

**Issue 1 – Should the current prohibition of political campaign intervention by 501(c)(3) organizations be relaxed or modified in some way to permit limited speech in support of or opposition to political candidates?**

Excerpt from Staff Memo to Senator Grassley Relating to Commission

## **Appendix E: Eliminate or Circumscribe Electioneering Prohibition**

### **Present law**

#### **(1) Tax Law**

##### *(a) Electioneering Prohibition*

An organization cannot be exempt from federal income tax as an organization described in section 501(c)(3) unless it “does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to), any candidate for public office.” The regulations provide that activities that constitute participation or intervention in a political campaign include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of, or in opposition to, a candidate for public office.<sup>1</sup> A determination whether an organization has participated or intervened is based upon all the relevant facts and circumstances. This prohibition on political campaign intervention by section 501(c)(3) organizations is referred to as the “electioneering prohibition” for short.

Under section 4955, an amount paid or incurred by a section 501(c)(3) organization to participate in, or intervene in, a political campaign for public office is considered a “political expenditure.”<sup>2</sup> Section 4955(a) imposes an initial tax on each political expenditure by a section 501(c)(3) organization equal to 10 percent of the amount of the expenditure. In addition, an initial tax equal to 2½ percent of the organization’s political expenditures is imposed on any organization manager who agrees to the making of any expenditure, knowing it to be a political expenditure. If the expenditure is not promptly corrected, section 4955(b) imposes an additional tax equal to 100 percent of the political expenditure upon the organization, and an additional tax equal to 50% of the expenditure upon any manager who refuses to agree to the correction.

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<sup>1</sup> Treas. Reg. 1.501(c)(3)-1(c)(3) (iii).

<sup>2</sup> I.R.C. § 4955(d)(1).

Section 6852 authorizes the IRS to immediately determine the amount of income tax and section 4955 tax due from an organization that flagrantly violates the electioneering prohibition, which taxes shall be immediately due and payable.

Section 7409 authorizes the IRS to seek an injunction from a federal district court prohibiting any further political expenditures by an organization that “has flagrantly participated in, or intervened in . . . any political campaign” and that has not ceased the expenditures upon being notified that the Service intends to seek an injunction.

*(b) Lobbying Restriction*

An organization is exempt under section 501(c)(3) only if “no substantial part of [its] activities is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in [section 501](h)).”

Thus, section 501(c)(3) allows organizations exempt under that section to lobby so long as they do not devote a substantial part of their activities to attempting to influence legislation. The IRS has not adopted a percentage test for determining whether a substantial part of an organization’s activities consist of lobbying; rather, a facts and circumstances test is used. But in one court case, the court held that an organization’s attempts to influence legislation that constituted less than five percent of the organization’s total activities were not substantial.<sup>3</sup> In another case, the court noted that an organization’s expenditures for lobbying activities ranged from 16.6 to 20.5 percent of total expenditures during a four-year period, and concluded that -for an Organization “to devote so much of its total resources to legislative activities, it fairly can be concluded that its purposes no longer accord with conceptions traditionally associated with common-law charity.”<sup>4</sup>

Section 501(h) of the Code, enacted in 1976, allows section 501(c)(3) public charities to elect to have their lobbying activities governed by expenditure tests in lieu of being subject to the “substantial part” test (churches and private foundations and not allowed to make the election). A public charity that makes the election may make lobbying expenditures within specified dollar limits determined under section 4911. If an electing public charity’s lobbying expenditures are within the dollar limits determined under section 4911(c), the electing public charity will not owe tax under section 4911, nor will it lose its tax-exempt status. If, however, the electing public charity’s lobbying expenditures exceed its section 4911 lobbying limit, the organization is subject to an excise tax on the excess lobbying expenditures. Further, if an electing public charity’s lobbying expenditures normally are more than 150 percent of its section 4911 lobbying limit, the organization’s tax-exempt status as a section 501(c)(3) organization will be revoked.

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<sup>3</sup> Seasongood v. Comm’r, 227 F.2d 907, 912 (6<sup>th</sup> Cir. 1955).

<sup>4</sup> Haswell v. United States, 205 Ct. Cl. 421, 443-44 (1974).

A public charity that elects the expenditure test may nevertheless lose its tax exempt status if it is an action organization, i.e., its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and it advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public.<sup>5</sup>

In Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983), the Supreme Court ruled that the section 501(c)(3) lobbying restriction is constitutional. TWR, a section 501(c)(3) organization, argued that the lobbying limitation violated its right to freedom of speech under the First Amendment.

In holding that the lobbying restriction does not violate the First Amendment, the Court posited that—

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. The system Congress has enacted provides this kind of subsidy to ... those charitable organizations that do not engage in substantial lobbying. In short, Congress chose not to subsidize lobbying as extensively as it chose to subsidize other activities that non-profit organizations undertake to promote the public welfare....<sup>6</sup>

Relying on Cammarano v. United States, 358 U.S. 498 (1959) – in which the Court upheld a Treasury regulation that denied business expense deductions for lobbying activities, holding that Congress is not required by the First Amendment to subsidize lobbying – the Court in TWR said—

The Code does not deny TWR the right to receive deductible contributions to support its non-lobbying activity, nor does it deny TRW any independent benefit on account of its intention to lobby. Congress has merely refused to pay for lobbying out of public monies.... Congress has not infringed any first Amendment rights or regulated any First Amendment activity. Congress has simply chosen not to pay for TWR's lobbying.<sup>7</sup>

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<sup>5</sup> Treas. Reg. 1.501(c)(3)-1(c)(3).

<sup>6</sup> Regan v. Taxation With Representation of Washington, 461 U.S. 540, 544 (1983).

<sup>7</sup> *Id.* at 545-46.

## (2) Campaign Finance Law

In Buckley v. Valeo, 424 U.S. 1 (1976), the Supreme Court considered the constitutionality of the Federal Election Campaign Act of 1971 (FECA), as amended in 1974. The Court upheld the constitutionality of certain statutory provisions, including contribution limitations to candidates for federal office and disclosure and record-keeping provisions. But the Court found other provisions unconstitutional, including a \$1,000 limitation on independent expenditures. Former 18 U.S.C. § 608(e)(1), which the appellants contended is unconstitutionally vague, provides that “no person may make any expenditure ... relative to a clearly identified candidate during a calendar year which, when added to all other expenditures made by such person during the year advocating the election or defeat of such candidate, exceeds \$1,000.” Noting that “vague laws may not only ‘trap the innocent by not providing fair warning’ or foster arbitrary and discriminatory application’ but also operate to inhibit protected expression by inducing ‘citizens to steer far wider from the unlawful zone ... than if the boundaries of the forbidden areas were clearly marked,’”<sup>8</sup> the Court observed that “although ‘expenditure,’ ‘clearly identified,’ and ‘candidate’ are defined in the Act, there is no definition clarifying what expenditures are ‘relative to’ a candidate. The use of so indefinite a phrase as ‘relative to’ a candidate fails to clearly mark the boundary between permissible and impermissible speech ....”<sup>9</sup> The Court said that, although the context of section 608(e)(1) “clearly permits, if indeed it does not require, the phrase ‘relative to’ a candidate to be read to mean ‘advocating the election or defeat of’ a candidate [it is a mistake to think] that this construction eliminates the problem of unconstitutional vagueness altogether.”<sup>10</sup>

[T]he 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. In an analogous context, this Court in Thomas v. Collins, 323 U.S. 516 ... (1945), observed:

[W]hether words intended and designed to fall short of invitation would miss the mark is a question both of intent and of effect. No speaker, in such circumstances, safely could assume that anything he might say upon the general subject would not be understood by some as an invitation. In short, the supposedly clear-cut distinction between discussion, laudation, general advocacy, and solicitation puts the speaker in these circumstance wholly at the mercy of the varied understanding of

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<sup>8</sup> Buckley v. Valeo, 424 U.S. 1, 41 n.48 (1976).

<sup>9</sup> *Id.* at 41.

<sup>10</sup> *Id.* at 42.

his hearers and consequently of whatever inference may be drawn as to his intent and meaning. Such a distinction offers no security for free discussion. In these conditions it blankets with uncertainty whatever may be said. It compels the speaker to hedge and trim.<sup>11</sup>

The Court then concluded that:

The constitutional deficiencies described in “Thomas v. Collins” can be avoided only by reading s 608(e)(1) as limited to communications that include explicit words of advocacy of election or defeat of a candidate, much as the definition of “clearly identified” in s 608(e)(2) requires that an explicit and unambiguous reference to the candidate appear as part of the communication.... We agree that in order to preserve the provision against invalidation on vagueness grounds, s 608(e)(1) must be construed to apply only to expenditures for communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office.<sup>12</sup>

The Court said that “[t]his construction would restrict the application of § 608(e)(1) to communications containing express words of advocacy of election or defeat, such as ‘vote for,’ ‘elect,’ ‘support,’ ‘cast your ballot for,’ ‘Smith for Congress,’ ‘vote against,’ ‘defeat,’ ‘reject.’”<sup>13</sup>

The Bipartisan Campaign Reform Act of 2002 (BCRA), P.L. 107-155 (H.R. 2356, 107<sup>th</sup> Cong.) significantly amended the FECA. Section 203 of the BCRA prohibits corporations and labor unions from using their general treasury funds (and any person from using funds donated by a corporation or labor union) to finance electioneering communications. Instead, the statute requires that such ads be paid for with corporate or labor union political action committee (PAC) regulated hard money.

Section 201 of the BCRA defines “electioneering communication” as any broadcast, cable, or satellite communication that refers to a clearly identified candidate for Federal office, is made within 60 days of a general election or 30 days of a primary election or political party caucus, and, in the case of a communication that refers to a candidate for an office other than President or Vice President, is targeted to the relevant electorate.<sup>14</sup> But if such definition is “held to be constitutionally insufficient by final judicial decision,” Section 201 provides, alternatively, that the term “electioneering communication” means “any broadcast, cable, or satellite communication which promotes or supports a candidate for [Federal] office, or attacks or opposes ad candidate for that office (regardless of whether the communication expressly advocates a vote for or against a candidate) and which also is suggestive of no plausible meaning other than an exhortation to vote for or against a specific candidate.”

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<sup>11</sup> *Id.* at 42-43.

<sup>12</sup> *Id.* at 43-44.

<sup>13</sup> *Id.* at 44 n.52.

<sup>14</sup> 2 U.S.C. 434(f)(3)(A)(i).

In McConnell v. FEC, 540 U.S. 93 (2003), the Supreme Court held that neither the First Amendment nor Buckley prohibits BCRA's regulation of "electioneering communications," even though such communications do not contain express advocacy. The Court found that the speech regulated by section 203 of the BCRA was the "functional equivalent" of express advocacy. The Court said that the distinction made by Buckley between express and issue advocacy was a matter of statutory interpretation, not constitutional command, and that Buckley's narrow reading of the FECA provisions to avoid problems of vagueness and overbreadth "did not suggest that a statute that was neither vague nor overbroad would be required to toe the same express advocacy line."<sup>15</sup> While section 203 prohibits corporations and labor unions from using their general treasury funds for electioneering communications, the Court observed that they are still free to use separate segregated funds (PACs) to run such ads. Therefore, the Court concluded that it is erroneous to view this provision of BCRA as a "complete ban" on expression rather than simply a regulation.<sup>16</sup>

In Fed. Election Comm'n v. Wisconsin Right to Life, Inc., 127 S. Ct. 2652 (2007), the Supreme Court held that section 203 of the BCRA was unconstitutional as applied to ads broadcast by WRTL. Those ads accused a group of Senators of filibustering to delay and block federal judicial nominees, and told voters to contact Wisconsin Senators Feingold and Kohl to urge them to oppose the filibuster. Recognizing that the ads would be illegal "electioneering communications" under section 203 of the BCRA if run within 30 days of the Wisconsin primary, but believing it had a First Amendment right to broadcast them, WRTL filed suit against the FEC seeking declaratory and injunctive relief and alleging that section 203's prohibition was unconstitutional as applied to those ads. The Court said that because section 203 burdens political speech, it is subject to strict scrutiny under which the government must prove that applying BCRA to WRTL's ads furthers a compelling governmental interest and is narrowly tailored to achieve that interest. While recognizing that McConnell had ruled that the BCRA survives strict scrutiny to the extent it regulates express advocacy or its functional equivalent, the Court said that McConnell did not establish an intent-and-effect test for determining if a particular ad is the functional equivalent of express advocacy, and did not purport to overrule Buckley, which rejected an intent-an-effect test for distinguishing between discussions of issues and candidates. The Court found that, because the ads may reasonably be interpreted as something other than an appeal to vote for or against a specific candidate, they are not the functional equivalent of express advocacy and therefore fall outside McConnell's scope. To safeguard freedom of speech on public issues, a court should find that an ad is the functional equivalent of express advocacy only if the ad is susceptible to no reasonable interpretation other than as an appeal to vote for or against a specific candidate.<sup>17</sup> The

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<sup>15</sup> McConnell, 540 U.S. at 192.

<sup>16</sup> *Id.* at 204.

<sup>17</sup> WRTL, 127 S. Ct. at 2667.

Court held that because WRTL's ads were not express advocacy or its functional equivalent, and because the FEC identified no interest sufficiently compelling to justify burdening WRTL's speech, section 203 of the BCRA was unconstitutional as applied to the ads.

In Citizen's United v. Fed. Election Comm'n, 530 F. Supp. 2d 274 (D.D.C. 2008), the District Court rejected the plaintiff's claim that section 203 of the BCRA violated the First Amendment on its face. The Supreme Court, however, agreed that BCRA did in fact violate free speech rights.<sup>18</sup>

### **Past Legislative Proposals to Amend the Electioneering Prohibition**

Legislation has been introduced in the past several Congresses that would have allowed churches to participate in at least some campaign activity without jeopardizing their tax-exempt status.<sup>19</sup>

In the 107th Congress, the Houses of Worship Political Speech Protection Act (H.R. 2357) would allow churches to engage in campaign activity so long as such activity was "no substantial part" of the church's activities. The "no substantial part" test is a flexible test, and would require the IRS to judge each church on a case-by-case basis.<sup>20</sup> And the Bright-Line Act of 2001 (H.R. 2931) would allow a church to engage in campaign activity as long as it did not normally make expenditures for campaign activity in excess of 5 percent of its gross revenues and as long as it did not normally spend more than 20 percent of its gross revenues on campaign and lobbying activities combined. The bill did not define "normally."

In the 108th Congress, a provision in the American Jobs Creation Act of 2004, H.R. 4520, as originally introduced, would add a new subsection to section 501, entitled "Safe Harbor for Churches," which would provide that:

- A church would not be treated as having engaged in electioneering because of a statement by one of its religious leaders which is clearly identified as a statement made as a private citizen and not made on behalf of the church.
- A church would not lose its tax-exempt status unless its leaders unintentionally engage in electioneering on more than three separate occasions during any calendar year or intentionally engage in electioneering.

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<sup>18</sup> Citizens United v. FEC, 130 S. Ct. 876 (U.S. 2010)

<sup>19</sup> Erika K. Lunder & L. Paige Whitaker, Churches and Campaign Activity: Analysis of the Houses of Worship Free Speech Restoration Act and Similar Legislation, Congressional Research Service, at 1 (2009)

<sup>20</sup> *Id.* at 6.

H.R. 4520 would also add a new section to the Code imposing a tax on churches for “impermissible activities,” i.e., electioneering. If a church unintentionally engages in electioneering on three occasions during a calendar year, it would be subject to a tax equal to the highest corporate tax rate multiplied by the organization’s gross income for the calendar year. The amount would be reduced by 1/52 if there is only one violation in the year or by ½ if there are only two violations during the year. Any tax imposed under this new section would be reduced by the amount of any tax imposed under section 4955.<sup>21</sup>

The Houses of Worship Free Speech Restoration Act (H.R. 235) was introduced in both the 108th and 109th Congresses. It would add a new subsection to section 501 providing that a church would not lose its tax-exempt status or be deemed to have engaged in electioneering “because of the content, preparation, or presentation of any homily, sermon, teaching, dialectic, or other presentation made during religious services or gatherings.”

In the 110th Congress, H.R. 2275 would repeal the political campaign prohibition entirely, in which case a church’s political campaign activity would be limited only by the general section 501(c)(3) requirement that the church be organized and operated exclusively for exempt purposes. Churches and other section 501(c)(3) organizations would still be subject to the section 4955 tax on political expenditures.<sup>22</sup>

## Discussion

The electioneering prohibition on section 501(c)(3) organizations should be repealed or circumscribed with respect to churches and other section 501(c)(3) organizations (other than private foundations) because “the game is not worth the candle.” The IRS is required to draw on its limited resources to police a provision that has no express purpose that can be deduced from the legislative history,<sup>23</sup> is harsher than what is necessary to address legitimate policy concerns, is vague (and therefore difficult for charities to comply with and for the IRS to enforce), and rarely results in any punishment being imposed on non-complying organizations or excise tax revenues being collected for the U.S. Treasury. Several legal scholars have questioned the

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<sup>21</sup> *Id.* at 5

<sup>22</sup> *Id.* at 4.

<sup>23</sup> See, e.g., Deirdre Dessingue, Prohibition In Search of a Rationale: What the Tax Code Prohibits; Why; To What End? 42 B.C. L. Rev. 903. (2001).

constitutionality of the prohibition.<sup>24</sup> The only sure effect of the prohibition has been to cause headaches for the IRS, especially when a church is accused of overstepping the prohibition's tenuous borders.<sup>25</sup>

### **A Prohibition Without a Purpose? Congress Gave No Reasons for Enacting the Electioneering Prohibition**

Although "charitable" organizations have been exempt from paying federal income tax for as long as there has been a tax, it was not until 1934 that any limits were placed on their political activities, and then only on lobbying, not electioneering. An early Senate version of the bill that would become the Revenue Act of 1934 proposed limits on electioneering as well as a lobbying by denying a charitable contribution deduction for "contributions made to an organization a substantial part of whose activities is participation in partisan politics or in carrying on propaganda, or otherwise attempting to influence legislation."<sup>26</sup> However, the Conference Committee deleted the "partisan politics" language, one congressman stating that "we were afraid that this prohibition was too broad, and we succeeded in getting the Senate conferees to eliminate [the provision concerning] partisan politics"<sup>27</sup> Thus, the 1934 Revenue Act imposed a restriction on lobbying only.

But in 1954, then-Senator Lyndon B. Johnson introduced a floor amendment to the Revenue Act of 1954 that would prohibit electioneering by section 501(c)(3) organizations. No hearings were held on the subject, and there is no discussion of the Johnson amendment in the Act's legislative history, but Johnson's remarks on the Senate floor suggest that he intended merely to extend the existing lobbying restrictions to electioneering and not to creating a new, more punitive regime for electioneering.<sup>28</sup>

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<sup>24</sup> See, e.g., Laura Brown Chisolm, Politics and Charity: A Proposal For Peaceful Coexistence, 58 Geo. Wash. L. Rev. 308 (1990); Erik J. Ablin, The Price of Not Rendering to Caesar: Restrictions On Church Participation in Political Campaigns, 13 Notre Dame J.L. Ethics & Pub. Pol'y 541 (1999); Steffen N. Johnson, Of Politics and Pulpits: A First Amendment Analysis of IRS Restrictions on the Political Activities of Religious Organizations, 42 B.C. L Rev. 875 (2001); Chris Kemmitt, RFRA, Churches and the IRS: Reconsidering the Legal Boundaries of Church Activity in the Political Sphere, 43 Harv. J. on Legis. 145 (2006); Keith S. Blair, Praying for a Tax Break: Churches, Political Speech, and the Loss of Section 501(c)(3) Tax Exempt Status, 86 Denv. U.L. Rev. 405 (2009).

<sup>25</sup> For example, the Alliance Defense Fund (ADF) is intent on challenging the constitutionality of the electioneering prohibition. During the 2008 presidential campaign, ADF organized Pulpit Freedom Sunday, when "32 pastors in different parts of the country spoke out on candidates and their stands on the issues during church services, hoping to provide the IRS into revoking participating churches' exemptions and thereby spark a showdown in court. So far, the IRS response has been silence, so the ADF is planning another effort for this fall. An ADF attorney said Pulpit Freedom Sunday will take place every year until pastors have the right to preach freely from their pulpits." 2009 TNT 145-6 (July 31, 2009).

<sup>26</sup> S. Rep. no. 558, 73d Cong., at 26 (1934).

<sup>27</sup> 78 Cong. Rec. 7831 (1934).

<sup>28</sup>The transcript in the Congressional Record reads: -Mr. Johnson of Texas: Mr. President, this amendment seeks to extend the provisions of section 501 of the House bill, denying tax-exempt status to not only those people who influence legislation but also to those who intervene in any political campaign on behalf of any candidate for any public office (100 Cong. Rec. 9604 (1954))

## Revocation is Toughest Sanction

Section 501 of the Internal Revenue Code effectuates Congress's determination to favor organizations set up and operated to further certain purpose deemed beneficial to society at large (such as religious, charitable, and educational purposes) by exempting such organizations from federal income tax. Similarly, with section 170(c)(2), Congress encourages the public to support organizations that further religious, charitable, educational, and other "exempt" purposes, by allowing a deduction from federal income tax for contributions to such organizations. It is logical that Congress would not want tax-exempt organizations to engage in activities that further a purpose that is not one of those for which tax exemption is accorded. Likewise, it is logical that Congress would not want tax-deductible contributions used to further a purpose that is not one of the purposes that the charitable contribution deduction was meant to encourage. Under common law, political purposes are not considered to be charitable purposes. Reflecting case law, the Restatement of the Law on Trusts, Second, says that "a trust to promote the success of a particular political party is not charitable."<sup>29</sup> Therefore, it is logical that Congress would want to discourage tax-exempt organizations from engaging in political activities.

But other kinds of activities that do not further an exempt purpose are discouraged under the tax law without resort to revocation of exemption for the slightest infraction. The general rule is that a section 501(c)(3) organization must engage *primarily* in activities that accomplish exempt purposes; i.e., an organization is not regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.<sup>30</sup> Put another way, an organization generally will not lose its exemption under section 501(c)(3) for merely engaging in an activity that is not in furtherance of exempt purposes as long as non-exempt activities do not constitute a substantial part of overall activities. For example, an exempt organization may operate a trade or business and maintain its exemption as long as it is not organized and operated for the primary purpose of carrying on an unrelated trade or business.<sup>31</sup> Rather than revoke the exempt status of an organization that engages in an unrelated trade or business, the Code subjects the organization to a tax on its unrelated business income.<sup>32</sup>

The lobbying restrictions are in harmony with this "insubstantial part" rule, because they condone an insubstantial level of lobbying. An organization that elects to limit its lobbying expenditures to the levels prescribed in section 501(h) and 4911 is subject to tax only if it exceeds those expenditure levels, and it does not risk the loss of exemption unless it substantially exceeds those levels over the course of several years. In contrast, the absolute ban on electioneering with its hair-trigger revocation penalty is an anomaly.

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<sup>29</sup> Restatement (Second) of Trusts § 374, cmt. k (1959).

<sup>30</sup> Treas. Reg. § 1.501(c)(3)-1(c)(1).

<sup>31</sup> Treas. Reg. § 1.501(c)(3)-1(e).

<sup>32</sup> I.R.C. §§ 511-514.

Although electioneering is not the only activity that is absolutely proscribed by the terms of section 501(c)(3), it is the only proscribed activity for which there is no effective alternative. For example, section 501(c)(3) also contains a prohibition on inurement; i.e., “no part of the net earnings” of a section 501(c)(3) organization may “[inure] to the benefit of any private shareholder or individual.” But because “inurement” is difficult to prove (much less understand), and the penalty, even for a scintilla of inurement is so onerous (revocation of tax-exempt status), the inurement prohibition is rarely enforced. Eventually Congress enacted section 4958 to impose taxes, as an alternative to revocation, with respect to certain types of inurement (known as excess benefit transactions) involving public charities. Treasury regulations to section 4958 set out procedures that charities can follow to establish the reasonableness of their transactions with insiders, thereby giving charities a degree of confidence that such transactions will not be considered inurement that results in revocation.

Like inurement, the precise scope of proscribed electioneering is difficult to define. Like the inurement prohibition, the electioneering prohibition imposes an onerous penalty on an offending organization – loss of tax-exempt status. But unlike inurement, there is no alternative, less onerous scheme, similar to section 4958, for deterring electioneering. For although section 4955 imposes taxes on political expenditures, most violations of the electioneering prohibition do not involve “expenditures,” but merely speech, and section 4955 provides no “safe harbor” by which a charity might establish that certain speech is permissible issue advocacy rather than impermissible electioneering.

The problem with an absolute prohibition on electioneering is that there is no “bright line” between issue advocacy and partisan politics. The IRS can construe speech to be electioneering even if no mention is made of an election or a person’s status as a candidate for public office. For example, the James Madison Center for Free Speech filed a lawsuit in federal district court challenging an IRS determination that Catholic Answers, a section 501(c)(3) charity, had made “political expenditures” because its president, Karl Keating posted a message on the organization’s website prior to the 2004 election in which he argued that John Kerry (then a presidential candidate) should not receive Holy Communion because of his “pro-abortion” positions. The lawsuit accuses the Treasury regulations of being vague and overbroad and, consequently, of chilling the First Amendment free speech rights of non-profit organizations. The suit asks that the regulations on “political intervention” be struck down or narrowly construed to encompass only speech that expressly advocates the election or defeat of a clearly identified candidate.<sup>33</sup>

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<sup>33</sup> Complaint available at <http://www.jamesmadisoncenter.org/CAKK/CAKKComplaint.pdf>

## **The Parameters of a “Facts-and-Circumstances” Electioneering Test are Difficult to Circumscribe**

While the IRS has issued guidance to help charities understand the types of behavior that could constitute electioneering,<sup>34</sup> the “facts and circumstances” approach used by the IRS for determining a violation of the ban causes church and charity officials a great deal of confusion and anxiety. A Congressional Research Service report says that “the statute and regulations do not offer much insight as to what [electioneering] activities are prohibited.”<sup>35</sup>

Even the IRS officials responsible for investigating violations of the electioneering prohibition have difficulty discerning its scope. An audit by the Treasury Inspector General for Tax Administration (TIGTA) found that “[IRS] employees responsible for identifying and researching referrals with alleged political interventions ... did not always understand why certain referrals were not included in the initiative [by the Referral Committee].” TIGTA recommended that the director of the IRS’s EO function “seek to improve the consistent understanding of prohibited political intervention criteria within the EO function.”<sup>36</sup>

## **Enforcement Efforts Sap IRS Resources And Revocations are Rare**

Proving a violation of the electioneering prohibition, like proving inurement, is often difficult. And proving electioneering by church officials is particularly fraught with difficulty because the IRS is prohibited by the church audit procedures of section 7611 from conducting a church tax inquiry or examination unless a “high-level Treasury official reasonably believes (on the basis of facts and circumstances recorded in writing) that the church” has engaged in activity that puts its tax-exempt status in doubt. The staff of the Joint Committee on Taxation found that the church audit procedures “[make] it more difficult for the IRS to initiate an examination of a church even if there is clear evidence of impermissible activity on the part of the church and [hampers] IRS efforts to educate churches with respect to actions that are not permissible, such as what constitutes impermissible political campaign intervention.”<sup>37</sup>

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<sup>33</sup> Complaint available at <http://www.jamesmadisoncenter.org/CAKK/CAKKComplaint.pdf>

<sup>34</sup> See, e.g., Rev. Rul. 2007-41, 2007-25 I.R.B. 1421.

<sup>35</sup> Erika Lunder, Tax-Exempt Organizations: Political Activity Restrictions and Disclosure Requirements, Cong. Res. Serv., Sept. 11, 2007.

<sup>36</sup> Treasury Inspector General For Tax Administration, Improvements Have Been Made to Educate Tax-Exempt Organizations and Enforce the Prohibition Against Political Activities, but Further Improvements Are Possible 2-3 (June 18, 2008).

<sup>37</sup> Staff of the Joint Committee on Taxation, Report of Investigation of Allegations Relating to Internal Revenue Service Handling of Tax-Exempt Organization Matters, JCS-3-00, at 19 (2000).

Testifying before the House Ways and Means Committee in 2002, then-director of the IRS Exempt Organizations office, Steven Miller, said “this is a challenging area for the IRS to administer. This is not the first time that Congress has reviewed our activities in this area.” Miller went on to list some of those challenges:

First we have the issue of attribution. Was an individual making a pronouncement in his or her individual capacity, or can the pronouncement be attributed to the tax-exempt organization...?

A second difficult issue is whether a given pronouncement constitutes political campaign intervention. In this area specifically, the IRS is faced with reviewing both the content and circumstances surrounding the distribution of voter guides during worship services or on church property....

Finally, the section 4955 excise tax that can be used in lieu of revocation may not be effective [because] the tax is based on expenditures. Yet there are times when this excise tax does not correspond to the prohibited intervention. For example what is the expenditure related to an endorsement of a candidate during a sermon from the pulpit? ... [All] these considerations ... taken together ... make the area more challenging to regulate.<sup>38</sup>

Before 2004, the IRS only occasionally looked into third-party allegations electioneering activities. Miller testified at the 2002 Hearings that the IRS had “revoked religious organizations or religious-affiliated organizations four or five times in the last 20 years.”<sup>39</sup> But because the IRS “has seen a growth in the number and variety of allegations of [charities intervening in political campaigns] during election cycles ... coupled with the dramatic increases in money spent during political campaigns,” the IRS initiated a Political Activities Compliance Initiative (PACI) for the 2004 election cycle, the objective of which was to promote compliance with the electioneering ban by expeditiously reviewing allegations of political intervention by tax-exempt organizations and initiating examinations when deemed appropriate. Since the 2004 Initiative, the IRS has continued to conduct political activity compliance initiatives during Federal election years.

For the 2004 Initiative, the IRS received 166 referrals alleging prohibited political campaign intervention by section 501(c)(3) organizations, among which were nineteen allegations that a church official had endorsed a political candidate during regular church services. The number of referrals is quite small considering that GuideStar reports that there are 1.8 million IRS recognized tax-exempt organizations,<sup>40</sup> and the

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<sup>38</sup> Review of Internal Revenue Code Section 501(c)(3) Requirements for Religious Organizations, Hearing Before the Subcomm. On Oversight of the H. Comm. On Ways and Means, 107<sup>th</sup> Cong. (2002).

<sup>39</sup> *Id.* at 15 (2002).

<sup>40</sup> <http://www2.guidestar.org/rxg/analyze-nonprofit-data/index.aspx>; GuideStar maintains a database of tax-exempt organizations.

Yearbook of American and Canadian Churches reports that there are 331,000 church congregations in the United States.<sup>41</sup> The IRS selected 110 organizations for examination, including 47 churches. The examinations mainly concerned tax-exempt organizations that had allegedly been involved in a single instance of potentially prohibited electioneering. Forty-six referrals alleged the distribution of printed materials such as printed documents or signs supporting a particular candidate or biased voter guides. Thirty-five referrals alleged improper verbal statements, such as a church official endorsing a candidate during church services, or candidates making campaign speeches at functions sponsored by a tax-exempt organization. Thirty-four referrals alleged the distribution of prohibited electioneering material electronically such as on a Website or in an email. And fifteen referrals alleged inappropriate political contributions. In the majority of cases, the examination concluded with the IRS issuing a closing letter to the tax-exempt organization warning the organization of the consequences of future prohibited electioneering. However, six examinations resulted in the revocation of the organization's tax-exempt status. Of the 107 examinations concluded by December 2008, the IRS had substantiated electioneering by sixty two organizations.<sup>42</sup>

The Treasury Inspector General for Tax Administration, in its audit of the 2004 Initiative, observed that excise taxes on political activities are difficult to assess either because "tax exempt assets were not used" or because "it is difficult to calculate the amount of tax-exempt assets used in a prohibited activity.... As a result, it is rare for the IRS to assess excise taxes at the conclusion of an examination.... In 5 of the 99 cases, the IRS assessed excise taxes in the amount of \$12,945.37." The audit report also observed that "by their very nature, IRS examinations are highly intrusive and require resources of both the IRS and the tax-exempt organization being examined. In addition, some political activity examinations are lengthy due to their complexity and the fact that certain cases involve additional legal requirements that must be followed," probably an allusion to the church audit procedures. "For example, some of the initial examinations in the 2004 Initiative started in late 2004, while some of the examinations were not completed until mid-2007 or early 2008, and three were still ongoing when we completed our fieldwork."<sup>43</sup>

For the 2006 election cycle, the IRS received 237 referrals, among which were 13 allegations that a church official had endorsed a political candidate during regular church services. The IRS selected 100 organizations for examination, including 44 churches. As of March 30, 2007, at which time only 40 examinations had been closed, the IRS had substantiated political intervention by, and had issued written advisories to, only 4 churches. In neither 2004 nor 2006 did the IRS revoke, or propose to revoke, the exempt status of a church.<sup>44</sup>

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<sup>41</sup> Julia Duin, Americans Leaving Churches in Doves, Washington Times, Sept. 21, 2008, at A09.

<sup>42</sup> Treasury Inspector General for Tax Administration, Statistical Profile of Alleged Political Intervention by Tax-Exempt Organizations in the 2004 Election Season (May 12, 2009)

<sup>43</sup> *Id.*

<sup>44</sup> Internal Revenue Service, 2006 Political Activities Compliance Initiative, at [http://www.irs.gov/pub/irs-tege/2006paci\\_report\\_5-30-07.pdf](http://www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf)

The IRS undertook another PACI for the 2008 2010 election cycles, but results have not yet been reported.

### **Issues for Consideration**

Prior legislative proposals addressing the electioneering prohibition focused solely on churches. However, as discussed earlier, church status can be gamed. In addition, providing exceptions or separate rules for churches does not significantly reduce IRS's enforcement burden. We considered several ideas for reform of this provision but, again, lacked the expertise in constitutional law to make an informed recommendation. However, two ideas we believe would survive a constitutional challenge are:

- 1) Replace *the* prohibition with a limitation similar to the lobbying restrictions, or
- 2) Retain prohibition but define "Participate In" or "Intervene In" in terms of expenditures and electioneering communications per federal election law.