are able to assert authority over political activity by section 501(c)(4) social welfare groups through state laws governing charitable organizations. These laws, however, may not provide jurisdiction over section 501(c)(6) groups.¹⁴⁵

Freedom Partners and AJS also are organized under section 501(c)(6) because such groups can be funded by membership dues, concealing even the most basic information about their financial backers. While most tax-exempt organizations are not required to disclose to the public the names of their donors under tax law, they must identify to the IRS those who contributed more than \$5,000 in a year.¹⁴⁶ The public is allowed to see the amounts contributed by these large donors, but not their names.¹⁴⁷ Genuine membership dues – defined by the IRS as payments for which the donor received comparably valued benefits, such as subscriptions to publications or admission to events – are treated differently.¹⁴⁸ Unlike contributions, nonprofits need not provide the IRS with the names of those who paid membership dues or the amounts they paid. Taking advantage of this distinction, Freedom Partners claims it is funded largely by membership dues, and did not provide the IRS any information about \$255 million it received in revenue in 2011 and 2012.¹⁴⁹ A Koch brothers' operative touted this lack of reporting to financial supporters in 2013, saying Freedom Partners was set up as a business league to take advantage of the “additional safeguards” provided by section 501(c)(6) because “members’ names are not disclosed to the IRS.”¹⁵⁰

These advantages, the continuing focus on political activities of section 501(c)(4) organizations, and the direction taken by the Koch brothers-linked Freedom Partners strongly suggest those interested in dark money spending increasingly will turn to section 501(c)(6) to accomplish their goals. The activity by section 501(c)(6) groups to date likely is only the tip of the iceberg.

¹⁴⁴ The rulemaking initiated by the IRS in late 2013 asked for comments on whether changes to which activities qualify as “political” should apply to section 501(c)(6) groups, but again the IRS made no commitment to act. 78 Fed. Reg. at 71537. The rulemaking did not address any other guidance for section 501(c)(6) groups.

¹⁴⁵ Some state authorities have started increasing the regulation of political activities of nonprofits. New York Attorney General Eric Schneiderman, for example, adopted regulations in June 2013 imposing disclosure and other requirements on nonprofit groups involved in politics. *See, e.g.*, Byron Tau, [Eric Schneiderman Targets Political Nonprofits](#), *Politico*, June 7, 2013.

¹⁴⁶ 26 U.S.C. § 6104(d); 26 C.F.R. § 301.6104(d)-1.

¹⁴⁷ Internal Revenue Service, Schedule B, General Instructions, Public Inspection, at 5 (2012).

¹⁴⁸ Internal Revenue Service, Instructions for Form 990 Return of Organization Exempt from Income Tax, at 36-39 (2012).

¹⁴⁹ Adam Rappaport, [Freedom Partners Begrudgingly Discloses Limited Contribution Information](#), CREW blog post, November 8, 2013.

¹⁵⁰ Peter H. Stone, [Sean Noble, ‘Wizard’ Behind Koch Brothers’ Donor Network, Now On The Outs](#), *Huffington Post*, October 2, 2013.

For-profit groups

While section 501(c)(6) groups are the most likely vehicle for dark money, others may hide their political spending by using for-profit advocacy groups. While most political activity is conducted through tax-exempt organizations, the law does not bar for-profit entities from engaging in politics, especially after *Citizens United* freed corporations to make independent expenditures. With increasing scrutiny on tax-exempt organizations, there has been increasing interest in using for-profit entities to conduct political activity.¹⁵¹

A for-profit political entity could be set up to accept contributions or capital investments, and spend some portion of its expenditures on political activity. As long as the group did not spend so much on political activity that it would be considered a political committee or organization under campaign finance or tax laws, it would not have to disclose its funding. The public would learn less about the activities and finances of such groups than about tax-exempt organizations engaged in similar activities because the tax returns of for-profit entities are not public. Such entities would be subject to corporate taxes, however, reducing the amount they could spend on politics or other activities, although some tax law practitioners have suggested their tax exposure could be limited or eliminated.¹⁵² It is unclear how much political activity for-profit groups are conducting at this point, but greater regulation of tax-exempt organizations may make such groups more attractive.¹⁵³

Conclusion

Opponents of restrictions on political activity by tax-exempt organizations already are challenging efforts to respond to the explosion of dark money spending since *Citizens United*. Their arguments raise some difficult issues both with regard to the correct interpretation of the tax code and the constitutionality of restrictions. Analysis of the cases and facts demonstrates that, properly construed, section 501(c)(4) prohibits social welfare groups from engaging in any political activity, and that the restrictions applied to both section 501(c)(3) and (c)(4) organizations do not violate the First Amendment. Faced with the possibility of tighter restrictions on section 501(c)(4)s, individuals, groups, and corporations seeking to continue anonymous spending are turning to section 501(c)(6) business leagues, and also likely are considering the use of for-profit entities. Those seeking to curb the amount of anonymous money coursing through our political system will need to remain vigilant to the evolving tactics when crafting solutions.

¹⁵¹ See, e.g., Thomas Catan, Political Donors Chase Funding Alternative, *Wall Street Journal*, January 5, 2014.

¹⁵² *Id.*

¹⁵³ *Id.*