

SOCIAL WELFARE ORGANIZATIONS' ELECTORAL ACTIVITY:
HOW MUCH IS TOO MUCH?

Miriam Galston

Since the enactment of the McCain-Feingold campaign finance reform legislation (commonly known as “BCRA”)¹ in 2002, and especially since the core elements of BCRA were upheld by the Supreme Court in *McConnell v. FEC*² in December of 2003, attention has shifted to the consequences of these developments for section 527 organizations that do not register as political committees under the Federal Election Campaign Act (“FECA”),³ since many of these groups engage in activities intended to influence the selection or election of candidates for Federal office. During and since the 2004 presidential election, the status of “non-registering” 527 organizations has been discussed extensively in Congress, academic and practitioner journals, and the popular press.

What has been flagged, but not scrutinized to the same degree, are electoral issues related to 501(c)(4) organizations. Some of these issues are predominantly FECA issues, e.g., whether, or to what extent, 501(c)(4) groups should be regulated under federal campaign finance law. This nugget, in contrast, explores an issue on the tax law side of the equation, although it was

¹ Bipartisan Campaign Reform Act, Pub. L. No. 107-155, 116 Stat. 81 (codified as part of FECA at 2 U.S.C. §§ 431 et seq.).

² 540 U.S. 93 (2003).

³ The Federal Election Campaign Act of 1971, as amended. 2 U.S.C. §§ 431 et seq.

conceived in response to ripple effects of the recent changes in federal campaign finance law. In particular, my question is, how much electoral activity on the part of 501(c)(4) organizations is “too much” under the Internal Revenue Code (the “Code”) as currently interpreted and how much should be considered too much.

My chief reason for this focus is the concern, shared by many, that 501(c)(4) organizations will soon become one of the preferred vehicles for funneling “unregulated” campaign finance money into elections. Section 501(c)(4) groups may be increasingly attractive for campaign purposes because they appear to be more insulated from FECA regulation than do 527 organizations. For example, the proposals debated in Congress this past spring to redefine the concept of a “political committee” for FECA purposes in a way that would compel large numbers of nonregistering 527 organizations to register as political committees specifically provided that no provision of the proposed legislation would affect “the determination of whether a group organized under section 501(c)...is a political committee.”⁴ A second reason for their popularity is that 501(c)(4) organizations are not required to reveal the identities of their contributors. For some donors, this may make them a more desirable campaign finance vehicle

⁴ See section 4 of *527 Reform Act of 2004*, H.R. 5127, 108th Cong. (2d Sess. 2004), S. 2828, 108th Cong. (2d Sess.2004). The bill was not passed. A revised version (*527 Reform Act of 2005*) was introduced in 2005. See H.R. 513, 109th Con. (1st Sess. 2005), S. 271, 109th Cong. (1st Sess. 2005). S. 271 was reported out of the Senate Rules Committee and went to markup on April 27, 2005. H.R. 513 also went to markup under the auspices of the Committee of House Administration on June 29, 2005.

than 527 organizations, which are required to disclose their donors, or any entity subject to FECA disclosure rules.

It thus seems useful to examine the viability of 501(c)(4) groups as alternatives to 527 organizations from the perspective of tax law limitations on their political campaign activity. A complete examination of this question would have to take into account other tax law differences between the two groups, such as the possible applicability of the gift tax to contributions to 501(c)(4) organizations that exceed the annual gift tax limitation⁵ and differences in reporting requirements. This paper, however, will limit itself to the question posed in the title.

I. REGULATORY HISTORY OF THE PRIMARILY STANDARD

Section 501(a) exempts from federal income tax organizations described in sections 501(c) and (d). Described in section 501(c)(4) are “[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or [certain] associations of employees....” This paper addresses only the social welfare organization prong of section 501(c)(4).⁶

According to the current regulations implementing the statute, the promotion of social

⁵ On this topic, see Barbara K. Rhomberg, *Constitutional Issues Cloud the Gift Taxation of Section 501(c)(4) Contributions*, 15 TAX’N EXEMPTS 164 (2004); Barbara K. Rhomberg, *The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions*, 15 TAX’N EXEMPTS 62 (2003).

⁶ The exemption for civic leagues and social welfare organizations first appeared in the income tax law enacted in 1913 (exempting civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare). Section II G(a), chapter 16, 63d Congress, 38 Stat. 172. The provision was reenacted in subsequent Revenue Acts. In the Revenue Act of 1924 (section 231(8), 43 Stat. 253), exemption under the same section was added for “local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.”

welfare includes being “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community,...and operated *primarily* for the purpose of bringing about civic betterments and social improvements” (emphasis added).⁷ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i). The regulations provide only the most abstract formulation of the affirmative content of “social welfare” by identifying it with “promoting in some way the common good and general welfare of the people of the community” or furthering “civic betterments and social improvements.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(i). The regulations do, however, note specifically that “[t]he promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office nor being primarily engaged in operating a social club or operating a business similar to a for-profit business.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii). Thus, in determining whether a social welfare organization is primarily engaged in promoting social welfare, campaign activities as well as certain social and business operations will never count as part of the calculation.

The question of how much political campaign activity is appropriate for a 501(c)(4) organization thus presupposes in the first instance an understanding of the meaning of the “primarily” constraint. As a linguistic matter, the term “primarily” is ambiguous, given that

⁷ Prior to the enactment of the 1954 Code, the 501(c)(4) regulations did not equate exclusively with primarily. *See* Treas. Reg. § 39.101(8)-1, *in* 18 Fed. Reg. 5909 (Sept. 26, 1953). The regulation remained virtually the same from 1924 until the 501(c)(4) regulations were promulgated, except for minor changes in sentence structure. For most of that time, it read: “Civic leagues entitled to exemption under section 101(8) comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations comprehended within section 101(6) [now 501(c)(3)].”

plausible meanings could include a wide range of quantitative and qualitative measures and the 501(c)(4) regulations do not offer any guidance on this topic.

The first and arguably the most important guidance should come from the statutory provision that the regulations implement. As noted above, the statutory provision uses the term “exclusively.” The courts and the Service have a long history of interpreting the term “exclusively” in the exemption provisions in a nonliteral fashion, so that “less-than-exclusive” qualifies as exclusive under various subsections of the statute. This approach differs, for example, from the approach of the Service with regard to private inurement⁸ or charities engaging in political campaign activities, where zero tolerance is the rule in the regulations and administrative pronouncements as well as in the statute.

The most widely cited instance of authority for a nonliteral interpretation of exclusively is the reasoning advanced by the Supreme Court in *Better Business Bureau v. United States*, which involved a business league that was engaged in consumer and industry education as well as in activities traditionally associated with a 501(c)(6) organization.⁹ In upholding the Service’s determination that the group did not qualify for an exemption from Social Security taxes as an educational entity despite its educational activities, the Court stated that a “single noneducational purpose, if substantial in nature, will destroy the exemption [from the employment tax as an educational entity] regardless of the number or importance of truly educational purposes.”¹⁰

⁸ Whether the enactment of the excess benefit provisions signals the end of the “zero tolerance” era for private inurement in practice, if not as official policy, is a topic beyond the scope of this paper.

⁹ 326 U.S. 279 (1945). The case was decided under the predecessor to the 1954 Code.

¹⁰ 326 U.S. at 283.

The Court's reasoning in *Better Business Bureau* may have influenced the language subsequently adopted in the 501(c)(3) regulations, according to which an organization will not be "regarded [as engaging primarily in one or more exempt purposes] if more than an insubstantial part of its activities is not in furtherance of an exempt purpose." Treas. Reg. § 1.501(c)(3)-1(c)(1). As is well known, there is no bright line rule demarcating the boundaries of "insubstantial" for section 501(c)(3) purposes. Questions about the existence of a substantial nonexempt purpose arise frequently in the context of entities claiming charitable status and engaged in commercial activities that arguably are carried out to further of their exempt purpose(s). Parallel language also governs the inquiry into the amount of lobbying permitted a 501(c)(3) organization. In both settings, substantial and insubstantial are often interpreted as referring to a quantitative measure, whether a *de minimis* amount or something a little larger, but not too big. For example, in *World Family Corporation v. Comm'r*, the Tax Court concluded that an entity qualified for 501(c)(3) status even though its activities that were arguably nonexempt would "[a]t peak operations" consume ten percent of the organization's expenditures.¹¹ The court noted that, in an earlier opinion, it had found that another group exceeded the insubstantial limitation when its expenditures for a nonexempt purpose were approximately twenty percent. The court was quick to caution, however, that it should not be seen as establishing a percentage test as a "general rule for future cases," since every situation was unique and would require a facts and circumstances test.¹² Other authorities include or

¹¹ 81 T.C. 958, 966 (1983), *acq. in part*, 1984-2 CB 2, *non-acq in part*, 1984-2 CB 2.

¹² See also the decisions interpreting the "no substantial part" restriction on lobbying by charities. *Haswell. U.S.*, 500F.2d 1133, 1142 (Ct. Cl.), *cert. denied*, 419 U.S. 1107 (1974) (lobbying was substantial when lobbying expenditures comprised 16-20% of total expenditures

emphasize a more qualitative analysis of the 501(c)(3) primarily constraint, seeking to determine whether nonexempt activities are “incidental to” or in furtherance of an entity’s exempt purpose(s).¹³

The 501(c)(4) regulations do not elaborate the meaning of “primarily” even to the limited extent of the 501(c)(3) regulations. In other words, the 501(c)(4) regulations do not refer to a substantial or insubstantial standard. Numerous courts, including four appellate courts, have nonetheless adopted the *Better Business Bureau* language and imported it into the 501(c)(4) context. Typical is *Contracting Plumbers Cooperative Restoration Corp. v. U.S.*, in which the Second Circuit denied 501(c)(4) status for a nonprofit group that made street repairs in New York City in coordination with state and city agencies. The repairs in question were necessary because of plumbing work that damaged streets and curbs. The record showed that the public authorities had been able to repair only 60 percent of the damaged locations because of their limited resources. The cooperative, in contrast, was able to make virtually all necessary repairs and it accomplished this feat at approximately one-fifth of the cost incurred by the public authorities. However, the cooperative repaired only the damage caused by its members (making up roughly 98 percent of the city’s licensed plumbers). In reversing the lower court, the Second

and the group’s legislative program was an important part of its agenda in other respects); *Seasongood v. Comm’r*, 227 F.2d 907, 911-12 (6th Cir. 1995) (lobbying that accounted for less than 5 percent of a group’s total activities was not substantial).

¹³ See *Better Business Bureau*, 326 U.S. at 283-84 (the salutary attempts to educate and cleanse business practices were incidental to the “commercial hue permeating petitioners organization”); Rev Rul 72-102, 1972-1 CB 149 (holding that the benefits to the private developer of enforcing development covenants were “merely incidental”); Rev. Rul. 66-221 (holding that a volunteer fire department’s social activities, which appear to have been extensive, were incidental to and “in furtherance of” its primary objective or operating a fire department).

Circuit acknowledged that, even though the cooperative's "activities are totally commendable," its activities were also "of tremendous value" to its members, who were charged much less by the cooperative than they would have been by the city. The court thus held against the organization on the grounds that "the presence of a single substantial non-exempt purpose precludes [501(c)(4)] exemption regardless of the number or importance of the exempt purposes."¹⁴ This decision and decisions of the Fourth, Tenth, and Eleventh Circuits thus make no distinction between the amount of nonexempt activity (or purpose) permissible for 501(c)(3) as compared with 501(c)(4) organizations.

The Service, in contrast, has frequently taken (perhaps always takes) the position that the primary constraint for 501(c)(4) purposes is different from the counterpart constraint applied to 501(c)(3) entities. The earliest authority I could find, GCM 32394 (Sept. 14., 1962), was occasioned by a proposed letter ruling that would have revoked the 501(c)(4) status from an organization that rated candidates for public office on the ground that any amount of campaign activity was inconsistent with the 501(c)(4) exemption. In announcing its disagreement with the proposed ruling, the GCM explained that exemption under section 501(c)(4) can be denied "only to organizations that are primarily engaged in activity which constitutes direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate

¹⁴ 488 F.2d 684, 686 (2d Cir. 1973), *cert. denied*, 419 U.S. 827 (1974). Similarly *American Association of Christian Schools Voluntary Employees Beneficiary Ass'n Welfare Plan Trust v. U.S.*, 850 F.2d 1510, 1515-16 (11th Cir. 1988); *Police Benevolent Ass'n of Richmond, Va. v. U.S.*, 661 F. Supp. 765, 773 (E.D. Va. 1987), *aff'd without opinion*, 836 F.2d 547 (4th Cir. 1987); *Mutual Aid Association of the Church of the Brethren v. U.S.*, 759 F.2d 792, 796 (10th Cir. 1985); *American Women Buyers Club, Inc. v. U.S.*, 338 F.2d 526, 528 (2d Cir. 1964); *People's Educational Camp Soc'y, Inc. v. Comm'r*, 331 F.2d 923, 931 (2d Cir.), *cert denied*, 379 U.S. 839 (1964).

for public office.”¹⁵ As authority for that proposition, the GCM cited GCM 31300 (June 25, 1959), which I have not been able to locate.

Although GCM 32394 did not explicitly compare its formulation of the 501(c)(4) primarily standard with the standard applied to 501(c)(3) organizations, its reasoning certainly implied such a distinction. Subsequent IRS authorities have in fact made the distinction explicit, stating that the difference between the two standards is one of degree. Typical is the 1981 EO Continuing Professional Education (CPE) Text, according to which “[o]ne of the major distinctions between section 501(c)(3) and 501(c)(4) is the amount of activity that may be devoted to nonexempt purposes.”¹⁶ Similarly, Rev. Rul 66-179, 1966-1 CB 139, held that a garden club qualified for 501(c)(4) status when “a substantial part of the organization's activities, but not its primary activity, consists of social functions for the benefit, pleasure, and recreation of its members.”

Initially the Service had considerable doubts about interpreting exclusively to mean primarily and then defining primarily so as to permit a substantial amount of nonexempt activity.

¹⁵ The facts stated in the GCM do not include an assessment of the extent to which the organization was engaged in rating candidates as contrasted with its other activities, such as “conduct[ing] research and publish[ing] information regarding public affairs” so as to “promote an enlightened electorate and governmental efficiency.” The GCM did not express a view about the conclusion the Rulings group should reach, only that it should determine whether the candidate rating activities were primary or not.

¹⁶ *Social Welfare: What Does It Mean? How Much Private Benefit Is Permissible? What Is A Community?*, CPE Text for FY 1981, 95, 98. See also Raymond Chick and Amy Henchey, *Political Organizations and IRC 501(c)(4)*, CPE Text for FY 1995, 191, 192; John Francis Reilly, Carter C. Hull, and Barbara A. Braig Allen, *IRC 501(c)(4) Organizations*, CPE Text for FY 2003, I-1, I-25. The Reilly, Hull, and Allen article expressly states that “Since the test for exemption under IRC 501(c)(4) looks to the organization's primary activities, an organization exempt under IRC 501(c)(4) may engage in substantial non-exempt activities.” Both articles contrast the 501(c)(4) standard with the standard applied to 501(c)(3) organizations.

Attached to GCM 38215 (Dec. 31, 1979) is a memorandum,¹⁷ dated March 31, 1978, from Jerome Sebastian, Director, Interpretive Division, to the Deputy Chief Counsel (Technical). This memorandum refers to “a perennially troublesome question,” namely, should the 501(c)(4) regulations be changed, given that, as “has long been recognized [...] they are an unduly broad interpretation of the statute.” In Sebastian’s view, it “seems to be” the case that the 501(c)(4) regulations permit a 51%-49% dichotomy.” He refers to a 1962 GCM questioning “whether the Regulations were a valid interpretation of the statutory requirements and suggest[ing] that there should be a policy decision whether the language of the statute or that of the Regulations controls.”¹⁸

The issue was raised again in 1976 as a result of controversy within the Service about a proposed Revenue Ruling. As detailed by the Sebastian memorandum, there was a reconciliation conference in August of 1976 attended by the Director of the EO Division, the Chief Counsel, and representatives from other offices. They discussed whether the Service could change its rulings position, applied for more than a decade, without changing the regulations themselves, and they appear to have concluded that this should be avoided. The conversation

¹⁷ This is one of two GCMs that were written in connection with Rev. Rul. 81-95, the ruling that endorsed the view that social welfare organizations can engage in campaign activities as long as such activities are not primary. The second GCM (GCM 38264, dated Jan. 30, 1980) modified GCM 38215 to take into account the provision in FECA prohibiting corporations from making campaign contributions using general treasury funds. GCM 38215 contained two other attachments in addition to the memorandum summarized in the text. The first, dated March 31, 1975, was entitled “Background Information Note.” The second was a memorandum from George Jelly, dated November 21, 1979, regarding “Proposal to Amend I.R.C. § 501(c)(4) Regulations.”

¹⁸ That the regulation “significantly liberalized” the statute was also noted by the Second Circuit in *Contracting Plumbers Cooperative Restoration Corp. v. U.S.*, 488 F.2d at 686.

covered the impact of the enactment of section 527 and the effect of extending the UBIT rules to 501(c)(4) organizations in 1969. The decision was made to write a memorandum for Treasury reviewing the history of the 501(c)(4) regulations and the problems they raise and to recommend that the regulations be reconsidered. As presented to Treasury, the memorandum¹⁹ apparently recommended replacing the primarily test with an exclusively criterion interpreted to permit only an insubstantial amount of nonexempt activities.

Sebastian does not report on what transpired between the time Treasury received the group's recommendation (in October of 1976) and March 31, 1978, when he wrote the memorandum I am summarizing.²⁰ He does recommend against undertaking a regulations project at that time for several reasons, "even though there may be substantial agreement that the current regulations are deficient" and even though he states that the insubstantial test applied to 501(c)(3) organizations "might be a reasonable test under section 501(c)(4)." First, he notes that there are higher priorities in the exempt organization area, not to mention the rest of the Code. Second, he believed that the 501(c)(4) regulations should not be changed without reconsidering the 501(c)(3) regulations at the same time because the development of the primarily test in the latter probably exerted a significant influence on the former. Finally, Sebastian argues that "the impact of the current Regulations has been significantly diluted" by the enactment of the 527 tax

¹⁹ By the time it was presented to Treasury, it was referred to as a "study."

²⁰ Sebastian does refer to "extensive and protracted efforts" from 1975 to 1977 to change the 501(c)(3) regulations. Perhaps these efforts are what derailed the discussion about the 501(c)(4) regulations. Sebastian says that, at the time he was writing his memorandum, consideration of amending the 501(c)(3) regulations was either "abandoned" or "dormant."

and the extension of the UBIT rules to 501(c)(4) organizations.²¹

As far as I can tell, there has been no serious consideration given since the late 1970s to changing the primarily standard in the regulations or the Service's application of that standard (although I am hoping that Marc Owens can enlighten us further about this and related issues on Thursday). It thus seems safe to say that the IRS interprets the primarily standard for 501(c)(4) groups as permitting a substantial amount of nonexempt activity, although it is less clear what quantum of activity is permitted. Marc Owens has suggested publicly that the Service construes the quantitative measure as a percentage analysis, with 49%/51% nonexempt/exempt ratio permitted.²² The rulings issued by the Service never mention a specific percentage. Rather, they usually pronounce in a conclusory fashion that an organization did or did not primarily engage in an exempt or nonexempt activity.

II. ACTIVITIES v. PURPOSES

One possible way to reconcile the apparent discrepancy between the statutory emphasis on exclusivity and the primarily standard in the regulations is to distinguish between the permissible scope of a social welfare organization's activities (which must be primarily, although not exclusively exempt) as contrasted with the permissible scope of its purposes (which must be

²¹ He also concedes that the UBIT rules constitute "only a partial solution" to the problem of social welfare organizations engaging in commercial activities.

²² See *Roundtable Discussion with Miriam Galston, Marc Owens and Celia Rody*, in 9 PAUL STRECKFUS'S EO TAX JOURNAL 19, 24 (September/October 2004).

exclusively exempt).

This distinction shows promise in the context of the regulations implementing section 501(c)(3) because the regulations consistently stipulate that a charitable organization's purposes must be exclusively one or more exempt purposes, whereas the term primarily is always followed by the word "activities, throughout Treas. Reg. § 1.501(c)(3)-1(a)-(c). This pattern might be construed as permitting a charitable entity to engage in an insubstantial amount of nonexempt activities as long as, in aggregate, they do not reflect a single nonexempt purpose. Two considerations prevent this explanation from bridging the gap between the statute and the regulations. The first is the fact that the concept of a "primary purpose" permeates Treas. Reg. § 1.501(c)(3)-1(d)-(e). The second is the teaching of *Better Business Bureau* that charitable exemption is possible absent a single substantial nonexempt purpose. In light of this teaching, a charity can in fact pursue a nonexempt purpose as long as it is not substantial, so its purposes need not be exclusively exempt. In fact, the 501(c)(3) regulations may well have been crafted to reflect the Supreme Court's teaching. If so, the pattern observed in the first half of the regulations was probably not intentional.

The activities-purpose distinction is even less tenable as regards the 501(c)(4) regulations, since they are too sparse to be mined even by a determined Talmudist.²³ In any event, the distinction strikes this author as the triumph of form over substance since typically an

²³ The affirmative account of the meaning of social welfare is devoid of references to purpose or activity, preferring instead the phrase "promotion of social welfare." See Treas. Reg. § 1.501(c)(4)-1(a)(2). The paragraph devoted to the conclusively nonexempt character of political, social, and commercial activities speaks of an organization being "operated primarily for social welfare." The implication is that it is permitted for a 501(c)(4) group to have social welfare as its primary rather than exclusive purpose.

organization's activities will be the best objective evidence of its purpose.

III. THE PRIVATE BENEFIT LIMITATION

More promising is the tendency of the Service to contrast an organization's exempt or primary purpose with the restrictions on the permissible private benefit that such entities can confer. In GCM 38920 (Nov. 26, 1982), for example, the Service considered the eligibility for 501(c)(4) status of an organization established to provide financial and other assistance to minority and "small-scale" businesses. The Service compared the private benefit restrictions imposed upon 501(c)(3) groups with the counterpart restrictions on 501(c)(4) groups. It observed that "the amount of private benefit that is tolerable in a section 501(c)(4) context may be greater than that permissible under section 501(c)(3). The GCM elaborated on the "may" by first noting that, because of the statutory prohibition against being organized for profit, a 501(c)(4) organization must have "a total absence of proprietary interest or element of individual profit." "Beyond that," the Service then concluded, the possibility of private benefit must be weighed against the public benefit on a case by case basis to determine if tax exemption is merited." The Service thereby appeared to endorse a balancing test. Although it did not indicate the standards to be used to determine when the right balance exists or has been exceeded, it did appear to offer the balancing test as the explanation for the view that the 501(c)(4) primarily constraint may encompass a greater amount of private benefit than the 501(c)(3) primarily constraint.

Assuming that the political activities limitation is one instance of the general limitation against private benefit, the second area flagged by the 501(c)(4) regulation—commercial activities—could in principal be useful in fleshing out the primarily standard. In this area as well,

the analysis incorporates a facts and circumstances standard. Unfortunately, here too the Service tends to assert in a categorical fashion that an organization's primary purpose or activities do or do not further social welfare without elaborating on the quantitative factors that led to its judgment.

In addition to the absence of useful analysis, the limitation on commercial activities would also seem to be quite different from the limitation on political campaign activities as a conceptual matter for two reasons. First,²⁴ in enacting the unrelated business income tax, Congress in effect endorsed the view that business activities of exempt organizations further their exempt purposes when they are "substantially related." In contrast, based upon the 501(c)(4) regulation's assertion that political campaign activities cannot be considered to promote social welfare for purposes of that section, it seems clear that political campaign activities can never be construed as instrumental to the group's exempt purpose. Business activities engaged in by a 501(c)(4) organization might then be conceptualized as on a continuum. At one pole would be activities clearly unrelated to the organization's exempt purpose; at the other, activities clearly substantially related to its exempt purpose. In between would be some activities arguably substantially related or not, others related or unrelated to different degrees, and other hybrid activities that are substantially related in some respects but not in others.²⁵ This can never happen with political campaign activities because the category as such has been stipulated to be unrelated. In contrast, once the determination is made that an activity constitutes a trade or business, it is still necessary to examine if it is related or not or

²⁴ Discussion of the second reason begins on p. 17, below.

²⁵ On the hybrid theme, see *Living Faith, Inc. v. Comm'r*, 950 F.2d 365, ___ (7th Cir.

sufficiently related to escape taxation.

How would this difference affect the primarily constraint or the private benefit analysis?

One could argue that application of the standard should be more lenient for purposes of assessing the impact of commercial activities on an organization's primary purpose because, even after determining that an activity is a regularly carried on trade or business, some ambiguity may remain about its role in promoting the organization's exempt purpose. By the same token, one could argue that the determination about what is primary should be less forgiving in the case of campaign activities because, once an activity is determined to be electoral, there is (as a matter of law/regulation) no ambiguity about its possible role in promoting the organization's exempt purpose.

(This line of reasoning assumes the validity of the regulation's categorical stipulation as to the inability of political campaign activities to promote an organization's exempt purpose under any circumstances. I think that this premise could be debated. Imagine an 501(c)(4) organization dedicated to environmental issues, whether by monitoring polluters, lobbying, grassroots lobbying, research, development of energy and environmental policies, and the like. It would seem that intervening in a campaign to promote the prospects of Ralph Nader would likely further that organization's exempt purpose as a practical matter—both as regards the organization's intention and the probable effect, because if Nader were elected, he could be counted on to promote the green agenda through thick and through thin. The regulation's premise appears to be much stronger, however, in the ordinary case, that is, with candidates less

1991).

monomaniacal than Ralph. Since most candidates represent a wide array of issues, they are far less predictably going to pursue an organization's agenda once elected, i.e., when confronted with an avalanche of competing demands on their resources, regardless of how loyal they are to the sponsoring organization's issues in their hearts and minds.

Interestingly, the Service once took the view that 501(c)(4) organizations could engage in political campaign activities if these were not primary AND they were germane to the entity's social welfare purpose.²⁶ This position, of course, implies that there can be a sufficiently strong connection between support of a campaign and an organizations purposes for germaneness to be meaningful. Yet, in the same paragraph, the Service endorsed the proposition that campaign activity can never constitute social welfare activity. I have found no recent reference to a germaneness constraint on campaign activity with respect to 501(c)(4) or any other exempt groups. In light of the ease with which candidates make promises to voters, a germaneness limitation on campaign activity would come close to being unenforceable in any event—which may account for the doctrine's desuetude.)

The second reason the commercial and campaign prongs of the private benefit issue may not be analogous also derives from the aspect of the unrelated business income tax. Because the tax exists, it might be assumed that the price an organization has to pay for engaging in unrelated business activities will act as a disincentive and thus restrain by economic pressures the amount of such activity a group will be willing to undertake. In other words, there are two independent mechanisms in the commercial area that create restraints on an organization's unrelated business activities—the primarily constraint and the economic incentives. How should this affect the

²⁶ GCM 33495 (April 27, 1967).

answer to the interpretive question, *i.e.*, what should primarily mean? One could argue that it is less necessary to interpret the private benefit standard narrowly in the commercial area than in other areas because the UBIT will create an independent pressure on the group to limit its activities of that kind in any event. (Whether the UBIT has this effect is an empirical question, one about which I am ignorant. If there is evidence that the UBIT does not in fact have this effect, it would undermine the preceding line of argument.)

There is, of course, a potential tax imposed by section 527 on 501(c)(4) entities that engage in campaign activities as part of their operations rather than as isolated in a separate segregated fund.. However, the 527 tax is calculated on the base of the organization's net investment income or campaign expenditures, whichever is less. As a result, groups with relatively little net investment income will be insulated from the bite of the tax regardless of the extent of their campaign expenditures (not to mention the extent of their campaign activities as a whole). In instances involving little likelihood of net investment income, in other words, the potential 527 tax would not be an effective second mechanism independent of the primarily test for exerting downward pressure on 501(c)(4) entities' campaign activities. There are, of course, a number of large or very large 501(c)(4) groups—such as the NRA, AARP, Common Cause, and Sierra Club—that would be affected by the 527 tax, and they may well consider this cost in deciding how to allocate campaigning between their own activities and those of their separate segregated funds. But the more usual situation will be that the threat to an entity's exemption will weigh more heavily than the threat to its pocketbook.

IV. WHY EXERT DOWNWARD PRESSURE?

Apart from historical and interpretive considerations surrounding the 501(c)(4) regulations, why try to limit the amount of campaign activities permitted to 501(c)(4) organizations to less than 49 percent of expenditures or activities?

1. Congressional intent. The statutory language requires that 501(c)(4) organizations operate exclusively for their exempt purposes. This is evidence that Congress intended exempt entities to dedicate themselves wholeheartedly to their mission. *Better Business Bureau's* gloss on exclusively in the 501(c)(3) context, and assuming it is legitimate to import its primarily constraint holding into section 501(c)(4), Congress's intent would appear to be that social welfare organizations devote themselves predominantly to their basic purpose, allowing for an insubstantial amount of activity directed toward other purposes. This is in fact the interpretation given to the primarily constraint in a 501(c)(4) context in the judicial decisions cited above.²⁷

On the other hand, one could argue that, all of the significant milestones in this discussion occurred more than two decades ago. Thus, Congress has acquiesced in the Service's more liberal reading of the appropriate standard by virtue of its failure to correct the interpretation evidenced in so many Revenue Rulings over the years. The doctrine of Congressional acquiescence is, of course, controversial, and depends upon assumptions about Congressional awareness of the positions in which it has supposedly acquiesced.²⁸ Although it would seem as a general matter that Congress is far less likely to be aware of IRS rulings than of judicial decisions, the Supreme Court in *Bob Jones University* found substantial awareness on

²⁷ Above, p. 7 and note 13.

²⁸ See, e.g., the sparring among Justices Scalia, Blackmun, and Brennan in *United Steel Workers of America v. Weber*, 443 U.S. 193 (1979) and *Johnson v. Transportation Agency, Santa Clara County*, 480 U.S. 616 (1987), as reported in *Johnson*, 480 U.S. at 626 n. 6.

the part of Congress that the IRS had repeatedly determined that sections 170 and 501(c)(3) of the Code are inconsistent with racial discrimination in education.²⁹ In contrast to the facts described in *Bob Jones*, it does not seem likely that Congress has focused at all on the wording of the 501(c)(4) regulations, except perhaps last spring when the 527 reform legislation was under consideration, and it is even less likely that Congress has acquiesced in the 49%-51% interpretation of primarily, considering that this formulation has never been enunciated in precedential (nor, as far as I can tell, nonprecedential) guidance.

Congress did once weigh in on the specific question of the amount of campaign activity it considered appropriate for 501(c) organizations. According to the Senate Report accompanying the enactment of section 527, The committee expects that, generally a section 501(c) organization that is permitted to engage in political activities would establish a separate organization that would operate primarily as a political organization, and directly receive and distribute all funds related to nomination, etc., activities. In this way, the campaign-type activities would be taken entirely out of the section 501(c) organization, to the benefit both of the organization and the administration of the tax laws.³⁰

This language clearly evidences Congressional intent that the amount of campaign activity undertaken by 501(c) groups directly, as part of their own operations, be kept to a

²⁹ *Bob Jones University v. U.S.*, 461 U.S. 574, 599-600 (1983).

³⁰ Senate Rep. No 93-1357, 93rd Cong. 2d Sess (Dec. 16, 1974) (Upholstery Regulators), reprinted in 1974-1 CB 517, 534.

minimum and that such activity should occur “entirely” in separate segregated funds established under section 527. At the same time, Congress did not in fact mandate that 501(c) organizations act in this fashion. Read fairly, the 527 tax presents organizations described in 501(c)(4) with two options. Further, the relevance of the legislative history surrounding the enactment of section 527 is further limited by the fact that Congress was not addressing the primary constraint in the regulations. In fact, one could argue that the comment quoted presupposes that Congress recognized that such 501(c) organizations were legally engaged in campaign activity and could probably, under the existing rules, be allowed to do a considerable amount of it. Otherwise why create the 527 tax in the first place, and why would the transfer of campaign activity be a benefit worth commenting upon, if the permissible amount of campaign activities was *de minimis* in any event? The most that the enactment of the 527(f) tax and the comment in the legislative history can be said to illustrate, then, is that as a public policy matter, Congress would prefer all 501(c) campaign activity to be done by affiliated 527 organizations. This does not strengthen the argument that the Service should interpret exclusively in section 501(c)(4) of the Code more literally, but it does lend some support for a proposal to impose more stringent limits on 501(c)(4) campaign activity as a policy matter.

2. Fulfilling the Organization's Mission. The Code affords exemption from income taxation to twenty-eight separate types of organization described in section 501(c) as well as to entities exempt under other Code sections, such as sections 527 and 528. The underlying premise of the Code (although not necessarily of commentators) is that organizational income is taxable unless an exception is specifically created. These “carve outs” are each created for a reason, in order to provide a special tax status for entities that Congress deems socially useful

along some dimension. To qualify for that tax exemption under section 501(a), a group must be “described” in one of the subsections of section 501(c). Those descriptions encapsulate Congress’s understanding of the particular mission characteristic of each type of organization entitled to exemption under that section.

That each organization thus described has a characteristic mission seems to me to carry with it certain consequences. Charities must be fundamentally charitable in what they do and what they are to qualify under section 501(c)(3). In other words, a charity must satisfy the specific affirmative claims that are inherent in its description. These claims comprise its mission and the public good that justifies its special treatment. This public good is more than the flip side of private benefit. Imagine an entity established to further some aesthetic passion of an idiosyncratic donor, something which all can agree has no educational, artistic, or other 501(c)(3) merit. Such an entity would not qualify for treatment as a 501(c)(3) organization, even if there was no private benefit, private inurement, commerciality, or campaign activity.³¹

The same is true for 501(c)(4) organizations. To be sure, the requisite public good is not identical with that demanded of a 501(c)(3) organization. Sometimes a social welfare organization will indeed pursue what would qualify as a charitable purpose under section 501(c), but the magnitude of its lobbying, rather than the character of its purpose, will keep it from qualifying under section 501(c)(3). In other instances, however, the social welfare

³¹ Under the Code as written, the absence of these four attributes constitute threshold conditions of an organization having or fulfilling a charitable mission. I say “Under the Code as written,” because it has never been clear to me if some or all of these attributes are prohibited because they are inconsistent with being a charitable enterprise in the first place. The alternative is that some or all of the attributes are prohibited to implement independent public policies that charities must satisfy in addition to fulfilling a charitable mission.

characterization is appropriate because it embraces a wider range of public benefits that does charity, even when lobbying is not an issue.

Either way, “social welfare” has a meaning for purposes of the statutory provision. (I realize that some people have said that “social welfare” is merely a catchall for cases that do not fit neatly under some other subsection of section 501(c), but seem to offer some public benefit worthy of exemption.³²) If social welfare has a meaning, and if the justification for exemption is an organization’s commitment to accomplish the specific affirmative claims inherent in the concept of social welfare, organizations should be expected to pursue a social welfare mission to the greatest possible degree in order to qualify for exemption under section 501(c)(4). It may well be impossible to describe the social welfare mission with any precision because of the lack of consensus about the nature of the concept. At the same time, it is crystal clear what social welfare is *not*. “The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office nor being primarily engaged in operating a social club or operating a business similar to a for-profit business.”³³ Thus, while we can debate what activities are properly included within a social welfare mission, there is certainty about three types of enterprise that are clearly outside its purview.

How does all this advance the argument about the meaning of primarily in a 501(c)(4) context? It is difficult to reconcile the idea of organizational mission with the idea that an entity

³² In contrast, some have argued that not every public benefit will fit in one of the descriptions, in which event no exemption would be forthcoming. *See Contracting Plumbers Cooperative Restoration Corp. v. U.S.*, 488 F.2d at 685.

³³ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

can dedicate itself to activities related to its mission 51 percent of the time, while deliberately engaging in activities not in furtherance of its mission 49 percent of the time. If social welfare is a mission, then it cannot be merely a calculation. We can, like the Court in *Better Business Bureau*, readily acknowledge that an organization with a characteristic mission may, from time to time, engage in activities that are not part and parcel of its purposes or instrumental to achieving its purposes. This could happen from inadvertence. But it could also happen knowingly, for example, when the nonexempt activities are insignificant in amount and in the role they play in the organization's basic enterprise. Either way it would not upset our expectation that organizations entitled to exemption should pursue their missions wholeheartedly.

By the same token, it is difficult not to wonder whether an entity that seeks to maximize the extent to which it pursues nonexempt purposes is, in fact, animated by the nonexempt purposes as much as the exempt purposes, if not oriented by the nonexempt purposes first and foremost. Under either of these two scenarios, of course, a group would not pass the primarily test however liberally construed. The reasoning based upon the idea of a mission in the previous two paragraphs, in contrast, would support limiting social welfare organizations to no more than an insubstantial amount or type of nonexempt activity, which is the standard currently associated with section 501(c)(3).

3. Is It All Relative? A third reason to reject the 49%-51% interpretation of primarily is that it can produce incongruous results that are difficult to defend. The Court of Appeals for the District of Columbia Circuit in *Akins v. FEC*, was asked to review the FEC's interpretation of the major purpose component of the definition of "political committee" for FECA purposes. The

court observed that to use a percentage test to determine what constitutes a major purpose would prevent an organization with an annual budget of \$1,000,000 from spending \$1,000,000 on electoral activities, while permitting an organization with a \$100,000,000 to spend many times that amount without becoming subject to the FECA rules for political committee.³⁴ The resulting disparity in treatment for small and large budget groups is a stronger argument in the FEC context, where the rationale for the restrictions in question is to prevent corruption or the appearance of corruption. Large dollar amounts in the absolute sense have the potential to corrupt or appear to corrupt the recipients regardless of the fraction of the contributor's funds being used for campaign purposes. In the social welfare context, in contrast, one could argue that \$1,000,000 would represent an insignificant portion of what a group with a \$100,000,000 budget does, even accepting my mission theory, because the large payments would not necessarily detract from the essential and core purpose(s) to which the group is committed. (Query, though, whether spending \$49,000,000 on campaign activity and \$51,000,000 on exempt activity evokes the same response, and is your response the same if the \$51,000,000 is spent on helping disadvantaged children or is spent on lobbying and grass roots lobbying crucial for enabling a political party to take or retain control of both Houses of Congress?)

The validity of a percentage interpretation of the primarily constraint in the exemption context also gains some support from the wording of the regulations, which speak, in both the 501(c)(3) and 501(c)(4) provisions, of "a substantial part of [the organization's] activities." "Substantial part" clearly connotes a relational measurement. "Substantial part," however, seems to refer only to the quantitative aspect of an organization's operations rather than to a qualitative

³⁴ *Akins v. FEC*, 101 F.3d 731, 743-44 (D.C. Cir. 1986) (en banc).

assessment of its overall mission. If one finds the distinction between purpose and activities persuasive, it is arguable that as an organization's expenditures for nonexempt activities increase as either a percentage of its total outlays or in absolute terms, the likelihood that one of its dominant purposes from a qualitative perspective is in fact funding the nonexempt portion of its activities.

V. RECOMMENDATIONS

This paper has tried to develop the building blocks for arguing that social welfare organizations should pursue social welfare goals and engage in social welfare activities to the greatest extent possible so that nonexempt activities are never more than an insubstantial part of their overall operations. There are two ways to implement this view. Either the current regulations should be interpreted as requiring that an organization devote itself exclusively to its exempt purpose(s) and engage in nonexempt activities only to an insubstantial degree. This is how I interpret the 501(c)(3) standard, and it would mean that primarily has the same meaning for both subsections. I believe this interpretation is consistent with the statute and a literal reading of the 501(c)(4) regulations. Because the rulings have been so bereft of facts to enable the reader to make her own facts and circumstances judgments, preferring instead to make conclusory pronouncements, I also believe that this interpretation is consistent with the text of those rulings. The alternative is for the 501(c)(4) regulations to be amended to adopt the 501(c)(3) primarily standard.

Although I believe that the 501(c)(4) regulations as currently written are consistent with the 501(c)(3) standard, and thus that amendment is not necessary to implement that standard from a textual point of view, I am nonetheless persuaded by the *stare decisis* type argument put

forward in Sebastian’s memorandum.³⁵ If it is true that the exempt organization community has been reasonably relying on an interpretation of the regulations according to which a social welfare entity can engage in more than an insubstantial amount of nonexempt activities, it would be prudent for the Service to undertake a full-fledged regulations project, with the appropriate public notice, both for fairness reasons and to learn more about the contours of 501(c)(4) organization operations than it knows at present.

It may be, for example, that fact-finding would suggest one version of the insubstantiality standard for small organizations and another for large ones. Congress adopted a tiered approach in the sections 501(h)/4911 context. That precedent seems especially germane to the present discussion given that the statutory standard being elaborated by the 501(h) election included “no substantial part” language. Alternatively, the Service could adopt a “one size fits all” approach, limiting all social welfare organizations to the same maximum quantum of nonexempt activities as a condition of retaining their exempt status. The 501(h) election model is interesting because Congress chose to permit lobbying expenditures to comprise a greater percentage of exempt purpose expenditures for 501(c)(3) organizations with smaller budgets than for those with larger budgets, and it established a million dollar ceiling for lobbying expenditures.³⁶ This appears to fly in the face of the mission argument (in the 501(c)(3) context), since it reveals Congress’s willingness to permit small charities to devote a large part (20 percent) of their budgets to nonexempt activities—surely enough to affect the overall character of their operations.³⁷ At the

³⁵ See *supra* p. 11.

³⁶ See I.R.C. § 4911(c)(2).

³⁷ I think an argument can be made that the “no substantial part” limitation on lobbying

same time, the 501(h) \$1,000,000 cap might reflect the view that, at a certain point, there is such a thing as too much spending on nonexempt activities in absolute terms, regardless of the ratio of such spending to an entity's aggregate spending on exempt function activities. If so,³⁸ the 501(h) approach would be support for the position, referred to earlier, that nonexempt activities should be assessed with respect to both the organization's allocation of its resources and the impact of its exempt spending in nonrelative terms.

Another possibility, as far as I know without precedent, would be to distinguish between social welfare organizations that engage to a considerable degree in lobbying and those that do not and to permit a greater amount of campaign activities to those that do not lobby or even preclude campaign activities for those that lobby. The argument in support of any kind of proposal that linked treatment of campaign activities with existence or extent of lobbying activities would revolve around campaign finance issues, rather than the meaning of exemption, and thus would be the subject of another paper. To defend connecting the two types of activities would involve developing the empirical evidence of a relationship between the impact of lobbying and the likelihood of corruption or the appearance of corruption. It might also require surmounting a constitutional challenge, although the ability of social welfare organizations to

by 501(c)(3) organizations does not suggest that lobbying cannot qualify as charitable (or as instrumental to charitable purposes). Rather, it may reflect an independent policy, namely, preserving the neutrality of the public fisc. *See Slee v. Comm'r*, 42 F.2d 184, 185 (2d Cir. 1930).

³⁸ See the previous note.

sponsor campaign activities through separate segregated funds (and Congress's express intent that their campaign activities be conducted entirely through such funds) would seem to deprive a constitutional challenge of some of its power.

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