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THE LEGAL QUAGMIRE OF IRC § 501(C)(4) ORGANIZATIONS
AND THE CONSEQUENTIAL RISE OF DARK MONEY IN
ELECTIONS

DANIEL C. KIRBY*

Crossroads GPS, Americans for Prosperity, League of Conservation Voters, Patriot Majority USA. On the surface, these groups sound like run-of-the-mill political and social groups advocating on behalf of their members' interests. However, these four groups pumped a combined \$125,778,252 into the 2012 Election Cycle.¹ When you take into account the groups' affiliates (for example, Political Action Committees (PACs) and Super PACs), which these groups can donate to, these four groups spent \$219,977,374 in the 2012 Election Cycle.²

Organizations spending millions of dollars towards elections is not a new concept in modern politics. However, these four groups are tax-exempt organizations that are supposed to operate for the promotion of the social welfare and not primarily to engage in political activity.³ Intuitively, spending over \$200 million seems like a large amount of money for groups that are not supposed to primarily engage in political activity. As organizations enjoying tax-exemption under Section 501(c)(4) of the Internal Revenue Code, these groups operate without tax liability, do not have to publically disclose their donors, and can self-declare as a 501(c)(4) without filing an application with the IRS.⁴

The landmark 2010 Supreme Court decision of *Citizens United v. Federal Election Commission* drastically changed the landscape of cam-

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1. 2012 *Outside Spending, by Group*, OPENSECRETS.ORG, <http://www.opensecrets.org/outsidespending/summ.php?cycle=2012&chrt=V&disp=O&type=U> (last visited Nov. 17, 2014) [hereinafter *2012 Outside Spending*].

2. *Id.*

3. *Id.*

4. Nicholas Confessore, *Uneven I.R.S. Scrutiny Seen in Political Spending by Big Tax-Exempt Groups*, N.Y. TIMES, May 13, 2013, at A14; *Outside Spending: Frequently Asked Questions About 501(c)(4) Groups*, OPENSECRETS.ORG, <http://www.opensecrets.org/outsidespending/faq.php> (last visited Nov. 17, 2014) [hereinafter *Frequently Asked Questions*].

paign finance.⁵ After *Citizens United*, corporations, for-profit and not-for-profit, are able to spend unlimited amounts on campaigns.⁶ Since that decision, 501(c)(4) organizations became the most popular way for corporations to influence federal campaigns because such organizations do not have to publicly disclose the names of their donors.⁷ The amount of spending by 501(c)(4) organizations in the 2008 Election Cycle was around \$69 million.⁸ During the 2012 Election Cycle, this number more than quadrupled to \$311 million.⁹ Commentators have labeled this type of spending by 501(c)(4) groups as “dark money” because the groups are not required to disclose their donors to voters before the election.¹⁰ This note explores why savvy political donors have chosen 501(c)(4) groups as their new favorite method of campaign finance, and why change is needed to end this trend.

Section 501(c)(4) groups, formally known as “social welfare organizations,” are one of many types of groups provided tax-exemption under Section 501 of the Internal Revenue Code (IRC).¹¹ The IRC defines 501(c)(4) organizations as “civic leagues or organizations not organized for profit but operated *exclusively* for the promotion of social welfare.”¹² Many of these social welfare organizations include prominent issue groups that have long existed as 501(c)(4) groups, such as the National Rifle Association and the Sierra Club.¹³

In 1959, the Treasury Department published a regulation that liberalized the requirements for 501(c)(4) organizations.¹⁴ Notwithstanding the statutory requirement that a social welfare organization must operate “*exclusively*” for the promotion of social welfare, the regulation defines “*exclusively*” to require the organization only to be “*primarily* engaged in promoting in some way the common good and general welfare of the peo-

5. See *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

6. Sean Sullivan, *What is a 501(c)(4), Anyway?*, WASH. POST, May 13, 2013, <http://www.washingtonpost.com/blogs/the-fix/wp/2013/05/13/what-is-a-501c4-anyway/>.

7. *Id.*

8. *2008 Outside Spending, by Group*, OPENSECRETS.ORG, <http://www.opensecrets.org/outsidespending/summ.php?cycle=2008&chrt=V&disp=O&type=U> (last visited Nov. 17, 2014) [hereinafter *2008 Outside Spending*].

9. *2012 Outside Spending*, *supra* note 1.

10. See, e.g., Ryan Sibley, *Dark Money: Super PACs Fueled by \$97.5 Million that can't be Traced to Donors*, SUNLIGHT FOUND. (Oct. 21, 2010), <http://sunlightfoundation.com/blog/2010/10/20/quarterly-filings-fec-reveals-big-power-behind-big-money/>.

11. I.R.C. § 501(a) (2006).

12. § 501(c)(4)(a) (emphasis added).

13. *Frequently Asked Questions*, *supra* note 4.

14. Deirdre Shesgreen, *1959 IRS Rule is at the Center of Tea Party Scandal*, USA TODAY, June 20, 2013, <http://www.usatoday.com/story/news/politics/2013/06/20/irs-nonprofits-rule-politics-1959/2439177/>.

ple of the community.”¹⁵ With the 2010 *Citizens United* decision, this regulation enables social welfare organizations to become more active participants in political campaigns as long as it is not their primary activity. While the regulation does not define “primarily,” some today believe that as long as a group’s political activity is forty-nine percent or less of its total activity, then that group has not jeopardized its (c)(4) status.¹⁶ Political donors have infused millions of dollars into elections by exploiting these statutory interpretations of 501(c)(4) organizations.¹⁷

This note aims to end the misuse of 501(c)(4) groups by proposing a solution to the “loopholes” that currently exist in (c)(4) regulations. The standards and criteria the IRS uses for 501(c)(4) determinations are outdated, unworkable with the current state of campaign finance, and inevitably assign too much latitude to the discretion of an oversight agency that vigorously tries to remain apolitical. Section 501(c)(4) should revert to its original interpretation—501(c)(4) groups should “operate *exclusively* for the promotion of social welfare.”¹⁸ The political activity ban enforced before the 1959 Regulation would again be in effect. Thus, if a 501(c)(4) group were to engage in some form of political activity, it would lose its (c)(4) status because it would no longer be operating exclusively for the promotion of social welfare.

Part I of this note looks at the history of 501(c)(4) organizations, the statutory structure, and the guidelines that social welfare organizations must operate within. It also explores how the IRS and other federal agencies have traditionally treated these groups. Part II analyzes the proliferation of social welfare organizations following the *Citizens United* decision as well as the 2013 IRS “targeting” of conservative groups that brought (c)(4) groups to the forefront of national news. Part III evaluates the IRS’s November 2013 (and subsequently withdrawn) proposed regulations to Section 501(c)(4),¹⁹ and explains why the IRS should revert to the original meaning of the statutory language of Section 501(c)(4) as well as adopt other amendments. Part IV addresses the opposing arguments to adopting the proposals in this note.

15. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (1960) (emphasis added).

16. *Id.*; Shesgreen, *supra* note 14.

17. *See, e.g., 2012 Outside Spending by Group, supra* note 1.

18. § 501(c)(4)(a) (emphasis added).

19. Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2), 78 Fed. Reg. 71535 (Dec. 23, 2013) [hereinafter 2013 IRS Proposed Regulations].

I. CURRENT REGULATORY FRAMEWORK AND TREATMENT OF IRC § 501(C)(4)

The Revenue Act of 1913 created the first modern Federal Income tax statute.²⁰ In the early twentieth century, Congress believed civic leagues and organizations “should get a pass on taxes” as long as they were operating for the “common good or general welfare of a community.”²¹ Thus, in 1913, Congress created social welfare organizations.²²

Besides requiring that (c)(4) “civic leagues or organizations not [be] organized for profit but operated *exclusively* for the promotion of social welfare,” the IRC mandates only that a social welfare organization’s net earnings be devoted exclusively to charitable, educational, or recreational purposes.²³

Social welfare organizations received little attention until 1959, when the Treasury Department issued a regulation²⁴ that redefined the requirements imposed on 501(c)(4) organizations. The Regulation, still in effect today, states, “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 people of the community.”²⁵ This type of activity includes “bringing about civic betterments and social improvements.”²⁶ Social welfare organizations under IRC Section 501(c)(4) no longer need to operate “exclusively” for the promotion of social welfare; it only needs to be their “primary” activity.²⁷ In other words, the Treasury lowered the amount of social welfare these organizations had to actually promote.

The problem with the shift from “exclusively” to “primary” is that the Treasury never defined “primary”—is it a qualitative or quantitative test?²⁸ The Training Manual’s instructions for the Regulation simply states that a group’s application for 501(c)(4) status goes through a “facts and circumstances” test to determine whether the group is “primarily engaged in promoting social welfare.”²⁹ The IRS’s internal training material from the

20. Revenue Act of 1913 (Underwood-Simmons), ch. 16, § 2(A), 38 Stat. 114, 166 (1913).

21. Shesgreen, *supra* note 14.

22. § 2(G)(a).

23. § 501(c)(4)(a) (emphasis added).

24. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (1960).

25. *Id.*

26. *Id.*

27. *Id.*

28. Shesgreen, *supra* note 14.

29. Raymond Chick & Amy Henchey, *Political Organizations and IRC 501(c)(4)*, in 1995 EO CPE TEXT (1995), available at <http://www.irs.gov/pub/irs-tege/eotopicm95.pdf>.

1990's includes some factors that are designed to help with (c)(4) exemption determination: the amount of funds the group receives, where and how the group directs those funds, the time group members devote to certain activities, the manner in which these activities are carried out, and the purpose these activities serve.³⁰

In response to a Freedom of Information Act suit brought by Tax Analysts in January 2014, the IRS released its internal training materials for their tax-exemption determination employees.³¹ The training materials did not define "primary;" however, a supporting document indicated that "primary is generally understood to mean 51 percent."³² The IRS cautioned that it "has never been that precise with the 49 percent or with the 51 percent, because precision would require something definite to be measured—expenditures, staff time, volunteer time . . . and other non-program expenses between primary and secondary activities, which [the IRS] hasn't done."³³ Nonetheless, the IRS, at the least, gave credence to what critics always assumed: applying a quantitative test, a 501(c)(4) organization only needs fifty-one percent of its activities to promote social welfare.³⁴

Currently, Congress does not require organizations seeking 501(c)(4) designation to file an application with the IRS. Section 501(c)(4) organizations are allowed to "self-declare and hold themselves out as tax-exempt."³⁵ Self-declaring groups can rely on their self-determination as "long as the organization has not deviated from the organizational structure and operational activities set forth in its application," and as long as the groups continue to file their annual Form 990 returns.³⁶ Issues arise when 501(c)(4) groups form before elections to make political expenditures. A group can "pop up" right before an election, self-declare as a (c)(4), spend large amounts on activities that influence the outcome of an election, and by the time the IRS receives that group's Form 990 tax return, the group could already have disbanded.³⁷

30. *Id.*

31. See Lindsey McPherson, *EO Training Materials Suggest 51 Percent Threshold for Social Welfare Activity*, 73 EXEMPT ORG. TAX REV. 122 (2014).

32. *Id.* (internal quotations omitted).

33. *Id.*

34. *Id.*

35. Letter from Steven T. Miller, Deputy Comm'r for Servs. & Enforcement, IRS, to Orrin G. Hatch, Ranking Member, Comm. on Finance, U.S. Senate (Apr. 26, 2012), available at <http://www.scribd.com/doc/143268848/04-26-12-IRS-501-c-4-Response-to-Hatch-March-14th-Letter-1>.

36. *Id.*

37. Doug Mancino, *Don't Eliminate 501(c)4 Exemption*, N.Y. TIMES, May 15, 2013, <http://www.nytimes.com/roomfordebate/2013/05/15/does-the-irs-scandal-prove-that-501c4s-should-be-eliminated/dont-eliminate-501c4-exemption>.

Worse, the tax-exemption determination of a Section 501(c)(4) group becomes particularly worrisome when these groups engage in political activity. As a starting point, the 1959 Treasury Regulation states that the promotion of social welfare does not encompass “direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”³⁸ This statutory language and the promulgated liberalized interpretation put the onus on the IRS to determine two difficult questions: what constitutes political activity and how much political activity is too much. This creates a tall order for an agency that emphatically tries to remain apolitical. The IRS has formally acknowledged that “politics is not an exact science,” and with the increasing number of political strategists coming up with creative campaign methods, it has become more difficult for the IRS to make clear-cut determinations about a group’s amount of political activity.³⁹

Tax-exemption under IRC Section 501(c)(4) is less desirable but more flexible than under Section 501(c)(3), which is available for charitable organizations.⁴⁰ Donations to (c)(3) groups are tax-deductible as charitable contributions, while contributions to (c)(4) groups are not.⁴¹ However, (c)(3) groups cannot engage in any political campaign activity, but can engage in limited lobbying on proposed legislation.⁴² By contrast, (c)(4) groups can engage in significant political activity, as long as it is not their primary activity, and unlimited lobbying⁴³ (indeed, a charity that intends to lobby too much will instead claim exemption under Section 501(c)(4)).⁴⁴

Separately, IRC Section 527 provides tax-exemption for political organizations.⁴⁵ The IRC defines a Section 527 political organization as “a party, committee, association, fund, or other organization . . . organized and operated *primarily* for the purpose of directly or indirectly accepting contributions or making expenditures or both, for an exempt function.”⁴⁶ This “exempt function” must be the group’s primary activity, which includes

38. Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (1960).

39. Chick & Henchey, *supra* note 29.

40. See I.R.C. § 501(c)(3) (2006).

41. *Donations to Section 501(c)(4) Organizations*, IRS, [http://www.irs.gov/Charities-%26-Non-Profits/Other-Non-Profits/Donations-to-Section-501\(c\)\(4\)-Organizations](http://www.irs.gov/Charities-%26-Non-Profits/Other-Non-Profits/Donations-to-Section-501(c)(4)-Organizations) (last updated Mar. 4, 2014); *Substantiating Charitable Contributions*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Substantiating-Charitable-Contributions> (last updated Apr. 10, 2014).

42. *Lobbying*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Lobbying> (last updated Apr. 10, 2014) (note that additional limitations apply to those charities that are private foundations).

43. *Social Welfare Organizations*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Social-Welfare-Organizations> (last updated Mar. 6, 2014).

44. *Lobbying*, *supra* note 42.

45. I.R.C. § 527(a) (2006).

46. *Id.* § 527(e)(1) (emphasis included).

attempting to influence the appointment, defeat, nomination, or selection of candidates in an election for public office.⁴⁷ Section 527 organizations include, among other groups, traditional political parties, PACs, and Super PACs.⁴⁸

In contrast to the rules for 501(c)(4) groups, Section 527 groups must primarily engage in political campaign activity to remain tax-exempt.⁴⁹ Section 527 groups are at the intersection of tax law and federal election laws.⁵⁰ A 527 group must register with the Federal Election Commission (FEC) as a federal political committee if it receives contributions or makes expenditures greater than one thousand dollars in a calendar year to influence federal elections, and that group's "major purpose" is the nomination or election of federal candidates.⁵¹ However, if a group does not meet the FEC's threshold of expenditures, it need not register with the FEC.⁵² Section 527 groups can spend unlimited funds on independent expenditures, which the FEC defines as "a communication 'expressly advocating the election or defeat of a clearly identified candidate that is not made in cooperation, consultation, or concert with, or at the request or suggestion of, a candidate.'"⁵³

Thus, 501(c)(4) groups are somewhat a hybrid of 501(c)(3) and 527 groups. If a 501(c)(4) group makes independent expenditures, that group must disclose those expenditures to the FEC, just like a 527 group.⁵⁴ However, more importantly, 501(c)(4) groups do not have to disclose the identity of their donors.⁵⁵ The statutory structure of 501(c)(4) groups allows political donors to escape the extensive disclosure requirements the FEC enforces on Section 527 groups, and anonymously donate unlimited amounts of money for independent expenditures.

47. *Id.* § 527(e)(2).

48. *Filing Requirements*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Political-Organizations/Filing-Requirements-1> (last updated Sep. 23, 2014).

49. I.R.C. § 527(e)(1).

50. *A Guide to the Current Rules for Federal Elections*, THE CAMPAIGN LEGAL CTR., http://www.campaignlegalcenter.org/index.php?option=com_content&id=1187%3Aa-guide-to-the-current-rules-for-federal-elections (last visited Nov. 17, 2014).

51. *Id.*

52. *Id.*

53. *Coordinated Communications and Independent Expenditures*, FED. ELECTION COMM'N, http://www.fec.gov/pages/brochures/index.shtml#Who_IE (last updated Apr. 2014) (quoting 11 C.F.R. § 100.16(a) (2009)).

54. *See Political Activity of 501(c)(4) Tax Exempt Organizations*, INDEPENDENT SECTOR, https://www.independentsector.org/501c4_organizations (last visited Nov. 17, 2014).

55. *Id.*

II. *CITIZENS UNITED*, THE PROLIFERATION OF 501(C)(4) GROUPS, AND THE 2013 IRS “TARGETING” SCANDAL

Congress, the Treasury, and the IRS never intended to create such a messy, gray area of statutory interpretation for 501(c)(4) organizations. What opened the door for political strategists to exploit the use of 501(c)(4) groups was the repurposing of the 1959 IRS regulation after *Citizens United*. Although this regulation was at the core of the controversy surrounding the IRS’s Tea Party “targeting” scandal, at the time it was issued, the 1959 Regulation was harmless.

In 1959, corporations (tax-exempt and non-tax-exempt) could not use their money for political expenditures.⁵⁶ The prevailing test the IRS currently uses to determine 501(c)(4) tax-exempt determination originated from an era when the IRS did not even contemplate that an organization or corporation would be able to make unconstrained political contributions or campaign expenditures.⁵⁷

The *Citizens United* decision and subsequent rash of 501(c)(4) applications helped bring this statutory “loophole” to the forefront of the national media. In *Citizens United*, the U.S. Supreme Court held the First Amendment prohibits the government from restricting independent expenditures by corporations, associations, or labor unions.⁵⁸ The Court held, for the purposes of political speech, there is no difference between individuals and corporations.⁵⁹ The Supreme Court’s striking of Congress’s statutory ban on corporate funding of independent expenditures and financing electioneering communications “gave corporations and unions the green light to spend unlimited sums on ads and other political tools, calling for the election or defeat of individual candidates.”⁶⁰

However, *Citizens United* did not change the rules for corporate campaign contributions.⁶¹ Corporations and labor unions still cannot give direct contributions to candidates for federal office or coordinate expenditures with them.⁶² However, the Supreme Court made a distinction between direct contributions and independent expenditures as well as electioneering

56. John L. Buckley & Dallas Woodrum, *The Intersection of the Tax Code and Citizens United*, 139 TAX NOTES 169, 178 (2013).

57. *Id.*

58. *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310, 365–66 (2010).

59. *Id.* at 342–43.

60. John Dunbar, *The ‘Citizens United’ Decision and Why it Matters: Nonprofits or Political Parties?*, CTR. FOR PUB. INTEGRITY, <http://www.publicintegrity.org/2012/10/18/11527/citizens-united-decision-and-why-it-matters> (last updated May 19, 2014).

61. *Id.*

62. *Id.*

communications: the latter types of spending “do not give rise to corruption or the appearance of corruption.”⁶³ This distinction had strong implications for the future of campaign finance.

The right to speak, however, is distinct from entitlement to tax-exemption. The *Citizens United* holding is best known for allowing corporations to spend unlimited funds directly to influence elections, but the decision’s effect on 501(c)(4) organizations has made the greatest impact.⁶⁴ Even though *SpeechNow.org v. Federal Election Commission* held that unlimited corporate contributions to Super PACs are constitutional, 501(c)(4) organizations became the most attractive vehicle for corporate political donations.⁶⁵

In contrast to federal political committees (Section 527 groups, PACs, Super PACs), 501(c)(4) groups generally are not statutorily required to publicly disclose their donors.⁶⁶ Section 501(c)(4) groups must file Form 990 tax returns with the IRS that includes the names of the groups’ significant donors.⁶⁷ However, the IRS does not publically release the donors’ names barring certain exceptions.⁶⁸ One such exception is when a donor gives the money with an explicit request that the money fund a political ad.⁶⁹

This shift in campaign finance law is what has attracted political donors to provide their political contributions through 501(c)(4) organizations. Corporations find it very attractive to donate unlimited funds to 501(c)(4) groups, with these funds being spent on the corporation’s behalf and without public disclosure.⁷⁰ By comparison, Target and Best Buy faced strong public criticism after both companies made six-figure donations to MN Forward, a conservative PAC that endorsed a gubernatorial candidate

63. *Citizens United*, 558 U.S. at 357.

64. *Frequently Asked Questions*, *supra* note 4.

65. Dunbar, *supra* note 60; see *SpeechNow.org v. Fed. Election Comm’n*, 599 F.3d 686 (D.C. Cir. 2010).

66. *Exempt Organizations Annual Reporting Requirements—Public Disclosure and Availability of Exempt Organizations Returns and Applications*, IRS, http://www.irs.gov/pub/irs-tege/eo_disclosure_faqs.pdf (last updated July 11, 2013).

67. *Id.*

68. *Id.*

69. Emma Schwartz, *The Rules That Govern 501(c)(4)s*, PBS: FRONTLINE, <http://www.pbs.org/wgbh/pages/frontline/government-elections-politics/big-sky-big-money/the-rules-that-govern-501c4s/> (last updated October 30, 2012).

70. Justin Elliot, *Could Corporations Take Tax Breaks on Political ‘Dark Money’?*, PRO PUBLICA, <http://www.propublica.org/article/could-corporations-be-taking-tax-breaks-on-political-dark-money> (last updated Mar. 19, 2012).

who was opposed to same sex-marriage.⁷¹ Both corporations claimed they based their donations on MN Forward's endorsement of candidates with strong positions on Minnesota's economy and job growth.⁷² Nevertheless, because the corporate donation was to a PAC, the corporations' names were publicly released, and public backlash ensued.⁷³

In the years following *Citizens United*, the number of 501(c)(4) applications filed with the IRS more than doubled.⁷⁴ The amount of money 501(c) groups spent in the 2012 election was estimated at \$333 million, a 53 percent increase from the 2008 election.⁷⁵ However, that \$333 million does not paint a clear picture of how much and where the 501(c) groups spent their money. Because of the vague reporting requirement the IRS imposes on the 501(c) groups, the Form 990s which the groups file only provide for the "major vendors" they hire, what groups they have given money to, and require vague explanations of how they used the money (oftentimes only saying "consulting or fundraising").⁷⁶

As the number of (c)(4) applications continued to rise, the IRS faced internal problems handling the increased workload. At the same time, Congress cut the IRS's funding.⁷⁷ In 2011, President Barack Obama called for an increase of \$1 billion in the IRS's budget of \$12.1 billion, for the hiring of 5,100 employees.⁷⁸ Instead, Congress reduced the agency's budget to \$11.8 billion, causing the IRS to buy out 5,400 of its 95,000 employees.⁷⁹ The U.S. National Taxpayer Advocate, Nina E. Olson, commented on this dilemma:

The overriding challenge facing the I.R.S. is that its workload has grown significantly in recent years, while its funding is being cut This is causing the I.R.S. to resort to shortcuts that undermine fundamental taxpayer rights and harm taxpayers—and at the same time reduces the I.R.S.'s ability to deliver on its core mission of raising revenue.⁸⁰

71. Emily Friedman, *Target, Best Buy Angers Gay Customers by Making Contribution to GOP Candidate*, ABC NEWS, July 28, 2010, <http://abcnews.go.com/Business/target-best-buy-fire-campaign-contributions-minnesota-candidate/story?id=11270194&singlePage=true>.

72. *Id.*

73. *Id.*

74. *Id.*; *Frequently Asked Questions*, *supra* note 4.

75. This includes contributions from IRC 501(c)(5) and (c)(6) groups in addition to (c)(4) groups. *Frequently Asked Questions*, *supra* note 4.

76. *Id.*

77. David Kocieniewski, *Budget Cuts Hamper the I.R.S. in Efforts to Collect Billions in Taxes*, *Report Says*, N.Y. TIMES, Jan. 11, 2012, at B2.

78. *Id.*

79. *Id.*

80. *Id.*

In March 2010, the IRS began to scrutinize 501(c)(4) applications more closely based on certain words in organizations' names.⁸¹ The Cincinnati IRS office, which is responsible for exempt-organization determinations, created a "Be On the Lookout" list (BOLO list) that set out criteria for the IRS to quickly determine what types of (c)(4) groups should be flagged for potential engagement in politics.⁸² At the heart of the Treasury Inspector General's May 2013 report (TIGTA report) was the IRS's use of the BOLO list and the alleged inappropriate criteria the IRS used to screen (c)(4) tax-exempt applications.⁸³ The TIGTA report accused the IRS of targeting Tea Party groups because the BOLO list included words like "Tea Party," "Patriots," "make America a better place to live," and statements in case files "criticizing how the country is being run."⁸⁴

The TIGTA report placed the IRS under the microscope and on the front page of newspapers.⁸⁵ Congress forced the IRS to comply with an extensive and very intrusive investigation. As of July 23, 2014, 250 IRS employees spent 125,000 hours complying with Congressional requests and provided Congress with 1.6 million documents.⁸⁶ Congress interviewed thirty-five former and current IRS employees in addition to those employees who testified at fifteen Congressional hearings.⁸⁷ The IRS's total cost for compliance with Congress' investigation is approximately \$10.75 million and is still ongoing.⁸⁸ Despite Congress's extensive investigation, Congress found "zero evidence of any political motivation or outside involvement" by the IRS in their exemption determinations.⁸⁹

81. Richard Rubin & Julie Bykowicz, *IRS Look at Progressive Groups Complicates Controversy*, BLOOMBERG.COM, June 25, 2013, <http://www.bloomberg.com/news/2013-06-24/irs-screened-applications-using-progressive-israel-.html>.

82. *Id.*

83. *See Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review*, TREAS. INSPECTOR GEN. FOR TAX ADMIN. (May 14, 2013), available at <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf> [hereinafter *TIGTA Report*].

84. *Id.* at 6.

85. *See, e.g.*, Jonathan Weisman, *Management Flaws at I.R.S. Cited in Tea Party Scrutiny*, N.Y. TIMES, May 15, 2013, at A1, available at <http://www.nytimes.com/2013/05/15/us/politics/report-on-irs-audits-cites-ineffective-management.html>.

86. Written Testimony of John A. Koskinen, Comm'r, IRS, Before the H. Oversight & Gov't Reform Comm., Subcomm. on Econ. Growth, Job Creation & Regulatory Affairs (July 23, 2014), at 4, available at <http://oversight.house.gov/wp-content/uploads/2014/07/Koskinen-IRS-Final.pdf> [hereinafter *Koskinen Testimony*].

87. Press Release, Comm. On Oversight & Gov't Reform, Republican IRS Investigations Have Cost at Least \$14 Million—And Counting (Feb. 26, 2014), <http://democrats.oversight.house.gov/news/press-releases/republican-irs-investigations-have-cost-at-least-14-million-and-counting-0>.

88. Koskinen Testimony, *supra* note 86.

89. Press Release, *supra* note 87.

The IRS subsequently produced redacted BOLO lists demonstrating that the agency also flagged applications using terms such as “progressive” for extra scrutiny.⁹⁰ The TIGTA report revealed that the IRS never denied a conservative or Tea Party group its tax-exemption application.⁹¹ In fact, the only rejected (c)(4) application was a progressive and Democratic-leaning organization.⁹² A former chief of staff to a legislative commission restructuring the IRS commented, “The BOLO list in my mind loses this sinister nature And it becomes another way of creating criteria lists to try to deal with the huge volumes that come through the agency.”⁹³

In sum, it has become increasingly apparent that the IRS Tea Party “Targeting” Scandal was more a byproduct of an underfunded and understaffed agency, rather than of an agency inappropriately motivated by partisan and ideological concerns. Despite the contentious relationship between Republicans and Democrats over this issue, there is one idea that people on both sides of the aisle can agree on: The regulations dictating the IRS’s processing of Section 501(c)(4) groups’ tax-exemption determinations need to be fixed.

III. PROPOSED AMENDMENTS TO IRC § 501(C)

Campaign finance reform has been an ongoing process for as long as money has played a role in politics. Campaign finance reform has now come to resemble a whack-a-mole game—legislators ban types of spending and then political strategists find innovative ways to skirt the laws to continue influencing election outcomes.

The IRS is not fit for making political decisions about campaign finance. The IRS’s stated mission is to “[p]rovide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.”⁹⁴ The proper agency to oversee campaign finance is the FEC.⁹⁵ It is the role of the FEC, not the IRS, “to govern the financing of federal elections [and be the agency] to disclose campaign finance information, to enforce the provisions of

90. Rubin & Bykowicz, *supra* note 81.

91. See *TIGTA Report*, *supra* note 83, at 14.

92. Julie Bykowicz & Jonathan D. Salant, *IRS Sent Same Letter to Democrats That Fed Tea Party Row*, BLOOMBERG.COM, May 14, 2013, <http://www.bloomberg.com/news/2013-05-15/irs-sent-same-letter-to-democrats-that-fed-tea-party-row.html>.

93. Rubin & Bykowicz, *supra* note 81.

94. *The Agency, its Mission and Statutory Authority*, IRS, <http://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority> (last updated Feb. 12, 2014).

95. *FEC Mission and History*, FED. ELECTION COMM’N, <http://www.fec.gov/info/mission.shtml> (last visited Nov. 17, 2014).

the law such as the limits and prohibitions on contributions, and to oversee the public funding of Presidential elections.”⁹⁶

However, that does not mean that the U.S. tax code and Treasury regulations should not adapt to the recent trends in campaign finance. The outdated IRC Section 501(c)(4) originates from a pre-*Citizens United* era when corporations could not make political contributions. A 2013 IRS report stated, “The distinction between campaign intervention and social welfare activity, and the measurement of the organization’s social welfare activities relative to its total activities, have created considerable confusion for both the public and the IRS in making appropriate section 501(c)(4) determinations.”⁹⁷ Political spending groups have seized the opportunity to abuse the current confusion concerning IRC Section 501(c)(4) and have misused 501(c)(4) groups to spend hundreds of millions of dollars to influence federal elections. The Treasury and the IRS need to amend the tax regulations to reflect these changes in campaign finance.

In November 2013, the IRS proposed a set of changes to the regulations for (c)(4) groups and asked the public for comments on the proposals.⁹⁸ The IRS received an overwhelming response from the public, over 160,000 comments⁹⁹—the most in the IRS’s history on a proposed regulation.¹⁰⁰ On May 22, 2014, the IRS withdrew the proposed regulations and stated it would propose new regulations taking into consideration the comments they received.¹⁰¹ This note evaluates many of the IRS’s proposals below, and offers suggestions to improve the Treasury and IRS regulations governing tax-exempt organizations.

Any regulation the IRS adopts needs to return the IRS to serving its main purpose while returning federal campaign finance oversight to the FEC. The current state of the regulations place too many political decisions in the hands of the IRS, especially with respect to 501(c)(4) groups.

96. *Id.*

97. Daniel Werfel, *Charting a Path Forward at the IRS: Initial Assessment and Plan of Action*, IRS 28 (June 24, 2013), <http://www.irs.gov/pub/newsroom/Initial%20Assessment%20and%20Plan%20of%20Action.pdf>.

98. See 2013 IRS Proposed Regulations, *supra* note 19.

99. The regulation and comments are posted online at *Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities*, REGULATIONS.GOV, <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001> (last visited Nov. 17, 2014) [hereinafter *Guidance for Tax-Exempt Organizations*].

100. *IRS Update on the Proposed New Regulation on 501(c)(4) Organizations*, IRS, [http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501\(c\)\(4\)-Organizations](http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations) (last updated May 22, 2014).

101. *Id.*

A. Proposed Amendments to the IRC § 501(c)(4) Regulations

The best solution for the IRS to save itself from the current quagmire of IRC Section 501(c)(4) is to return the regulation back to its original meaning. IRC Section 501(c)(4)'s original meaning requires social welfare organizations to be operated *exclusively* for the promotion of social welfare.¹⁰²

The most crucial inquiry in returning IRC Section 501(c)(4) back to its original meaning is how to define "exclusively," a term not defined in the IRC. Dictionary definitions of the word, as well as examples from other Treasury Regulations, provide guidance. West's Encyclopedia of American Law defines exclusively as "pertaining to that subject alone, not including, admitting, or pertaining to any others."¹⁰³ Thus, the dictionary definition of "exclusively" is a narrower term that does not encompass the "primarily" interpretation currently promulgated by IRC Section 501(c)(4).¹⁰⁴

The 1959 Treasury Regulation that has promulgated the current interpretation of 501(c)(4) groups also laid out a framework for 501(c)(3) groups.¹⁰⁵ Section 501(c)(3) uses similar language as IRC Section 501(c)(4), including reading "exclusively" as "primarily."¹⁰⁶ The regulations under Section 501(c)(3) state, "An organization will be regarded as '*operated exclusively*' for one or more exempt purposes only if it engages *primarily* in activities which accomplish one or more of such exempt purposes specified in [Section 501(c)(3)]."¹⁰⁷ In addition, the regulations for 501(c)(3) groups state, "An organization will not be so regarded [as exempt] if more than an *insubstantial part of its activities* which in themselves are not in furtherance of one or more exempt purpose."¹⁰⁸ Despite both using "exclusively" in the same context, the regulations under IRC Section 501(c)(3) construe the term "exclusively" more narrowly than the Section 501(c)(4) regulations.¹⁰⁹

The Treasury's disparate interpretations of "exclusively" appear completely arbitrary. Its 2013 proposed regulations asked for comments on whether the standard for (c)(4) groups should mirror the more precise "ex-

102. See I.R.C. § 501(c)(4) (2006).

103. WEST'S ENCYCLOPEDIA OF AMERICAN LAW (2d ed. 2008).

104. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (1960).

105. 2013 IRS Proposed Regulations, *supra* note 19.

106. § 1.501(c)(3)-1(c)(1).

107. *Id.* (emphasis added).

108. *Id.* (emphasis added).

109. 2013 IRS Proposed Regulations, *supra* note 19.

clusively” (c)(3) standard.¹¹⁰ The Treasury indeed should adopt such a revision. For a group to receive tax-exempt status under IRC Section 501(c)(4), that group’s activities should exclusively promote social welfare. If more than “an insubstantial part of [the group’s] activities” are not in furtherance of social welfare, then that group should not be granted tax-exemption under Section 501(c)(4).¹¹¹ This regulatory change would eradicate the “exclusively” versus “primarily” confusion in the 501(c)(4) regulations, providing consistency in the interpretation of “exclusively” within the IRC Section 501(c) regime.

All parties involved would benefit from shifting the regulatory interpretation of 501(c)(4) back to its original meaning. The IRS would have clearer guidelines for determining (c)(4) groups’ applications. The more precise standard would eliminate the significant discretionary power the IRS staff currently possesses and would speed up the application process. Clearer guidelines lead to greater transparency in how the IRS makes its determinations. This transparency would aid groups seeking tax-exempt status under IRC Section 501(c)(4) because prospective groups would not face ambiguity in the level of activity that does not promote social welfare—anything more than “insubstantial” would violate the “exclusively” standard.

Furthermore, the IRS would be able to focus on serving its mission. If a group seeking exemption under Section 501(c)(4) engages in some form of political activity, the group’s tax-exemption determination is easily resolved. The IRS will deny the exemption because the group is not exclusively promoting social welfare. With clearer guidelines on what exactly constitutes political activity—discussed below—the IRS will no longer be forced to decide political and campaign finance questions.

Lastly, returning Section 501(c)(4) back to its original meaning also would slow the rapid growth of “dark money” in elections. The vast majority of dark money formerly funneled through 501(c)(4) groups would be donated to PACs or Section 527 groups, which are subject to extensive FEC disclosure requirements.

The next important step the IRS must take is to clarify what political activity exempt organizations can and cannot engage in. IRC Section 501(c)(4) needs clearer guidelines on the distinction between political activities and social welfare, and whether they intersect. The Treasury and the FEC interpretations regarding organizations’ “political activity” are incon-

110. *Id.*

111. *See* § 1.501(c)(3)-1(c)(1).

sistent. The two agencies should coordinate their regulations regarding what constitutes “political activity.” The system of campaign finance would be best served by having consistent definitions and language between the Section 501(c) regime and FEC campaign finance laws. Such consistency eliminates the ambiguous overlap in the agencies’ roles in campaign finance and allows the agencies to focus on their own oversight responsibilities. The IRS began to express this idea in its proposed regulations for Section 501(c)(4).¹¹²

The regulations under IRC Section 501(c)(4) currently use the term “political campaign activities” to describe political activity that does not promote social welfare.¹¹³ However, the regulations do not define “political campaign activities.”¹¹⁴ Instead, the IRS relies on a “facts and circumstances test” and several examples “to be considered in determining whether a Section 501(c)[4] organization’s activities . . . result in political campaign intervention.”¹¹⁵ However, these examples do not provide the IRS or would-be (c)(4) groups with clear guidelines. This case-by-case process delegates too much discretion to the IRS staff. Making matters worse, the IRS is a tax-collection agency, not a political-regulatory body like the FEC. Therefore, the IRS staff lacks the requisite expertise to make the political decisions on the 501(c)(4) applications.¹¹⁶ The ambiguity in the Treasury regulations deprives the IRS staff and the public of a clear understanding of exactly what activity counts as “political” for 501(c)(4) groups.

The 2013 proposed regulations suggested replacing “political campaign activity” with “candidate-related political activity.”¹¹⁷ The proposed regulations identified specific political activities that would be “candidate-related political activities,” and thus not activities promoting social welfare.¹¹⁸ Candidate-related political activity would have included what the IRS traditionally has found to be political campaign activity—contributions to candidates and communications expressly advocating for election or defeat of candidates—as well as some activities allowed even to Section

112. See 2013 IRS Proposed Regulations, *supra* note 19.

113. § 1.501(c)(4)-1(a)(2)(ii).

114. See *Id.*

115. Rev. Rul. 2007-41, 2007-1 C.B. 1421.

116. To see an example of the types of questions applicants must answer regarding political activity, see *Applying for Exemption/Misc. Determination: Sample Questions*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions-Attempting-to-Influence-Legislation-or-Political-Campaign-Intervention-Activities> (last updated Feb. 21, 2014).

117. 2013 IRS Proposed Regulations, *supra* note 19.

118. *Id.*

501(c)(3) organizations.¹¹⁹ The proposal drew ideas and definitions from FEC campaign laws and other Section 501(c) regulations.¹²⁰

The Treasury should adopt the “candidate-related political activity” definition. If adopted, Regulation Section 1.501(c)(4)-1 would state, “The promotion of social welfare does not include direct or indirect candidate-related political activity, as defined in paragraph (a)(2)(iii) of this section.”¹²¹ The proposed Section 1.501(c)(a)(2)(iii) appropriately provided the following bright line rules:

For purposes of this section, candidate-related political activity means:

(1) Any communication (as defined in paragraph (a)(2)(iii)(B)(3) of this section)¹²² expressing a view on, whether for or against, the selection, nomination, election, or appointment of one or more clearly identified candidates or of candidates of a political party that

(i) Contain words that expressly advocate, such as ‘vote,’ ‘oppose,’ ‘support,’ ‘elect,’ ‘defeat,’ or ‘reject;’ or

(ii) Is susceptible of no reasonable interpretation other than a call for or against the selection, nomination, election, or appointment of one or more candidates or of candidates of a political party;

(2) Any public communication (defined in paragraph (a)(2)(iii)(B)(5) of this section)¹²³ within 30 days of a primary election or 60 days of a general election that refers to one or more clearly identified candidates in that election or, in the case of a general election, refers to one or more political parties represented in that election;

(3) Any communication the expenditures for which are reported to the Federal Election Commission, including independent expenditures and electioneering communications;

(4) A contribution (including a gift, grant, subscription, loan, advance, or deposit) of money or anything of value to or the solicitation of contributions on behalf of—

119. *Id.*

120. *Id.*

121. *Id.*

122.

‘Candidate’ means an individual who publicly offers himself, or is proposed by another, for selection, nomination, election, or appointment to any federal, state, or local public office or office in a political organization, or to be a Presidential or Vice-Presidential elector, whether or not such individual is ultimately selected, nominated, elected, or appointed. Any officeholder who is the subject of a recall election shall be treated as a candidate in the recall election.

Id.

123.

‘Public communication’ means any communication (as defined in paragraph (a)(2)(iii)(B)(3) of this section)—(i) By broadcast, cable, or satellite; (ii) On an Internet Web site; (iii) In a newspaper, magazine, or other periodical; (iv) In the form of paid advertising; or (v) That otherwise reaches, or is intended to reach, more than 500 persons.

Id.

- (i) Any person, if the transfer is recognized under applicable federal, state, or local campaign finance law as a reportable contribution to a candidate for elective office; or
- (ii) Any section 527 organization; or
- (iii) Any organization described in section 501(c) that engages in candidate-related political activity within the meaning of this paragraph (a)(2)(iii) (see special rule in paragraph (a)(2)(iii)(D) of this section);
- (5) Conduct of a voter registration drive or “get-out-the-vote” drive;
- (6) Distribution of any material prepared by or on behalf of a candidate or by a section 527 organization including, without limitation, written materials, and audio and video recordings;
- (7) Preparation or distribution of a voter guide that refers to one or more clearly identified candidates or, in the case of a general election, to one or more political parties (including material accompanying the voter guide); or
- (8) Hosting or conducting an event within 30 days of a primary election or 60 days of a general election at which one or more candidates in such election appear as part of the program.¹²⁴

This redefining of what constitutes non-qualifying political activity for 501(c)(4) groups is a major overhaul, but it is a needed one. The proposed definitions offered by the Treasury for what constitutes “candidate-related political activity” is extensive, and provides applicants and the IRS with a superior approach to tax-exemption determinations. The IRS would no longer be limited to arbitrary examples of how political campaign activities could apply to a would-be 501(c)(4) organization. The proposed definition of “candidate-related political activity” would arm the IRS with a detailed list of specific activities that would fall under that barred category. The IRS would be able to make tax-exemption determinations with more ease and with less reliance on its own discretion of “what is political.”

The specific provisions and definitions under the proposed “candidate-related political activity” standard would provide consistency within the IRC as well as federal election laws. The definition of candidate would be consistent with IRC Section 527’s definition.¹²⁵ The definition of “express advocacy” borrows language from the FEC’s laws for express advocacy but expands to encompass more specific types of advocacy.¹²⁶ Furthermore, the Treasury’s proposal borrowed FEC language for political communications close in time to elections—which the FEC calls electioneering com-

124. *Id.*

125. *Id.*

126. *Id.*

munications—and extended the application of those rules to state and local elections too.¹²⁷

B. Proposed Amendments to the IRC § 501(c)(3), (c)(5), and (c)(6) Regulations

Adopting regulatory changes to IRC Section 501(c)(4) begs the question of what implications these new regulations would have on the other IRC Section 501(c) groups. One of the main goals of this note's proposals is consistency among terminology and rules so it is clear what activities prospective tax-exempt groups can engage in. Thus, the candidate-related political activity rule should also apply to IRC Section 501(c)(3) charities, (c)(5) labor unions, and (c)(6) trade and professional groups (business leagues).

Applying a Section 501(c)(4) candidate-related political activity rule to IRC Section 501(c)(3) is a logical clarification. While many state-law charities are exempt under Section 501(c)(4), the IRC expressly forbids 501(c)(3) groups from engaging in any form of political activity.¹²⁸ Thus, if the regulations under IRC Section 501(c)(3) adopted the candidate-related political activity rule, it would constitute only a small change in the wording of the regulation with a minimal effect on its application.

Additionally, applying the candidate-related political activity rule to IRC Sections 501(c)(5) and (c)(6) is also a logical move that would create consistent terminology for all of the 501(c) tax-exempt groups—except for the Section 527 political groups. Exempt 501(c)(5) organizations must, the regulations provide, “Have as their objects the betterment of the conditions of those engaged in [the pursuits of labor, agriculture, or horticulture], the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.”¹²⁹ The regulations under 501(c)(6) state:

A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and . . . [whose] activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.¹³⁰

127. *Id.*

128. See I.R.C. § 501(c)(3) (2006).

129. Treas. Reg. § 1.501(c)(5)-1(a)(2) (1960).

130. § 1.501(c)(6)-1.

Sections 501(c)(5) and 501(c)(6) resemble Section 501(c)(4) concerning their treatment of groups engaging in political activity. The regulations under 501(c)(5) and (c)(6) state:

[p]articipating directly or indirectly, or intervening, in political campaigns on behalf of or in opposition to any candidate for public office does not further exempt purposes under Internal Revenue Code Section [501(c)(5) or (c)(6)]. However, [a (c)(5) or (c)(6) group] may engage in some political activities, so long as that is not its primary activity.¹³¹

Thus, the same dilemma, described above concerning the amount of permissible political activity by 501(c)(4) groups applies to 501(c)(5) and (c)(6) groups.

Therefore, the Treasury should not only include a candidate-related political activity rule in its re-proposed (c)(4) regulations, but also extend it to 501(c)(5) and 501(c)(6) groups. Amending only the 501(c)(4) regulations to curb dark money spending “would do little to deter powerful individuals or large companies from engaging in limitless dark money electioneering.”¹³² If the IRS narrowly implements amended regulations, political spending groups would shift their focus to 501(c)(5) and (c)(6) groups, which could maintain tax-exemption status without having to disclose their donors.¹³³ Trade associations, especially, would become immensely popular because, like 501(c)(4) groups, they would be able to “take unlimited donations and engage in unrestricted partisan or election activity”¹³⁴ (as long as the group’s activities are presumably less than fifty percent). That being said, 501(c)(5) and (c)(6) groups would also need to operate “exclusively” for their respective purposes as stated in the IRC. If the “exclusively” standard is not implemented into the regulations under IRC Sections 501(c)(5) and (c)(6), in addition to the candidate-related political activity rule, dark money will migrate to 501(c)(5) and (c)(6) groups, instead of (c)(4) groups, spending unconstrained amounts of money in elections.

For example, if an oil company sought to prevent a pro-green energy and climate change candidate from taking office, this is how the company could use IRC Section 501(c)(6) to its advantage: The oil company “could simply route the money through a 501(c)(6) trade group, like the U.S. Chamber of Commerce . . . which could then air the negative campaign

131. *Id.*

132. Lee Fang, *IRS Dark Money Reforms Would Curb Voter Registration, Leave Lobbying Groups Untouched*, THE NATION (Jan. 10, 2014), <http://www.thenation.com/blog/177868/irs-dark-money-reforms-would-curb-voter-registration-leave-lobbying-groups-untouched>.

133. *Id.*

134. *Id.*

advertisement independently or through another third party. The voter would have no idea where the money was coming from.”¹³⁵ This strategy enables corporations to keep their “corporate logo out of the [public’s] bull’s-eye.”¹³⁶

Since 2008, election cycles have shown that corporations and political spending groups know how to abuse the IRC in its current structure, and it is only a matter of time before 501(c)(5) and (c)(6) groups become the attractive route for dark money.¹³⁷ Evidence already suggests that forward thinking strategists and groups have begun creating 501(c)(6) organizations.¹³⁸ The Koch brothers¹³⁹ created “Freedom Partners” in 2011 as a 501(c)(6) organization, which has been notoriously labeled “[t]he Koch brothers’ secret bank,” as it spent \$250 million in the 2012 election cycle.¹⁴⁰

Holding IRC Sections 501(c)(3), (c)(4), (c)(5), and (c)(6) groups to an exclusive standard of not engaging in candidate-related political activity is a necessary step for the tax-exempt regime. If the Treasury adopted these proposals, a tremendous amount of dark money would stop flowing through 501(c) tax-exempt organizations. These proposals would result in Section 527 groups becoming the sole type of tax-exempt group that could engage in political campaign activity. Further, the IRS could focus on making Section 501(c) tax-exempt determinations without having to assess campaign finance activities.

IV. OPPOSING ARGUMENTS TO ADOPTING THE PROPOSED AMENDMENTS

Adopting a significant regulatory change like the proposal above will surely raise opposition—as the IRS acknowledged when it withdrew the

135. *Id.*

136. Lee Fang, *Never Mind Super PACs: How Big Business is Buying the Election: Thanks to Citizens United, US and Foreign Corporations can Secretly Spend Millions on Political Campaigns under the Cover of Trade Associations*, THE NATION (Aug. 29, 2012), <http://www.thenation.com/article/169639/never-mind-super-pacs-how-big-business-buying-election>.

137. See 2012 *Outside Spending*, *supra* note 1; 2008 *Outside Spending*, *supra* note 8.

138. Mike Allen & Jim Vandehei, *Exclusive: The Koch Brothers’ Secret Bank*, POLITICO, Sept. 11, 2013, <http://www.politico.com/story/2013/09/behind-the-curtain-exclusive-the-koch-brothers-secret-bank-96669.html#ixzz2hj4y5I8o>.

139. Charles and David Koch are the co-owners of Koch Industries, the second largest privately held corporation in the United States. The Koch Brothers are notorious for contributing significant amounts of money to Republican candidates. See Daniel Fisher, *Inside the Koch Empire: How the Brothers Plan to Reshape America*, FORBES, Dec. 24, 2012, available at <http://www.forbes.com/sites/danielfisher/2012/12/05/inside-the-koch-empire-how-the-brothers-plan-to-reshape-america/2/>.

140. Allen & Vandehei, *supra* note 138.

2013 proposal.¹⁴¹ The strongest argument opposing the regulatory changes would come from 501(c)(4), (c)(5), and (c)(6) groups that claim that political campaign activity is necessary for the advancement of their group's purpose. These groups want the regulations to remain the status quo so they can continue to engage in political campaign activity while remaining tax-exempt under Section 501(c).

Among the 501(c) groups clamoring that political activity advances their purpose, 501(c)(4) groups have the strongest argument. Proponents of this idea argue that neither the statute nor the regulations have ever defined "social welfare," and that political activity actually promotes social welfare.¹⁴² Proponents argue that the IRS has interpreted political campaign activity to be a part of "social welfare."¹⁴³ To support this argument, proponents claim political activity raises public awareness, educates the public, and creates social change.¹⁴⁴

However, this assertion is simply unfounded because it contradicts the current interpretation of IRC Section 501(c)(4) concerning groups' political activity.¹⁴⁵ The 1959 Treasury Regulation defines "'social welfare' to *exclude* political activity, not include it."¹⁴⁶ Furthermore, courts have defined social welfare to require the promotion of "the common good and general welfare of the 'community as a whole.'"¹⁴⁷ Intuitively, advocating for the election of a candidate cannot benefit the community as a whole because one candidate's victory generally does not advance the interests of the losing candidates' supporters.¹⁴⁸ Therefore, the argument that political campaign activity promotes social welfare does not hold water because of the precedents set by the Treasury Department, IRS, and the courts on this issue.

Section 501(c)(5) and (c)(6) organizations would advocate similar arguments, but they would also fail. These groups would argue that political campaign activity promotes the purposes they are required to uphold for

141. See *Guidance for Tax-Exempt Organizations*, *supra* note 99.

142. See, e.g., Bradley Smith, *The Latest IRS Power Grab*, WALL ST. J., Dec. 8, 2013, available at <http://online.wsj.com/news/articles/SB10001424052702303497804579239970456967130>.

143. *Id.*

144. Adam Rappaport, *The Dark Money Debate: Responses to Arguments against IRS Treatment of 501(c) Groups*, CITIZENS FOR RESP. & ETHICS IN WASH. 7–8 (Jan. 2014), http://www.citizensforethics.org/page/-/PDFs/General%20CREW/Reforming_IRS_501c_Treatment_CREW_1_2014.pdf?nocdn=1.

145. *Id.* at 8.

146. *Id.*

147. *Id.*; see *Comm'r v. Lake Forest, Inc.*, 305 F.2d 814, 818–19 (4th Cir. 1962); see also *Mutual Aid Assoc. of the Church of the Brethren v. United States*, 759 F.2d 792, 795 (10th Cir. 1985); *People's Educ. Camp Soc'y, Inc. v. Comm'r*, 331 F.2d 923, 931 (2d Cir. 1964).

148. Rappaport, *supra* note 144, at 8.

exemption.¹⁴⁹ However, these arguments would fail for the same reasons that political campaign activity does not promote social welfare for (c)(4) organizations.

Many opponents of these proposals would argue that such an amendment to the regulations would improperly impede their First Amendment right to spend their money in elections. However, the proposed regulations allow members of tax-exempt groups to spend all the money they want in elections, within the confines of FEC laws. Nothing in the proposed regulations would prevent these groups or their members from creating a PAC or other Section 527 group, thereby bringing their contributions under FEC oversight and disclosure requirements. Thus, the members of 501(c)(5) and (c)(6) groups could still engage in political activity to advance their interests. They just could not do so with 501(c)(5) or (c)(6) groups.

In addition, opponents to the 2013 Treasury proposals argued that some of the specific activities barred under “campaign-related political activity” would ban neutral and non-partisan activities. For instance, opponents pointed to activities like voter registrations and “get-out-the-vote” drives as being non-partisan, and argued that tax-exempt groups should be allowed to conduct such activities.¹⁵⁰ However, determining the neutrality of certain election-related activities is highly fact-intensive.¹⁵¹ Political groups can craft sophisticated voter guides or sponsor “get-out-the-vote” drives that seem nonbiased. However, partisan and ideological motivations are the driving forces behind these “neutral” activities.

A sounder policy would be to remove this decision from the IRS entirely. If a social welfare organization wanted to host a get-out-the-vote drive, it could form another political group (a Section 527 group or PAC) to fund and conduct the drive. With this procedure, the IRS does not need to make the fact-intensive political determination of whether the drive was actually nonbiased. This responsibility would properly belong to the FEC. Although critics insist the FEC is a “toothless tiger that shirks its responsibility of enforcing campaign finance laws” in need of reform itself, that topic is beyond the scope of this note.¹⁵²

149. See Treas. Reg. § 1.501(c)(5)-1, (c)(6)-1 (1960).

150. See 2013 IRS Proposed Regulations, *supra* note 19.

151. *Id.*

152. See, e.g., Jeremy Wallace, *Critics Say FEC Fails to Enforce Campaign Finance Law*, HERALD TRIB., July 21, 2011, <http://politics.heraldtribune.com/2011/07/21/critics-say-fec-for-failing-to-enforce-campaign-finance-law/>.

CONCLUSION

The proposed amendments to the Treasury regulations that this note calls for are not flawless. However, this regulatory overhaul would bring positive change in several ways. The IRS and public would possess clear guidelines as to what activities tax-exempt groups could engage in. The proposals would stop the recent explosion of dark money stemming from tax-exempt organizations. Lastly, the proposals best serve the IRS as an agency, allowing it to return to its traditional purposes and mission.