

6/14/2001

EXPRESS ADVOCACY IN THE POST McCAIN-FEINGOLD WORLD

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The purpose of this paper is to revisit a few questions relating to the prohibition against campaign intervention in Federal tax law.¹ The occasion is the recent passage of the Bipartisan Campaign Reform Act of 2001 (“Act”) in the Senate.² If the Act, or something like it, passes in the House and is enacted into law, it will be the end of the soft money universe as we know it.³ At the same time, it may well be the beginning of a new universe in which there is significant pressure on exempt organizations (under both section 501 and section 527 of the Code) to pick up the slack by performing campaign-useful activities. Voter education, voter registration, get-out-the-vote activities, candidate forums, and issue advocacy are likely to be areas where this pressure is felt the most.

The campaign activities subject to regulation under the Federal Election Campaign Act (“FECA”)⁴ are different from the campaign intervention prohibited to section 501(c)(3)

¹ Our colleague, Antonia Grumbach, wrote about the intersection of educational and political activity for this group in 1993, in a paper entitled “Between Scylla and Charybdis: Navigating the Shoals Between Educational and Political Activity.” My paper began as an attempt to discuss developments in that area since 1993, but it was transformed as I became increasingly interested in the way in which the relationship between tax law and election law affects that area.

² The Bipartisan Campaign Reform Act of 2001, S. 27, 107th Cong. (2001) (passed April 2, 2001). All references to the “Code” are to the Internal Revenue Code of 1986, as amended.

³ This paper has a public policy perspective and does not express a view as to the constitutionality of the portions of the Act under attack for violating the First Amendment.

⁴ All references are to the Federal Election Campaign Act of 1971, as amended. 2 U.S.C. §§ 431 et seq. (2000).

organizations and circumscribed for other organizations described in section 501(c), just as issue advocacy for purposes of FECA is different from issue advocacy under the Code. Speaking very generally, under the FECA scheme, communications made in connection with Federal elections are either express advocacy or issue advocacy. FECA regulations define express advocacy;⁵ all other campaign-related communications are referred to popularly as issue advocacy. Since express advocacy is very narrowly defined,⁶ many communications related to a Federal election will be classified as FECA issue advocacy even though they clearly identify a candidate.⁷ The situation under the Code is very different: the concept of intervening in an election has been broadly interpreted by the IRS, whereas under the Code, issue advocacy is only one part of the educational activities with potential campaign consequences.

It is unclear what impact the enactment into law of McCain-Feingold would have on the Code's treatment of campaign intervention, issue advocacy, or other educational activities with potential campaign impact. There is some fear that restrictions on the broader class of FECA issue advocacy will sweep in the narrower IRC counterpart category. This may not, in fact, be the outcome. None of McCain-Feingold's provisions will limit the public discussion of issues by any group as long as no candidate is mentioned by name or clearly identified by photo, a likeness, or some other means. Rather, although its contours are still imprecise, what some commentators

⁵ See 11 C.F.R. 100.22 (definition of "expressly advocating") (copy attached to this paper).

⁶ See *infra* note Part I.A.

⁷ For brevity's sake, I use the phrase "FECA issue advocacy" to refer to every form of advocacy relating to a Federal election, including candidate-centered communications, that would not be considered express advocacy for FECA purposes. I also use the phrase "IRC issue advocacy" as a shorthand as well, although somewhat differently.

refer to as “pure issue advocacy” will probably be permitted, even in situations where FECA issue advocacy is restricted by McCain-Feingold. In that event, some forms of IRC issue advocacy could become the communication vehicles of choice in situations where FECA issue advocacy is subject to restrictions. Even if this turns out not to be the case, or if McCain-Feingold (or a sibling) is not enacted into law, there is likely to be intense scrutiny of campaign intervention and issue advocacy engaged in by exempt organizations as long as the atmosphere of campaign reform is with us.

I. CAMPAIGN-RELATED ADVOCACY UNDER FECA

A. The Distinction between Express Advocacy and FECA Issue Advocacy

FECA does not contain the term “issue advocacy,” although it refers at several points to the activity of “expressly advocating the election or defeat of a clearly defined candidate.”⁸ The distinction between express and issue advocacy was introduced by the Supreme Court in Buckley v. Valeo⁹ and elaborated thereafter in court cases, FEC regulations, and FEC Advisory Opinions.¹⁰

Buckley involved an attack on the constitutionality of the dollar limits on contributions and expenditures under the original FECA as well as the disclosure and reporting regime imposed

⁸ See 2 U.S.C. §§ 431(9)(B)(iii) (obligation for corporations to report certain expenditures for express advocacy), 431(17) (definition of independent expenditure), 441d(a) (obligation to identify source of funding for statements or sollicitaions including express advocacy) (2000). Congress added the “express advocacy” language to the statute after the Buckley decision, described below. See H.R. Conf. Rep. No. 94-1057, at 38 (1976), reprinted in 1976 U.S.C.C.A.N. 946, 954.

⁹ Buckley v. Valeo, 424 U.S. 1 (1976).

¹⁰ The FEC also refers to express advocacy as “candidate advocacy.” See FEC, Campaign Guide for Corporations and Labor Organizations 22 (August 1997), available at <http://www.fec.gov/pdf/colagui.pdf>.

by the statute. The Court upheld contribution limits and, for the most part, the reporting and disclosure regime proposed by Congress. However, the Court found that the proposed expenditure limits were a substantial and impermissible restraint on the “quantity and diversity of political speech” and upheld the statute’s regulation of independent expenditures only to the extent that they paid for “communications that in express terms advocate the election or defeat of a clearly defined candidate for federal office.”¹¹ At this point in the opinion, the Court wrote the now famous footnote 52, which equated express advocacy with words such as “vote for,” “Smith for Congress,” etc., and which is sometimes referred to as creating the “magic words” test. The Court did not try to define issue advocacy, although it referred to the term several times.

Motivating the Court’s narrow interpretation of speech that could be subject to FECA regulation was its desire to avoid anything that would suppress discussion of “public issues involving legislative proposals or government action” or “infringe on privacy of association and belief guaranteed by the First Amendment.” The Court’s larger purpose was to preserve these speech rights in a way that was consistent with the voters’ right to information and the government’s right to deter corruption and to prevent the appearance of corruption.¹²

Arguably the Buckley express advocacy standard was broadened somewhat by the Supreme Court in 1986 to include a campaign communication that exhorted people to vote “pro-life” and for candidates who were “pro-life,” contained photographs of such candidates, and included a tear-off coupon to take to the polls with the candidates’ names, even though there was

¹¹ Buckley, 424 U.S. at 44.

¹² See id. at 23, 42, 64, 67-68, 80. The Court also emphasized that the criminal penalties involved made it even more important to avoid vagueness in FECA regulations; hence its desire for a bright line rule. Id. at 41-42, 76-77.

also a disclaimer that the message was not intended as an endorsement of any particular candidate.¹³ At the same time, the Court specifically noted that, depending upon the context, a discussion of public issues could be considered issue advocacy even if it mentioned certain candidates.¹⁴ District and appellate courts ruling since then have moved in opposite directions, some circuits construing Buckley-MCFL narrowly and others, more liberally.¹⁵

The FEC regulations defining express advocacy, which were promulgated in 1995, claim to be elaborating Buckley and judicial decisions since then.¹⁶ However, the regulation seems to be at the liberal end of the liberal interpretation of those decisions.¹⁷ According to the FEC, section 100.22 describes two routes to classification as express advocacy. Route one, or the “magic words” route, is described in paragraph (a) of that section, which begins by paraphrasing the Buckley footnote. Paragraph (a) also equates express advocacy with phrases and slogans inspired by, and— in my view—true to the decision in MCFL. Paragraph (b), which describes the “reasonable person” route, appears to be an attempt to “push the envelope.” It states that the FEC

¹³ These were the facts in FEC v. Mass. Citizens for Life, Inc., 479 U.S. 238 (1986) (“MCFL”). The communication mentioned voting in capital letters several times.

¹⁴ MCFL, 479 U.S. at 249.

¹⁵ For the former, see Faucher v. FEC, 928 F.2d 468 (1st Cir. 1991); for the latter, see FEC v. Furgatch, 807 F.2d 857 (9th Cir. 1987), *cert. denied*, 484 U.S. 850 (1987).

¹⁶ See Express Advocacy; Independent Expenditures; Corporate and Labor Organization Expenditures, 60 Fed. Reg. 35,292 (July 6, 1995) (to be codified at 11 C.F.R. §§ 100.17, 106.1(d), 109.1(b), 100.22, 114.10). The text of 11 C.F.R. § 100.22 is at the end of this paper.

¹⁷ Several appellate courts have found that paragraph (b) of the regulation goes beyond what the Supreme Court considered constitutional restriction in Buckley and MCFL. See Right to Life of Duchess County, Inc. v. FEC, 6 F. Supp. 2d 248 (S.D.N.Y. 1998), Maine Right to Life Comm. Inc. v. FEC, 914 F. Supp. 8 (D. Me.), *aff'd per curiam*, 98 F.3d 1 (1st Cir. 1996), FEC v. Christian Action Network, Inc., 110 F.3d 1049, 1052-55, 1061 (4th Cir. 1997).

will classify as express advocacy any communication that, in context, no reasonable person would construe as anything other than an attempt to elect or defeat one or more specific candidates. The regulation also states that to reach its interpretation, the FEC can only look at the communication as a whole and with “limited reference to external events.”

The FEC’s regulation defining express advocacy thus seems to combine what might be considered three standards: a literal magic words test; a broader, implied magic words test; and a broader still, yet carefully circumscribed implied advocacy test. I believe that the FEC test is significantly more restrictive than the prohibition against campaign intervention of the Code, as interpreted by the IRS in its public and private rulings, even taking into account the implied advocacy test of subparagraph (b) of the regulation.¹⁸

B. Application in FECA of Express/Issue Advocacy Distinction

1. Hard money. “Hard money” is a non-technical shorthand that refers, first and foremost, to any money contributed by individuals to candidate committees and separate segregated funds exempt under section 527(f)(3) of the Code (“PACs”). These contributions can be used by the recipients for advocating the election or defeat of specific candidates, i.e., for express or candidate advocacy.¹⁹ The amount of money that individuals can contribute to such entities is subject to

¹⁸ See infra Part II.C, where I apply both standards to specific facts.

¹⁹ Such contributions need not be thus used; however, they must be reported to the FEC as hard money by virtue of the fact that they are contributed to the named entities. In contrast, when individuals contribute to parties and their committees, they can contribute to either the hard money account (assuming they have not used up their statutory contribution limit giving to candidate committees and PACs) or to the soft money account.

dollar limits per candidate, per election, and/or per year.²⁰ Their contributions must be reported to the FEC.²¹

Hard money cannot be contributed to a candidate's committees by labor organizations or corporations from funds in their general treasuries.²² Such entities can, however, establish PACs to receive voluntary contributions from their salaried employees and they can pay the administrative expenses of such PACs using general treasury funds. Finally, to close the loop, PACs can contribute money to candidate committees as well as to other political committees, even if the PACs were set up and are administered by corporations and labor unions, who cannot make such contributions directly to candidate committees.

Because of the contribution and source limits on raising it, hard money is sometimes viewed as the hardest type of money to raise in an election.²³ Because of the fact that it can be used for express or candidate advocacy (whereas other types of funds cannot be so used), hard money is sometimes viewed by recipients as the most desirable type of money to have

²⁰ A chart summarizing all the contribution limits by donor and recipient is attached to this paper. Note that a primary counts as an election for each candidate for purposes of the contribution limits. If there is a run-off, that is another election. The general election is an election, as is a convention with the authority to nominate the party's candidate. 2 U.S.C. § 431(1)(A).

²¹ See 2 U.S.C. § 441a(a) (2000); 11 C.F.R. § 110.1 (2000).

²² 2 U.S.C. § 441b (2000). There is an exception for contributions made by political committees that have incorporated. Corporations are permitted to use treasury funds to pay for all their PACs administrative costs. FEC Advisory Opinion 1975-23 (SUN PAC).

²³ In recent elections, the Republicans have raised more hard money than the Democrats, allegedly because the Republicans have a much larger base of individual small donors than the Democrats. The two parties raised roughly the same amount of soft money in 2000. CITE. This has led some commentators to opine that the Democrats will try to sabotage McCain-Feingold in the House.

contributed. The latter fact has become less important as campaigns have learned to design messages that do not expressly advocate the election or defeat of a candidate, while nonetheless being perceived by audiences as advocating the election or defeat of a candidate, since such messages can be financed with other (“soft”) money. In a post McCain-Feingold world, both of these “facts” would be true and, as a consequence, hard money would likely be viewed as both the most desirable type of campaign funds and the hardest to raise.²⁴

2. Soft money. “Soft money,” also a shorthand, refers to funds contributed or spent for reasons other than to advocate electing or defeating a candidate. Soft money has acquired a bad name because FECA imposes no contribution limits on raising or spending such money,²⁵ and corporations and labor unions are entitled to contribute soft money from their general treasuries. As a consequence, the amounts that can be raised are limited only by the ingenuity of campaign staffs and the generosity of donors.²⁶

²⁴ It is not yet clear how hard it will be to raise hard money if McCain-Feingold is enacted because the Act raises the contribution limits significantly. Commentators differ in their estimates of how much “lost” soft money will be made up in “found” hard money.

²⁵ Soft money is sometimes called “non-Federal” money because it can also be given to state candidate committees, state party committees, and state PACs. These amounts can be used to elect or defeat a non-federal candidate and for issue ads, but it cannot be used to advocate the election or defeat of a federal candidate. Some states impose limits on such soft money contributions. These amounts are reported, if at all, to state agencies, but are not subject to FEC reporting. Not all states require reporting of these amounts.

²⁶ For a powerful analysis of the campaign finance system as revolving around rent-seeking as the currency valued by both politicians and donors, see Frances R. Hill, “Softer Money: Exempt Organizations and Campaign Finance,” 32 EOTR 27 (2001). Hill coined the name “softer money” to describe money raised by organizations described in sections 501(c)(3) and 501(c)(4) and certain section 527 organizations to be used for activities that are political enough to qualify as exempt function income under section 527 of the Code but not so candidate oriented that they would be considered express advocacy for FECA purposes. As a result, the amounts that could be raised were both unlimited in amount and source and not subject to FEC

As a matter of definition, soft money cannot be contributed to a candidate committee; thus, it is usually contributed to parties, their committees, and PACs.²⁷ The amounts of soft money contributed in connection with Federal elections, the identity of the contributors, and the amount of soft money expenditures must be reported to the FEC. Soft money can be spent on party building (such as voter registration and GOTV activities), certain administrative expenses, and FECA issue advocacy, but not express or candidate advocacy.²⁸ As noted above and in the popular and trade presses, the lion's share of such money appears to have been funneled into issue advocacy oriented towards primaries and elections. A recent analysis revealed that only 15% of such ads mentioned a party label, even though they were funded by a party committee, and that issue ads run by advocacy groups were more likely than party issue ads to mention a party.²⁹

3. Independent expenditures. Any expenditure for a communication "expressly advocating the election or defeat of a clearly identified candidate" that is not coordinated with any

reporting and disclosure rules. This state of grace was eliminated by the disclosure reforms enacted in July of 2000 (infra note 35). Hill argues that it will be possible to replace much of the anonymity that was lost as a result of that legislation by using organizations exempt under sections 501(c)(3) and (4). See "Softer Money," at 43-50. The article also contains an account of how soft money arose and acquired a legal status recognized by the FEC and the courts. See id. at 41-42.

²⁷ See FEC Advisory Opinion 1979-17.

²⁸ When soft money is spent by the national parties, their committees, and House and Senate committees, allocations between soft and hard portions of expenditures are prescribed by the FEC.

²⁹ See Jonathan S. Krasno and Daniel Seltz, "'Issue Advocacy' in the 1998 Elections," a draft, presented at the Urban Institute on [date], 2001. The data base relied upon by the authors was purchased from Campaign Media Analysis Group, which tracks all noncommercial advertising on regular networks and national cable stations in the 75 largest media markets.

member of a candidate's campaign is independent.³⁰ Individuals, partnerships, committees, associations, qualified nonprofit corporations, and separate segregated funds established by a labor organization, corporation, or national bank may all make such expenditures³¹ with no restrictions on the contribution levels allowed.³² Corporations, labor organizations, or national banks without separate segregated funds, government contractors, and foreign nationals are barred from making independent expenditures.³³ The only other restriction on independent expenditures is that such spending must be reported to the FEC.³⁴

4. Contributions and expenditures not regulated by the FEC. Money contributed for and spent on communications that do not expressly advocate the election or defeat of a Federal candidate are unregulated by the FEC if they are contributed to and spent by entities other than candidate committees, parties, party committees, and some PACs (Hill's "softer money"). As a

³⁰ 11 C.F.R. §§ 100.16, 109.1(a).

³¹ 11 C.F.R. § 109.1(b)(1). FECA originally did not allow party committees to make independent expenditures, presuming that the "parties and their candidates were so intertwined that there could be no truly uncoordinated expenditures." Trevor Potter, Where Are We Now? The Current State of Campaign Finance Law, in Campaign Finance Reform: A Sourcebook 9 (Anthony Corrado et al. eds., 1997). However, the Supreme Court held that "the independent expression of a political party's views is "core" First Amendment activity" and that since the Constitution grants the right to make unlimited independent expenditures to individuals, candidates, and ordinary political committees, the Court would not "deny the same right to political parties." Colo. Republican Fed. Campaign Comm'n v. FEC, 528 U.S. 604, 616, 618 (1996).

³² Buckley v. Valeo held that it was unconstitutional to impose dollar limits on independent expenditures. See 424 U.S. at 51.

³³ General Public Political Communications Coordinated With Candidates and Party Committees; Independent Expenditures, 65 Fed. Reg. 76,138 (December 6, 2000). 11 C.F.R. §§ 100.8(a)(3), 104.4, 109.2.

³⁴ 11 C.F.R. §§ 100.8(a)(3), 104.4, 109.2.

practical matter, the main vehicles for raising and spending such money are organizations described under sections 501(c)(3) or (4) or section 527. Thus, individuals, corporations, and labor unions may be able contribute money unregulated by the FEC to such entities.

There are no FEC contribution limits applicable to money raised and spent in this fashion. The recipient organizations may, however, be limited in the amounts they can accept for such purposes by the need to operate primarily for their exempt purpose. In addition, if the donors give to a section 501(c)(4) organization, they may experience some limitation by the applicability of the gift tax to contributions in excess of \$10,000 for individuals and \$20,000 for married couples. However, as the reform/repeal of the unified tax credit slowly unfolds, donors should be increasingly willing to “borrow” against their unified life credit. Groups exempt under section 501 must, however, must file Form 990, and since July of 2000, section 527 organizations have been subject to disclosure and filing requirements on a periodic and annual basis.³⁵

C. Impact of McCain Feingold on Exempt Organizations

One of the primary purposes of the McCain-Feingold proposal is to reduce or eliminate the use of soft money in Federal elections. The Act does this primarily by prohibiting national parties and their committees from raising or spending any money except hard money, i.e., money subject to contribution limits.³⁶ Contributions of hard money would still be limited by both

³⁵ See Pub. L. 106-230, IR-2000-049, IR-2000-050, IR-2000-72.

³⁶ S. 27, § 101. State party committees are, with some exceptions, also required to use hard money to fund “Federal election activities” during a Federal election year (even-numbered years). For the meaning of this term, see *infra* note 39. However, there is an exception to this requirement that permits state parties to use soft money to pay for voter registration and get-out-the-vote activities in the 120 days preceding an election.

amount and source, but the dollar limits would be increased.³⁷ In addition, the Act provides that national parties can no longer contribute to or solicit contributions for organizations described in section 501(c) or section 527.³⁸ Candidates, however, would still be able to raise funds for such exempt organizations, but only for purposes that do not fall under the FECA definition of “federal election activity.”³⁹ As noted above, it is expected that, if enacted, these measures will reduce the aggregate amount of money spent during an election cycle, although no one is sure to what degree the increase in permissible hard money will offset the reduction in soft money.

The Act also takes aim at organizations described in section 501(c)(4) of the Code by prohibiting them from making certain communications within 60 days of a Federal election or 30 days of a primary unless they use their PACs and hard money.⁴⁰ Called “electioneering communications,” these communications are defined in the Act as messages that 1) clearly identify a candidate for Congress or President; 2) are made via broadcast, cable, or satellite media; 3) are made within 60 days of a general election or 30 days of a primary; and 4) are made to an

³⁷ S. 27, §§ 102, 308.

³⁸ S. 27, § 101.

³⁹ The term “Federal election activity” includes voter registration activity during the 120 days before a Federal election, voter identification, GOTV, or “generic campaign activity” in which a candidate for Federal office appears on the ballot (even if there are non-Federal candidates as well), a public communication referring to a candidate for Federal office that promotes/supports/attacks/opposes a candidate for that office (even if not express advocacy), and services provided any month by an employee of a State, district, or local committee of a political party who spends more than 25% of his/her time during the month on activities in connection with a Federal election. S. 27 § 101(a).

⁴⁰ S. 27, § 204. Corporations and labor organizations are subject to the same restrictions. S. 27, § 203.

audience that includes a substantial number of voters for that election/primary.⁴¹

The 60/30 rule has generated strong opposition in the nonprofit community on both constitutional and policy grounds. If upheld, this provision threatens to eliminate, or radically transform the content of, some of the most popular forms of advocacy group issue ads in the traditionally frenetic campaign period between Labor Day and a Presidential election as well as the counterpart period preceding House and Senate races in off years.⁴² Still permitted during these periods would be issue advocacy by section 501(c)(4) organizations that clearly identifies a Federal candidate using non-broadcast media. Issue advocacy that does not identify a Federal candidate would also be permitted using any media during the 60/30 day period. The Act would impose no new limits on the activities of section 501(c)(4) organizations in relation to non-Federal candidates.

Finally, as alluded to in the first paragraph, the biggest impact of McCain-Feingold for exempt organizations would likely be the pressure to fill in the vacuum created by the ban on soft money expenditures to the extent feasible under Federal tax law. In the last election, parties and their committees spent unprecedented amounts on advertising using soft money, and they even

⁴¹ S. 27, § 201. The phrase “clearly identifies a candidate for Congress or president” appears aimed at some FECA issue advocacy as well as express advocacy. It thus goes beyond the parameters of Buckley and MCFL, and will surely be challenged on this ground, among others.

⁴² Empirical work done by Jonathan Krasno and Daniel Seltz found that only two of 180 issue ads run in the top 75 media markets in the United States in the 60 days preceding the 1998 elections were “genuinely aimed at informing viewers about an issue without advocating either candidate.” These two ads appeared 2,808 times in those markets during that period, out of 38,923 airings of all 180 issue ads in those markets during that period.

spent more on television advertising than did the candidates themselves.⁴³ If this vehicle for campaign communications is effectively eliminated, it is reasonable to believe that alternative vehicles, which do not violate the law, will be devised. Since exempt organizations already have the ability to communicate in campaign-useful ways under existing law, it is also reasonable to expect that, at least until superior alternative campaign vehicles are discovered, exempt organizations will be presented with even more contributions than they have received to date. What researchers call “interest groups” spent roughly \$57 million in media advertising in the 75 biggest media markets in 2000, which was an increase of 60 percent over their spending in 1998.⁴⁴ If the amounts potentially available to section 501(c) organizations in the next presidential election continue their present rate of growth, not to mention substitute to some degree for advertising previously funded by political parties, the sums involved are likely to be rather

⁴³ See “Political Television Advertising Tables,” attached to “2000 Presidential Races First in Modern History Where Political Parties Spent More on TV Ads Than Candidates,” Press Release, December 11, 2000, available at www.brennancenter.org/presscenter/pressrelease_2000_1211cmag.html.

⁴⁴ *Id.* Approximately \$13 million was spent by Citizens for Better Medicare, an organization representing pharmaceutical companies; \$8 million was spent by the AFL-CIO; and \$7 million was spent by Planned Parenthood. The estimates by Krasno and Seltz for the Brennan Center do not include media markets other than the top 75 media markets. The Campaign Finance Institute Task Force on Disclosure did an analysis of five groups that were active in the 2000 election and concluded that “[u]ndisclosed election related communications represent a large, and rapidly growing, part of the election scene.” They studied communications in direct mail, telephone banks, and the print media as well as the radio and television issue ads monitored by the Brennan Center. They did not attempt to quantify the dollar amount of this larger pool information about issue advocacy (by the five groups). However, based in part upon the finding that the average recipient finds such messages “indistinguishable from ones coming from candidates or parties,” they speculated that the total amount spent on issue advocacy across the nation could possibly be double the \$57 million estimated by the Brennan Center based upon data from broadcast media in the 75 largest media markets. See Issue Ad Disclosure: Recommendations for a New Approach at 5-7 (2000), available at www.cfinst.org/studies/mccainfeingold/index.html.

staggering.

II. ADVOCACY UNDER THE CODE

A. What Is IRC Issue Advocacy?

Neither the Code nor the Treasury regulations use the term “issue advocacy,” and it seems to have been used only by taxpayers in IRS rulings of any kind.⁴⁵ Yet the term is widely used by commentators and sometimes seems to serve as a catchall for activities of organizations described in section 501(c) of the Code that do not constitute campaign activity prohibited under section 501(c)(3) or limited under section 501(c)(4).

As a linguistic matter, issue advocacy would appear to mean a communication that combines a discussion of issues with an endorsement of certain positions or an attempt to persuade others of those positions. As such, some nonpartisan analysis, study, or research could be issue advocacy if it includes taking a position in addition to meeting the other conditions of nonpartisan communications set forth in IRS rulings and Treasury regulations.⁴⁶ In the Code, this category is elaborated to remove from characterization as lobbying what would otherwise be considered lobbying. At the same time, from the description in the Treasury regulations, it is clear that the activity elaborated could also be considered “issue advocacy,” whether or not it included a legislative recommendation. The same could be said for general discussion of broad social issues, were the discussion to include an endorsement of certain views or an attempt to persuade an

⁴⁵ See, e.g. LTR 9609007, LTR 9652026, LTR 9808037, LTR 199925051.

⁴⁶ See Rev. Rul. 66-258, 1966-2 C.B. 213, Rev. Rul. 64-195, 1964-2 C.B. 138; Treas. reg. § § 56.4911-2(c)(1), 53.4945-2(d)(1) (2000).

audience of them.⁴⁷ Without endorsements, these activities would be simply “education,” rather than issue advocacy.

As used in the context of elections and tax exemption, however, issue advocacy seems to refer to a subset of the class of educational or information-providing activities of exempt organizations, in particular those that are carried out in some proximity to an election and have as their purpose and/or effect influencing voters or potential voters in that election. In the words of one somewhat jaded commentator,

issue advocacy has come to be used for tax purposes as a shorthand rhetorical device for a mixture of education and lobbying that comes as close to supporting or opposing candidates for public office as an organization can come without jeopardizing its exempt status.⁴⁸

On this basis, Fran Hill concludes that “[t]he obverse of issue advocacy in tax law is participation or intervention in support of or opposition to a candidate for public office.”⁴⁹

As a conceptual matter, then, IRC issue advocacy does not need to be understood as a function, obverse or perverse, of prohibited campaign intervention. I believe that this is true even if IRC advocacy takes place in the charged atmosphere of an election. However, there appears to be a trend for IRC issue advocacy to aspire to be FECA issue advocacy. Whether this portends a greater degree of informative communications useful for voters to make informed choices than

⁴⁷ In the Code, this category of communication is also elaborated as an exception to lobbying, although by its terms it seems unsuited for portrayal as lobbying in the first place.

⁴⁸ Hill, “Softer Money,” at 45.

⁴⁹ *Id.* The situation is probably not that bad. See Krasno and Seltz, “Issue Advocacy in the 1998 Election,” *supra* note 29, who found some “genuine issue ads” run by interest groups such as the Business Roundtable (focusing on free trade).

was true before exempt organizations became so active in the electoral phase of the political process is something I hope we will discuss at our meeting.

B. Application of IRC Standard to Fund-Raising Letters by Candidates for Exempts

In connection with my claim that the FEC's implicit advocacy standard, embodied in 11 C.F.R. § 100.2(b), is different from and more restrictive (read: more speaker-friendly) than the IRS standard for campaign intervention, I thought it would be useful to compare the likely outcome under each standard using the same fact pattern

In TAM200044038 the Service ruled that fund-raising letters sent by a section 501(c)(3) organization to more than two million people under the signature of an announced candidate for public office was impermissible campaign intervention.⁵⁰ The organization argued that it had used public figures to sign fund-raising letters for many years, that it chose this public figure because of his proven success as signatory to such appeals, and that it had received an (oral) opinion from tax counsel assuring it that the letter was in accordance with IRS standards. The Service concluded that the organization had intervened in the candidate's campaign by distributing statements that were indistinguishable from some of his "campaign statements, positions, and rhetoric" at a time when he "was more than a politician, he was a candidate for elected office."⁵¹

This ruling helps clarify how the IRS applies the facts and circumstances test in the

⁵⁰ DATE. According to Kristen Gurdin, who analyzed this ruling for EOTR, the organization was the Heritage Foundation and the candidate was Bob Dole. Kristen M. Gurdin, "Letter Ruling Alert," 30 EOTR 325, 325 n.1 (2000). This lengthy ruling is attached to the end of this paper.

⁵¹ TAM 200044038. Because of the advice of counsel relied upon, the Service did not impose the section 4955 excise tax on the organization's managers.

campaign intervention context. First, sending fund-raising letters signed by public figures is an extremely common practice when the figure is being talked about as a candidate and therefore receiving a lot of news coverage. The ability of exempt organization's to raise money on the candidate's coattails would appear to unproblematic; yet the structure of that relationship is necessarily troublesome given that the candidate usually agrees to let his popularity be used by the exempt entity in the hopes of receiving something of value in exchange. This TAM helps organizations and candidates alike to devise an exchange consistent with the entity's exempt purpose and the responsibilities it agreed to assume as part of the determination process.

Specifically, all of the details of the TAM fall under the general proposition that a charity can make use of a candidate to endorse its issues, but it should avoid endorsing the candidate's issues as a candidate.⁵² The Service says that its standard constitutes implied as well as express advocacy. In implementing its standard, the IRS said that the candidate's "authorship of the letter (and the language chosen by [him]) was the most determinative aspect of the letter in deciding whether there was impermissible political campaign intervention."⁵³ In addition, the letter was on the candidate's letterhead. The Service added that the statements in the letter were "not just about positive attributes or characteristics associated with [the candidate] or negative attributes associated with [his] opponent, but, additionally, it represents an affirmative statement by [the candidate] himself during [his] campaign." The implied contrast suggests that the IRS would

⁵² Unfortunately, in this case as well as most others discussed in this paper, the guidance is non-precedential.

⁵³ The letter included such comments as the following: "I WANT TO START BY ABOLISHING THE DEPARTMENTS OF EDUCATION, HOUSING AND URBAN DEVELOPMENT, ENERGY AND COMMERCE" and "BUT WITH [HIS OPPONENT] IN THE WHITE HOUSE, TRUE REFORM WILL NOT COME EASILY. IT REQUIRES ALL WHO WANT IT TO WORK TOGETHER."

have approved issue messages that contained, or were alongside of, characterizations of the candidate's strengths or weaknesses of his opponent as long as the red flags that it noted were not present.

C. Applying the FEC's Express Advocacy Standard

How would this fact pattern fare under FECA? Clearly it would flunk the magic words test of 11 C.F.R. §100.22(a), since there was no explicit endorsement by the exempt organization of the candidate. In those jurisdictions where the standard enunciated in § 100.22(b) has been declared unconstitutional,⁵⁴ that would end the inquiry and the outcome would be different under the two regulatory regimes, i.e., it would not be FECA express advocacy but it would be IRS prohibited campaign intervention.

In those jurisdictions where subparagraph (b) is in effect, it is still possible that the candidate's letter would not count as express advocacy because paragraph (b)'s language directs the FEC to have only limited reference to external events and to avoid finding express advocacy unless the electoral message is "unmistakable" and not capable of differing interpretations by reasonable minds. Perhaps it would not be possible for the FEC to take official notice of the organization's "pattern and practice" of raising money by capitalizing on endorsements by popular public figures, whether candidates or not. However, I can imagine an animal rights organization trying to raise money by sending many such letters, some featuring Gore (who was a candidate, would have made statements like those in the TAM, and would have volunteered that Tipper had never and would never be able to afford anything grander than cloth coats), some featuring Clinton (whose popularity and availability as a candidate were in inverse relation to one another,

⁵⁴ See supra note ____.

posing with Buddy ,and uttering canine-friendly platitudes on behalf of the Democratic party), and some featuring Zsa Zsa Gabor (who still looks gorgeous and has campaigned tirelessly on behalf of our furry friends for over a decade). Under those facts, I would have to give the Gore letters a pass. And if that is correct, I think I would have to give the Gore letters viewed in isolation a pass since it would not be the case that the various communications it contained admit of only one interpretation. If this analysis is correct,⁵⁵ it seems that the express advocacy standard currently expressed in § 100.22(b) may constitute a third standard, one that is intermediate between the magic words express advocacy standard of Buckley, MCFL, and § 100.22(a) and the more wide ranging IRS facts and circumstances standard.⁵⁶

III. SHOULD THE IRS ADOPT THE FECA EXPRESS STANDARD ADVOCACY?

It seems clear that, as a constitutional matter, the IRS is not required to limit its restrictions on what constitutional lawyers call “political speech” to the same degree as the FEC because the FEC is engaged in direct regulation of protected speech, whereas the IRS is not. That said, what standard the IRS has to observe when it regulates such speech is still unsettled. The Supreme Court has not addressed this question head on, although it is possible that it will approach restrictions on campaign intervention under the Code using the theory, adopted in Regan v. Taxation with Representation, that the availability of a section 501(c)(4) affiliate capable of engaging in campaign intervention disproves the claim that the restrictions impermissibly burden

⁵⁵ And I expect we will get into a rip-roaring fight as to whether I am importing an intent factor into what is supposed to be a “four-corners-of the document” analysis, in which case, the conclusion I go on to reach is wrong.

⁵⁶ A third model in principle. In practice, because of the indeterminacy of both the IRS standard and the standard stated in 11 C.F.R. § 100.22(b), it is unclear whether clear patterns of interpretation will emerge.

these important First Amendment rights.⁵⁷

It is also possible that the Court will be willing to enlarge its holding under Buckley and MCFL in light of changing facts, including empirical data that show ordinary people perceive most messages that qualify as FECA issue advocacy to be communications in support or opposition to specific candidates in an election.⁵⁸ Public opinion polls also regularly show that people do not trust their elected officials and that one reason is the widely held belief that elected officials are obligated to their big contributors. The bipartisan Campaign Finance Institute recently issued a report arguing, among other things, that the Buckley opinion does not say that express advocacy, as illustrated in its footnote, is the only constitutional standard justifying the burdens of disclosure. Rather,

[i]t was a means to an end—a way to fix an otherwise vague and overly broad statute in a situation in which the underlying statute was focused on the speaker’s purpose. The Court did not assert, nor has it ever asserted, that all disclosure laws must incorporate this particular test.⁵⁹

If the Court were to expand the constitutional options for regulating campaign activity, the FEC prong of the political intervention contrast would be different, presumably covering some kind of implied advocacy, possibly along the lines of what the FEC has promulgated as § 100.22(b).

Whatever may be the outcome of the constitutional debate, it is worthwhile to ask what

⁵⁷ See Regan v. Taxation with Representation of Washington, 461 U.S. 540, 544-45 (majority), 551-54 (Blackmun, concurring) (1983).

⁵⁸ CITE to data from the Brennan Center. I imagine a fabulous Brandeis brief with an avalanche of empirical data that would give the Justices a peg to hang a more expansive ruling on.

⁵⁹ The Report is available at www.cfinst.org/disclosure/report.

should be the relation between the FEC and IRS standards for public policy purposes. To some extent the answer to this question is dependent upon how many fixed points in the current statutory and regulatory landscape are assumed. For example, the statutory language of section 501(c)(3) is one such point. Assuming it is fixed, any recommendation with regard to interpreting the IRS standard must preserve the integrity of the explicit prohibition against intervening in a campaign on behalf or against a candidate. Representatives of the IRS have made just this point on occasion.⁶⁰ However, this begs the policy question to the extent that it assumes a fixed meaning to such intervention, given that the statutory directive is not self-explanatory.

One avenue to explore is the purpose of the prohibition in section 501(c)(3) and then, ultimately, to compare this purpose with that underlying the FECA restriction. This avenue is problematic for several reasons. Do we adopt the original purpose or the purpose as it is now understood by the courts? In most cases, the original legislative purpose is a fiction because lawmakers do not reveal clearly or agree upon their purpose(s) in drafting and enacting a statute. In the case of the provision in the Code, however, less is actually more: we know that Lyndon Johnson proposed the amendment that became the statutory language and that he was angry about a tax-exempt organization that had given financial support to his opponent in an election.⁶¹ At the same time, we know nothing about what the purpose of other lawmakers who voted to approve the amendment, assuming they had any. Finally, it is doubtful that we should attach moral force

⁶⁰ CITE.

⁶¹ See Lobbying and Political Activities of Tax-Exempt Organizations: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 100th Cong., 1st Sess. 418, 423 (1987) (testimony of Mark E. Chopko and Deirdre Halloran on behalf of United States Catholic Conference).

to an unreflective, even vindictive, gesture of an angry politician unless we can justify the core of his insight independently.

It makes more sense, then, to ask what is the purpose of the prohibition against campaign intervention as part of the surrounding statutory provision, assuming we can identify the purpose of the surrounding provision, and then comparing this with the FECA advocacy provision, situated in the context of that statute's objectives. Such an approach makes more sense both because it does not involve unearthing facts buried in the past and because we expect policymakers to look to the present and the foreseeable future in fashioning their recommendations. But the "context: present and future" approach seems like a blunt and imprecise analytical tool to use to generate practical decisions that can resolve present dilemmas persuasively or serve as templates to guide future decisions.

These reflections highlight the superiority of the FECA express advocacy rule, as interpreted by the FEC in its regulation. The FEC's approach would prevent the proliferation of virtual magic word communications by virtue of supplementing the Buckley footnote with MCFL inspired virtual magic words, and it would enable the IRS to exercise some judgment in determining whether express or candidate advocacy has occurred. At the same time, it would severely restrict the Service's exercise of judgment by imposing strict conditions justifying its exercise—stricter, as I have argued, than the current facts and circumstances test.

I believe this solution is inadequate for two, related reasons. First, it does not take seriously the reaction of a significant part of the electorate to its perception that the government is for sale, to be only slightly hyperbolic. If meaningful campaign finance reform ultimately is enacted into law, it is because there is a growing consensus that the current rules have been

abused by the infusion of too much money into individual elections, to the detriment of the long-term well-being of the political process as a whole. It would, then, violate the spirit, if not the letter, of campaign finance reform to loosen the rules governing campaign intervention by exempt organizations. That exempt organizations are perceived as part of the problem is shown by the adoption of the Snowe-Jeffords amendment to McCain-Feingold imposing a moratorium on certain types of pre-election activities for section 501(c)(4) organizations. In this context, I fear that relaxing the campaign intervention standard would risk undermining the respect that the nonprofit sector currently enjoys. If so, the very real benefits of the IRS adopting a more campaign- or speaker-friendly definition of impermissible campaign intervention, along the lines of 11 C.F.R. § 100.22, would have to be weighed against the potential harm to the sector that such a change might unwittingly invite.

Second, and relatedly, I believe that we need to engage again, as we have done repeatedly in the past, in a discussion of what we mean by the nonprofit sector in general and charities in particular. Over a decade ago, Laura Chisolm argued that classification as an exempt organization, even as public charity, was no assurance that a group would represent the public interest as it is understood by a significant constituency.⁶² She concluded that the ban on lobbying should be expanded from private foundations to public charities except for those that engage in advocacy on behalf of the chronically disadvantaged.⁶³ This reasoning could easily be extended to issue advocacy in a campaign context; whether it should depends upon what our notion of the

⁶² Laura noted that the public support test can be met by fewer than twenty donors.

⁶³ Laura B. Chisolm, "Exempt Organization Advocacy: Matching the Rules to the Rationales," 63 Ind. L. J. 201, 284-85 (1987).

public interest is. For some civil society theorists, participation in groups develops people's capacity to trust, fulfills certain profound psychological and human needs, and/or develops skills useful for citizenship, regardless of the specific purpose of the groups they participate in.⁶⁴ In that event, there should be a presumption in favor of creating opportunities for participation in groups and for groups' participation in civic life, absent strong evidence to the contrary. Others could derive such a presumption from some version of the marketplace of ideas and the elusive and changing nature of individual and social well-being in a complex and continuously evolving world. However, even those of us who accept some of these ideas, reject the separation of exemption coupled with advocacy based upon an ill-considered neutrality defense, and have doubts about the subsidy theory,⁶⁵ are nonetheless dismayed by what passes for the "educational" core in many instances of IRC issue advocacy. The problem with the pervasive reliance on "issue-light/advocacy-heavy" is that it violates an intuition some of us have about what the charitable/education exemption means. Differently put, it seems as though many charities and social welfare organizations have come to believe that the means justifies the end, in particular, their own ends.⁶⁶ Whether this belief is consistent with the ideas of charity and exemption is something that itself demands justification.

⁶⁴ See, e.g., Robert D. Putnam, Bowling Alone: The Collapse and Revival of American Community (2000); Nancy L. Rosenblum, Membership and Morals: The Personal Uses of Pluralism in America (1998).

⁶⁵ For example, Laura's article, supra note 63, and my "Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities," 71 Tex. L. Rev. 1269, 1286-1306 (1993).

⁶⁶ In my experience, it is primarily political and social theorists who defend advocacy as an intrinsic good; for most others, whether in the nonprofit or for-profit sectors, advocacy is unabashedly an instrumental good.

I look forward to having a full and fair discussion with the members of our group about these challenging and elusive subjects.

Code of Federal Regulations
Revised as of January 1, 2000
From the U.S. Government Printing Office via GPO Access
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PART 100--SCOPE AND DEFINITIONS (2 U.S.C. 431)--Table of Contents

Sec. 100.22 Expressly advocating (2 U.S.C. 431(17)).

Expressly advocating means any communication that--

(a) Uses phrases such as "vote for the President," "re-elect your Congressman," "support the Democratic nominee," "cast your ballot for the Republican challenger for U.S. Senate in Georgia," "Smith for Congress," "Bill McKay in '94," "vote [67] Pro-Life" or "vote Pro-Choice" accompanied by a listing of clearly identified candidates described as Pro-Life or Pro-Choice, "vote against Old Hickory," "defeat" accompanied by a picture of one or more candidate(s), "reject the incumbent," or communications of campaign slogan(s) or individual word(s), which in context can have no other reasonable meaning than to urge the election or defeat of one or more clearly identified candidate(s), such as posters, bumper stickers, advertisements, etc. which say "Nixon's the One," "Carter '76," "Reagan/Bush" or "Mondale!"; or

(b) When taken as a whole and with limited reference to external events, such as the proximity to the election, could only be interpreted by a reasonable person as containing advocacy of the election or defeat of one or more clearly identified candidate(s) because--

(1) The electoral portion of the communication is unmistakable, unambiguous, and suggestive of only one meaning; and

(2) Reasonable minds could not differ as to whether it encourages actions to elect or defeat one or more clearly identified candidate(s) or encourages some other kind of action.

[60 FR 35304, July 6, 1995]

PRIVATE RULING 200044038

INTERNAL REVENUE SERVICE NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

"This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code."

Section 501(c)(3) -- Charities;
Section 4955 -- Political Expenditure Tax

s 1 and 2, above?

[87] The information submitted by X shows that the officers of the organization relied on the advice of tax counsel as to the tax consequences relating to X's participation in the A/X direct mail fund raising campaign. As a matter of routine, X's counsel reviewed all of the direct mail fund raising materials, line by line, to determine if there was any violation of section 501(c)(3) of the Code. The officers felt it was unnecessary to examine in any depth the tax implication of the A/X mailing since that letter was reviewed and approved by X's tax counsel.

[88] The response of X's tax counsel was even more detailed in its description of the tax advice offered by him on the A/X letter. He stated that he examined and rendered a counsel opinion on all fund raising texts. Because of the volume of work, almost all opinions were rendered verbally. He also states that because of the lack of any authority on the subject, there was no need to express his opinion in writing. He also stated that "I okayed the A letter texts and the use of his signature." Further, he stated that "The A opinion, like others, approved the format, text, and related materials for his fund raising letter and was entirely verbal." Included in the counsel's correspondence with the organization was a letter dated May 25, 1995, regarding the A/X fund raising letter. A's tax counsel states that X's management made no "knowing" political expenditure because they had been consistently counseled by him that the direct mail fund raising letters did not constitute campaign intervention. He found no authority by the Internal Revenue Service that would, in his opinion, in the context stated in his letter, suggest a violation of section 501(c)(3) of the Code.

[89] As discussed above, section 53.4955-1(b)(7) of the Regulations generally provides a safe harbor for the reliance of the organization manager on the advice of counsel. It states, in part, as follows:

PRIVATE RULING 200044038; 2000 PRL LEXIS 1431

DATE: July 24, 2000

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

District Director: * * *

Taxpayer's Name: * * *

Taxpayer's Address: * * *

Taxpayer Identification: * * *

Number: * * *

Tax Years: * * *

Date of Conference: * * *

LEGEND:

A = * * *
B = * * *
C = * * *
D = * * *
E = * * *
F = * * *
G = * * *
H = * * *
J = * * *
K = * * *
L = * * *
M = * * *
O = * * *
T = * * *
X = * * *
Z = * * *

[1] ISSUES

1. Did certain letters sent in cooperation between the exempt organization, [*4] "X", and an active candidate for political office, "A", during A's campaign constitute intervention in a political campaign within the meaning of *section 501(c)(3) of the Internal Revenue Code* (hereafter "code") and *section 1.501(c)(3)-1(c)(3)(iii) of the Treasury Regulations* (hereafter "Regulations")?

2. Did X, by providing the candidate for public office, A, with the names and addresses of those who respond to the mailing of letters in question constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(c)(3)(iii) of the Regulations?

3. Do the acts involved in issues 1 and 2 above, constitute private benefit to the candidate, A, or to the political party, "T", with which he is affiliated, within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(c)(2) of the Regulations?

4. Do the sanctions provided under section 4955 of the Code apply to X under the facts involved in issues 1 and 2, above?

5. Do the sanctions provided under section 4955 of the Code apply to managers of X who knowingly participated in the acts involved [*5] in issues 1 and 2, above?

6. To what extent should X or its managers be granted relief by virtue of the application of section 7805(b) of the Code to the extent of any adverse conclusion under section 501(c)(3) or 4955 of the Code? Reference is specifically made to the technical advice memorandum of 1979 and/or the ruling letter of December 10, 1991, issued to X?

FACTS

A. Issues 1 through 4:

[2] X is a non-profit corporation organized and existing under the law of C. It was incorporated on February 11, 1973. X is exempt from federal income tax under section 501(c)(3) of the Code by virtue of a determination letter from the Service dated November 27, 1973. X was granted exemption on the basis of an educational purpose to conduct and sponsor research on the social and economic forces in the country and the governmental interaction with these forces.

[3] Z, an advertising agency specializing in direct mail fund raising, contacted X in April, 1995, to

determine if X would be interested in a fund raising package signed by A. A announced his candidacy for the T nomination for the office of K on April 9, 1995, the same month as Z's initial contact with X.

[4] X and A agreed to the fund raising [*6] arrangement proposed by Z. The initial fund raising package is discussed in greater detail hereafter. Z managed the conduct of the direct mail campaign including the design of the fund raising package.

[5] The initial package was sent by X as a prospect mailing, i.e., a mailing sent to potential donors who had not previously contributed to X. The prospect mailing lists were obtained in some instances by X paying rental fees for lists owned by others, and in other instances by X exchanging its list with other list owners. A third version of the package was a "housefile" version of the prospect mail package. The housefile version was mailed to persons who had previously contributed to X.

[6] The housefile mailing dated June 30, 1995, reached 293,628 addresses. The prospect mailings were made in batches. The batches sent out on June 7, 1995; June 12, 1995; April 6, 1995; March 29, 1995; and April 29, 1996, were sent to a total of 370,071 addresses. The prospect mailings sent out on May 15, 1995; January 17, 1996; January 19, 1996; and June 10, 1996, were sent to a total of 824,573 addresses. The batches sent out on August 14, 1995; August 31, 1995; October 26, 1995; and November 2, 1995, [*7] were sent to a total of 415,867 addresses. The second prospect package was mailed July 31, 1996; August 14, 1996; September 2, 1996; September 16, 1996; September 19, 1996; and October 4, 1996, to a total of 829,026 addresses. Taken together, all of the prospect and housefile mailings reached a grand total of 2,733,165 addresses. (There is no information on how many of these packages were mailed to the same address.)

[7] The June 30, 1995, housefile mailing cost \$ 111,024 to X and produced gross income of \$ 266,609, resulting in net income of \$ 155,585 from charitable donations. The net income from prospect mailings was \$ 32,994 based on direct costs of \$ 486,254 and gross income of \$ 519,198. The net income does not include indirect costs such as overhead. The first prospect mailing resulted in the addition of over 28,000 donor names to the housefile, and the second prospect package added 9,435 donor names to the housefile list.

[8] The initial fund raising package consisted of several elements. The package was mailed in an envelope which showed both "[Title] A" and "X" as the return addressee, although each was listed on a separate line. Each was of equal prominence. The address [*8] used on the return envelope was that of the X. The primary letter inside the package was a four page letter printed on the letterhead of "[Title] A" and was signed by A. The package also contained a four page brochure titled B by A and X. The package also contained a survey questionnaire to be mailed back by the recipient, indicating the recipient's view of various political issues and whether the recipient would describe him/herself as "Liberal", "Conservative", "Libertarian", or "Other."

[9] Substantially all of the revenues of X are raised from contributions from the public. In 1996, X received contributions and grants of \$ 5 million from private foundations, \$ 2 million from business corporations, \$ 9.1 million as major gifts from individuals (excluding direct mail) and \$ 5.8 million from direct mail support on the housefile. As is apparent, direct mail solicitation is an important component of X's total revenues of \$ 28.6 million for 1996. The prospect mailings are used to develop the housefile list. Most revenue from direct mail solicitations is generated by the housefile mailings. The prospect mailings are engaged in for the purpose of developing the housefile, rather than [*9] as a moneymaker alone. In 1995, X mailed 6,315,320 letters to prospects. In 1996, X mailed 4,775,435 letters to prospects.

[10] X has had a working relationship with A for a number of years prior to the mailings in question here. X used A's signature on fund raising letters mailed in 1987 and 1988. A was a candidate for K in 1987 and 1988. The possibility of using A's signature in 1994 was discussed.

[11] X states that A's signature was considered a good one for X to use for several reasons. X's prior experience with the use of A's signature had been positive. Further, A had high name recognition in 1995 with potential donors.

[12] Both A and X reviewed and approved all direct mail packages drafted by X's agents before they were mailed by X. Although the packages stated that the survey responses would be tabulated and provided to A and others, this was never done.

[13] Although the direct mail campaign began in June, 1995, the agreement between A and X was not reduced to writing until a "Memo of Understanding" dated July, 1996, was executed on behalf of A and X. Prior thereto, the agreement between X and A was only a verbal agreement. The July, 1996, agreement provides that in exchange [*10] for the use of A's signature, X will provide A with a one time use of the names and addresses of all donors and non-donors respondents to any mail sent over A's signature under the A/X fund raising letter. The Agreement also provided that the use of A's signature is not a X endorsement of A nor is it a A endorsement of X. A reserved the right to pull the A signature with 30 day written notice.

[14] Pursuant to the July, 1996, agreement, A had received, by early August, 1996, approximately 43,800 names of donors generated by the A/X direct mail campaign. However, A did not limit his use of the names he received from X to a one-time use as provided by the terms of the agreement. Rather, A's campaign added the names permanently to A's campaign mailing list, and used them more than once. Accordingly, a new agreement between the parties provided that X was to be compensated for the multiple use of donor names by A's campaign. This was to be accomplished by the transfer of 35,000 names of donors to A's campaign for one time use in X's direct mail prospect program.

[15] The multiple use by A's campaign of the X donors names resulted because X had not employed a technique called "seeding" [*11] to monitor multiple use of names. Seeding is a technique used by organizations conducting direct mail fund raisers to monitor use of names that have been rented to or exchanged with another organization. Seeding is a standard industry practice of placing dummy names in the rented or exchanged list. The transferor organization will detect multiple use of its rented or exchanged names when the "seeded" or dummy name x receive were transferred to political figures in consideration for their endorsements on X's direct mail fund raising campaign. As a result of the problems associated with A's campaign's multiple use of X's donor names, X now employs seeding as a standard technique with political figures who endorse X's direct mail fund raising campaigns.

[16] The A/X prospect mailing gained X 29,004 new donors and 53,532 non-donor responses, as of July, 1996. The A/X housefile mailing produced 15,135 responses with donations. Names of donor respondents to the mailing were given to A's campaign in accordance with the agreement. At some point A's campaign informed X that A did not care to receive the names of non-donor respondents.

[17] X's policy of providing a ONE-TIME use of a response [*12] generated mailing list, as compensation for the use of such persons signature on the direct mail campaign, has been X's standard compensation arrangement for a number of years. This policy has been uniformly applied, without exception, since 1990.

[18] X considers the use of signatures of certain elected officials to be important to its direct mail fund raising effort. For competitive reasons, X feels compelled to adequately compensate these elected officials for their signatures.

[19] From 1995 to mid-1997, X has used the signatures of a number of elected officials and public figures in its fund raising letters in addition to that of A, for both house file and prospect mailings. Such names included: D, E, F, G, H, and J. X states that these individuals were chosen primarily because their views on important topical issues coincide with the views X believes are held by prospective donors contained on X's donor lists. Each year X has used the signature of one or more elected officials.

[20] X has submitted information suggesting that the X/A fund raising campaign was conducted in an ordinary and customary manner typical of its other fund raising efforts. It was Z's idea to propose the [*13] test mailing using A's signature to X based on Z's understanding that other groups were having good financial results with A signed prospect packages. The contract was not initiated at A's request. All matters relating to the A prospect mailings were handled in the same fashion as other prospect mailings

using high profile signers for the X prospect mailings handled by Z. The placement of A's name on the carrier envelope, the heading of the solicitation letter and other places in the prospecting package is consistent with the placement of high name recognition signature on other prospect mailings. Z's representative also stated that multiple use, or even co-ownership, of the results of a prospect mailing is the consideration frequently necessary to secure the cooperation of a high profile signer.

[21] Information from the A campaign direct mail fund raising professional also has some bearing on this matter. He stated that A had the most powerful signature in the T market and those of allied interests in 1995 and 1996. Many direct mail vendors were aware that A's signature was "hot" and were interested in obtaining it for their own client for fund raising purposes.

B. Issue 5:

[22] [*14] The principal officers of the X are L, its President, M, its Vice President and Treasurer, and O, its Executive Vice President and Chief Operating Officer. The direct mail campaign is managed by these officers. A prospect package that is mailed out on a test basis is evaluated by M. M recommended the use of the A/X letter in a direct mail campaign. The one time use of names as compensation to the signer of the letter is a policy adopted by senior management: L, M, and O. M's nearly 35 years experience in the direct mail business led him to understand the value of certain signatures. The text of the A/X letter was written by the vendor and then approved by L, M, and O, and others at X.

[23] The affidavit of M describes his general responsibility at X for the direct mail campaign but does not describe his specific involvement with the A/X direct mail fund raising campaign.

[24] The above named officers of X were aware that some tax ramifications were associated with the A/X fund raising letters. However, they were not specifically aware that the A/X letter would result in IRS "challenge". Accordingly, they held no internal discussions or meetings regarding tax ramifications of that [*15] direct mail effort. All the officers were acquainted with the previously issued X technical advice memorandum and favorable ruling received by X.

LAW AND ANALYSIS

[25] *Section 501(c)(3) of the Internal Revenue Code* provides for recognition of exemption of organizations organized and operated exclusively for charitable, religious, educational, and other stated purposes; no part of the net earnings of which inures to the benefit of any private shareholder or individual; no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation; and which does not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of, or in opposition to, any candidate for public office.

[26] *Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations* provides that 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 exempt purposes specified in section 501(c)(3) of the Code. An organization will [*16] not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

[27] *Section 1.501(c)(3)-1(c)(3)(i) of the regulations* provides that an organization is not operated exclusively for one or more exempt purposes if it is an "action" organization.

[28] *Section 1.501(c)(3)-1(c)(3)(iii) of the regulations* provides that an organization is an "action" organization if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. The term candidate for public office means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such candidate.

[29] Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for [*17] one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or person controlled, directly or indirectly by such private interests.

[30] Section 4955(a)(1) of the Code imposes on each political expenditure by a section 501(c)(3) organization a tax equal to 10 percent of the amount thereof. This tax shall be paid by the organization. In 1987, Public Law 100-203 added Code section 4955 effective for tax years beginning after December 22, 1987.

[31] Section 4955(a)(2) of the Code imposes on the agreement of any organization manager to the making of any expenditure, knowing that it is a "political expenditure," a tax equal to 2 1/2 percent of the amount thereof, unless such agreement is not willful and is due to reasonable cause. This tax shall be paid by any organization manager who agreed to the making of the expenditure.

[32] Section 4955(d)(1) of [*18] the Code provides, in general, that the term political expenditure, means any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for political office.

[33] Section 53.4955-1(b)(1) of the Foundation and similar excise taxes Regulations (the Regulations) provide that the excise tax under section 4955(a)(2) on the agreement of any organization manager to the making of a political expenditure by a section 501(c)(3) organization is imposed only in cases where --

- (i) A tax is imposed by section 4955(a)(1);
- (ii) The organization manager knows that the expenditure to which the manager agrees is a political expenditure; and
- (iii) The agreement is willful and not due to reasonable cause.

[34] Section 53.4955-1(b)(4) of the Regulations provides in part that an organization manager is considered to have agreed to an expenditure knowing that, it is a political expenditure only if --

- (A) The manager has actual knowledge of sufficient facts so that, based solely on these facts, [*19] the expenditure would be a political expenditure;
- (B) The manager is aware that such an expenditure under these circumstances may violate the provisions of federal tax law governing political expenditures; and
- (C) The manager negligently fails to make reasonable attempts to ascertain whether the expenditure is a political expenditure, or the manager is aware that it is a political expenditure.

[35] Section 53.4955-1(b)(5) of the Regulations provides that an organization manager's agreement to a political expenditure is willful if it is voluntary, conscious, and intentional. No motive to avoid the restrictions of the law or an incurrance of any tax is necessary to make an agreement willful. However, an organization manager's agreement to a political expenditure is not willful if the manager does not know that it is a political expenditure.

[36] Section 53.4955-1(b)(6) of the Regulations provides that an organization manager's actions are

due to reasonable cause if the manager has exercised his or her responsibility on behalf of the organization with ordinary business care and prudence.

[37] Section 53.4955-1(b)(7) of the Regulations provides [*20] in part that an organization manager's agreement to an expenditure is ordinarily not considered knowing or willful and is ordinarily considered due to reasonable cause if the manager, after full disclosure of the factual situation to legal counsel, relies on the advice of counsel expressed in a reasoned written legal opinion that an expenditure is not a political expenditure under section 4955. However, the absence of advice of counsel with respect to an expenditure does not, by itself, give rise to any inference that an organization manager agreed to the making of the expenditure knowingly, willfully, or without reasonable cause.

[38] *Rev. Rul. 78-76, 1978-1 C.B. 377*, holds that a foundation manager (a trustee) of a private foundation (a trust) who, representing both himself and the trust, willfully and without reasonable cause, sells property he owns to the trust knowing that the sale is an act of self-dealing under the Internal Revenue Code, is liable for both the tax imposed on the participation of foundation managers by section 4941(a)(2) as well as the section 4941(a)(1) tax.

[39] Under situation 3 and 4 of *Rev. 78-248, 1978-1 C.B. 154*, [*21] the exempt organization is held to be engaged in the participation or intervention in a political campaign because the organization's questionnaire or voters guide shows bias in favor of one candidate or another.

[40] *Rev. Rul. 80-282, 1980-2 C.B. 178*, holds that the publication of the organization's newsletter concerning a broad range of political issues did not constitute the participation or intervention in a political campaign under the specific facts of that ruling.

Analysis:

Issue 1:

[41] A announced his candidacy for public office on April 9, 1995. Section 1.501(c)(3)-1(c)(3)(iii) of the Regulations defines the term "candidate for public office" as an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state, or local. The same definition is also found in section 53.4945-3(a)(2) of the Foundations and similar excise tax Regulations. Thus, A was clearly a candidate for public office at the time that the fund raising letters were produced and mailed by X.

[42] An organization may be found to have participated or intervened in a political campaign even [*22] though it is the organization's intention, in conducting such activities, to further its exempt purpose. In *Rev. Rul. 67-71, 1967-1 C.B. 125*, the Service held that the organization's activity in evaluating the qualifications of all potential candidates, and then selecting and supporting a particular slate of candidates, constitutes participation in a political campaign. The Service reached this conclusion notwithstanding that the selection process may have been completely objective and unbiased and was intended primarily to educate and inform the public about the candidates. Similarly, the Second Circuit in *The Association of the Bar of the City of New York v. Commissioner, 858 F2d 876* (2d Cir, 1988), cert. denied, *490 U.S. 1030* (1989), held that the organization's activity in rating candidates for judicial office, even though nonpartisan and in the public interest, constituted participation or intervention in a political campaign.

[43] *Rev. Rul. 76-456, 1976-2 C.B. 151*, describes an organization having an educational purpose of elevating the standards [*23] of ethics and morality that prevail in the conduct of campaigns for election to office. However, if the organization solicits the signing or endorsement of its code of fair campaign practices by candidates, it will fail to qualify for exemption because of such activity (and subsequent publication thereof), which constitutes the participation or intervention in a political campaign which may not be excused or avoided merely because that the organization regarded its activity as furthering its exempt purpose.

[44] Assuming that X did not intend to further A's political campaign X may still be deemed to have participated or intervened in a political campaign even if its purpose for the A/X direct mail fund raiser was

both further its exempt educational purpose and generate revenues. Based on the authority cited in the preceding paragraphs, an organization is not excused from acts of political campaign intervention because the organization had a "good" purpose. Political campaign intervention is not overcome by a "good" purpose.

[45] For example, in both *Rev. Rul. 67-71* and *Bar of the City of New York, supra*, it was [*24] clear that the intervention had some value to the public and was not necessarily motivated by purely partisan intentions. In *Rev. Rul. 67-71*, it was clearly stated that the information regarding which candidate was best qualified "was intended primarily to educate and inform the public about the candidates." In *Bar of the City of New York, supra*, it was clear that the Second Circuit considered the ratings of judicial candidates based on their legal background to be of value when, at page 881-82, it stated:

The members of this panel . . . empathize with efforts of such Association to improve the administration of justice. We recognize, however, that it is not within our province to grant Bar Associations a tax exemption that Congress has not seen fit to grant.

[46] A public statement disseminated by a charity may serve more than one purpose (e.g., a so-called "dual-purpose communication"). Even though one such purpose is proper and furthers the organization's exempt purpose, the public statement may nonetheless constitute prohibited campaign intervention. For example, a written or broadcast [*25] message may be BOTH educational and constitute intervention in a political campaign. As another example more closely on point, a communication may serve legitimate fund raising purposes of the organization, yet may also constitute prohibited campaign intervention. For example, jargon and catch phrases contained in an organization's fund raising letters may demonstrate evidence of bias and constitute improper political campaign intervention, even if, as the organization contended, contributions received in response to the letters were used only to finance nonpartisan, educational activities. Thus, the fact that the statements made in the letters in question here were coupled with a request for donations to X and a survey (and the fact that the fund raising campaign was successful) cannot insulate the letters from inquiry as to whether they also constitute prohibited campaign intervention.

[47] As to whether any particular letter constitutes campaign intervention, it has long been held that the determination of whether a public communication made by, or on behalf of, an organization constitutes intervention in a political campaign for purposes of section 501(c)(3) of the Code is made [*26] on the basis of all the surrounding facts and circumstances. See *Rev. Rul. 78-248*, cited above. This determination for purposes of section 501(c)(3) does not hinge on whether the communication constitutes "express advocacy" for Federal election law purposes. Rather for purposes of section 501(c)(3), one looks to the effect of the communication as a whole, including whether support for, or opposition to, a candidate for public office is express or implied.

[48] A number of published rulings have found there to be participation or intervention in a political campaign despite lack of express advocacy on behalf of or opposition to the election of a specific candidate. In *Rev. Rul. 76-456*, described above, the mere publication of the names of candidates for election who endorse or sign the organization's code of ethics is deemed to be participation or intervention in a political campaign in the nature of an attempt to influence voter opinion in favor of those who signed the code and in opposition to those who did not sign. In situation 3 and 4 of *Rev. Rul. 78-248, 1978-1 C.B. 154, [*27]* the exempt organization is held to be engaged in the participation or intervention in a political campaign merely because a candidate questionnaire or a "voters guide" shows some bias in favor of one candidate or another. Similarly, in *Rev. Rul. 86-95, 1986-2 C.B. 73*, the Service held that the conduct of public forums involving statements by qualified congressional candidates could be conducted in such a manner as to show bias or preference for or against a particular candidate. In such a case, the public forum would constitute political campaign intervention or participation in spite of the failure to explicitly propose the election or defeat of any candidate.

[49] In *Rev. Rul. 80-282*, the Service held that the publication of the organization's newsletter concerning a broad range of political issues did not constitute the participation or intervention in a political campaign. One issue of the newsletter is devoted to the listing of the voting records of all incumbent members of Congress on selected legislative issues together with an expression of the organization's position on such issues. The publication [*28] also indicates whether the congressional member voted in accordance with the organization's position on the issue. The newsletter is nonpartisan and will not refer to elections, campaigns or candidates. The Service contrasted the holding in this ruling to that of situation 3 and 4 of *Rev. Rul. 78-248*. The distinguishing features of *Rev. Rul. 80-282* are that the newsletter is distributed to relatively few persons, no attempt is made to target the publication of the newsletter toward particular areas where elections are being held, it doesn't name incumbents for re-election, includes all office holders, and makes no comparison with other candidates.

[50] *Rev. Rul. 80-282* is distinguishable from the facts of this case. The newsletter in the ruling is distributed only to a few thousand people. In the subject case, X mailed 2,733,165 letters. The newsletter in the Revenue Ruling is not published to coincide with an election campaign. In this case, X's fund raising letters do, in fact, coincide with the A's election campaign. There are other important differences [*29] discussed in following paragraphs.

[51] The issue of campaign intervention often focuses on whether the content, slant, and context of the comments of a fund raising letter constitute intervention in a political campaign. Other organizations, much like X, have argued that the catchwords and commentary contained in the fund raising letters were necessary to attract the financial support of the targeted audience. Factors of importance to these issues include consideration of whether statements of the organization were contemporaneous with election periods and were biased against certain candidates or in favor of other candidates.

[52] A's authorship of the letter (and the language chosen by A) is the most determinative aspect of the letter in terms of whether it involves political campaign intervention. This letter is not just about positive attributes or characteristics associated with A or negative attributes associated with A's opponent, but, additionally, it represents an affirmative statement by candidate A himself during A's campaign. It is a forum for A. This is a letter on A's letterhead and with A's signature at the bottom of the letter. The letter is most likely read by the [*30] recipient as fully representative of A's opinion and expression. In the letter, A takes a position on various issues that sound very much like his campaign statements. The prospect version of the A/X letter contains the following:

"I WANT TO START BY ABOLISHING THE DEPARTMENTS OF EDUCATION,
HOUSING AND URBAN DEVELOPMENT, ENERGY AND COMMERCE."

"BUT I AM COMMITTED TO GIVING YOU THE REFORM YOU WANT AND
AMERICA NEEDS."

"I WILL USE THE RESULTS -- AND YOUR SUPPORT -- TO KEEP THE
POLITICAL HEAT TURNED UP IN WASHINGTON."

"FAMILIES, NOT BUREAUCRATS, SHOULD CONTROL WHAT THEIR CHILDREN
ARE TAUGHT."

"LETS REFORM THE STRUCTURE OF THE FEDERAL GOVERNMENT BY STICKING
TO THE BASICS OF DEFENSE, FOREIGN AFFAIRS AND FIGHTING CRIME."

[53] Thus, X assisted A by distributing statements that are very much like his campaign statements, positions, and rhetoric. At the time the letters were mailed, A was more than a politician, he was a candidate for elected office. As such he was highly visible to the public and closely connected in the public mind with his campaign effort. Recipients of the A/X letter would naturally associate the statements of [*31] the letter as indistinguishable from A's election effort. As stated earlier, the letter does not

directly urge the election or the defeat of either candidate. Nevertheless, by featuring the A signature and using the first person with a text in the letter sounding very much like campaign rhetoric, the fund raising letter is inextricably tied to the election of the signatory of the letter.

[54] Further, the association of the statements by A in the letter with the 1996 campaign is made all the more likely by reference to negative associations with A's opponent. A's opponent is mentioned by name in a negative light three times in the letter and once in the attached "B." There is a "him or me" quality to this letter, a contest, likely to evoke an association with the election campaign in the mind of the recipient. By directly naming the principals to the election (in the text or by virtue of the signature), the association of the message of the letter to the election is greatly strengthened. As mentioned above, the wording of the political message by A has the flavor of campaign rhetoric which also adds to the picture of a campaign contest.

[55] The A/X letters include the following language [*32] which could be interpreted as opposition to A's opponent (the incumbent holder of K):

"I WANT TO CHANGE HOW WASHINGTON TAXES, SPENDS AND REGULATES.

"BUT WITH [A'S OPPONENT] IN THE WHITE HOUSE, TRUE REFORM WILL NOT COME EASILY. IT REQUIRES ALL WHO WANT IT TO WORK TOGETHER."

Even though there is no explicit call for the defeat of A's opponent, the language cited above suggests action by the recipient to oppose A's opponent.

[56] The fact that the letters were sent out under the joint letterhead of A and X, but were signed only by A does not change the analysis made above. This position is based on either of two principles. First, A ESSENTIALLY was X's agent for fund raising purposes such that it is appropriate to attribute the statements made by A in the letters to X. Secondly, the statements made by A in the letter may not be directly attributable to X, but X still engaged in prohibited campaign intervention by distributing A's statements that constituted political campaign activities on behalf of A and in opposition to his opponent. X's use of A as a fund raising spokesman under the facts at issue is analogous to the issues that arise when a candidate is invited [*33] to speak at an organization event, supposedly not in his capacity as a candidate but as a public office holder or expert in public policy. In such case, the organization must ensure that the candidate speaks only in his/her individual capacity at the event and that no campaign activity occurs in connection with the event. In contrast, with the A/X letters, there is no doubt that A is engaged in campaign activities for the reasons discussed in the preceding paragraphs.

[57] The Service has had a concern with the use of words like "conservative", "liberal", "leftist", "far right", "pro-life", or "pro-choice" as a means of supporting, in a disguised manner, a particular political candidate. The use of conservative or liberal labels may be used to attack a candidate and support another candidate. In addition to including affirmative statements by A during A's campaign regarding election issues and negative statements about A's opponent, X's fund raising letter uses politically loaded language and words. The original prospect letter had two references to persons of one political persuasion, both in close proximity to A's opponent in the text of the letter. On page 3 of the letter, the [*34] first line, A's opponent is described as follows:

"[A's opponent], WHO CAMPAIGNED AS A REFORMER HAS BECOME THE SPOKESMAN FOR THE STATUS QUO."

Two lines later persons of one political persuasion are described as follows:

"THE LIBERALS SPENT THE LAST YEARS TINKERING, SPENDING AND WRITING LAWS TO CREATE A "GREAT SOCIETY" BUT ALL WE HAVE GOTTEN

IS DEBT AND DESPAIR."

"THEIR THIRST FOR SPECIAL INTEREST LEGISLATION CRACKS THE FRAGMENTS OF OUR CULTURAL UNITY. RATHER THAN 'ONE NATION UNDER GOD' WE HAVE BECOME A NATION OF UNCONNECTED SPECIAL INTEREST GROUPS."

Thus, the text puts persons of one political persuasion in a bad light and indirectly connects them to A's opponent by indirectly challenging the assertion that he is new or different, and it links him as the spokesman for the status quo. The link becomes even closer spatially on the page entitled B, where it is stated that:

"BUT WITH WELL ORGANIZED LIBERALS' IN THE SENATE AND [A's opponent] IN THE [executive branch] -- TRUE REFORM WILL NOT COME EASILY."

[58] There are other statements contained in the house prospect mailing letter that have political meaning. The following [*35] statement puts A's opponent in a negative light by associating him with special interests:

"ALREADY [A's opponent] AND THE SPECIAL INTERESTS WHO PROFIT FROM THE CURRENT SYSTEM (LIKE THE NATIONAL EDUCATION ASSOCIATION) ARE FIGHTING PITCHED BATTLES TO PROTECT THE TURF THAT HAS MADE TOO MANY OF THEM RICH AND POWERFUL."

[59] At other points in the letter, A, as author of the letter, makes declarative statements concerning the issues he supports. He supports actions affecting government by elimination of certain existing conditions. He adopts the belief of X in a specific type of government, enunciated values, and a position on relations with other governmental bodies. Moreover, A is linked in this letter to his friend who is a former leader of the same political party as A.

[60] In summary, the content AND THE TIMING of the letters in question constitute prohibited political campaign intervention. Statements made in the letters supported A's political agenda and criticized the opposing candidate. The letters were sent during the period of A's primary election as well as the general election up to October 4, 1996. There were also mailings in July and August of 1996 [*36] and 3 mailings in September, 1996. The total of all letters were sent to 2.7 million addresses, many of recipients of such statements could be assumed to be eligible voters in the up-coming election in that the election was a national election as opposed to a district or state-wide election. As stated earlier, A's signature of the letter is the most determinative factor as to political campaign intervention. It represents a forum for A to present positive aspects of his candidacy and negative aspects of his opponent.

[61] Accordingly, we hold as follows:

The A/X direct mail fund raising letters constitute intervention in a political campaign within the meaning of *section 501(c)(3) of the Internal Revenue Code*.

Issue 2:

[62] A's campaign received from X the mailing list containing approximately 43,800 names by August, 1996. A's campaign used these names in its fund raising efforts. A's campaign was limited to a one time use of the names according to the contract between the parties. A's campaign exceeded this use and we may assume that for purposes of this memorandum that A's campaign exercised more or less unrestricted use of [*37] the names during the campaign period. Near the end of July, 1996, X was compensated for the excessive use of the donor names by means of the transfer of 35,000 names of

donors to A's campaign to X for a one time use of such names for a fund raising effort on behalf of X in its prospect program.

[63] The question of political campaign intervention relates to whether (1) the transfer to and use by A's campaign of X's donor names was a legitimate business transaction and (2) the use of X's donor names in exchange for A's signature and the one time use of 35,000 campaign donor names of A by X is a fair market value exchange.

[64] X has customarily exchanged its donor name list with political figures who have signed the fund raising letters. If its prior history in this regard is deemed reasonable, then, most likely, the actions with respect to this case would be deemed reasonable. It is a question of fact whether the use of the donor list, in essence a "renting" of the list, is an appropriate business transaction. We can make two observations in regard to this question. First, X has used the names of political figures in the past as a means of promoting its direct mail fund raising campaign. [*38] Second, we know that the sale or exchange of lists between exempt organizations for fund raising purposes is not an uncommon practice.

[65] In summary, as to the subject case, we do not see why, in general, the transfer of the use of the organizations' donors list generated by virtue of the A/X fund raising mailing would not be considered an appropriate and legitimate business transaction.

[66] Care should be taken however to distinguish the situation where a candidate is given an unfair advantage. One example is where mailing lists have been made available on an exclusive basis which would deny their access to other potential candidates.

[67] There is the issue of whether X favored A's campaign by not using ordinary and prudent business practices in the direct mail fund raising industry to limit the overuse of the donor list. By utilizing the seeding technique, X could have protected itself against the overuse of its donor list and thus maintain its proprietary interest. In any case, X was able to discover the violation and it received compensation therefor.

[68] The District raises the argument that the transfer of X's list of donors to A's campaign in accordance with the agreement [*39] between the parties saved A's campaign, in essence, the financing costs and other costs of generating its own donor list. It was said that A got his A friendly list basically "for free" because X paid all the out of pocket prospecting costs. Further, the cost of prospecting for X was less than that for A's campaign because a nonprofit postal rate was available to X for the mailings which is not available to the A's Campaign.

[69] All of this may be true, but the fact remains that A's campaign received the donor list in consideration for A's signature. It did not receive the list as a gift but as bargained for consideration for the use of A's name and signature. If X had paid A cash consideration for his signature on the prospect mailings and the house file mailings, A's campaign could have used the cash to pay costs of developing a list of supporters. X's list transferred to A's campaign for use was originally for a limited one time use. Additional consideration was paid by A's campaign for the excessive use of the lists in violation of the contract between the parties. If the various exchanges were all at fair market value, A's campaign has gained no advantage by virtue of its transaction [*40] with X. In addition, it is clear that the letters signed by A were a successful fund raising vehicle for X in terms of actual donations generated and housefile lists developed.

[70] Our office is provided no information regarding the values related to the exchange of X's list of donors accumulated from the A/X fund raising effort. X has provided information suggesting that its practice of allowing only a one time use of the donor's list is more restrictive than the standard practice in the industry, where multiple use of the donor list would be deemed necessary to acquire the signature of a prominent elected official like A. Lacking the required valuation necessary to this determination, we are unable to say that X's actions in allowing a one time use by A of the developed mailing list from the A/X letters constituted an inappropriate or disproportionate financial benefit to A's campaign by X. As a result, we are unable to establish campaign intervention or campaign participation with respect to this issue.

[71] Accordingly, we hold as follows:

We lack sufficient valuation information on to the various exchanges to establish that the providing of the donor's list [*41] from the A/X direct mail fund raising effort to A constituted campaign intervention or campaign participation within the meaning of section 501(c)(3) of the Code.

Issue 3: Private Benefit

[72] Another issue raised in this matter is whether providing a list of donor names from the A/X fund raising effort to A for use in his campaign is private benefit under section 1.501(c)(3)-1(d)(1)(ii) of the Regulations.

[73] The resolution of such issue is unnecessary in light of our determination under issue 1 that the A/X fund raising letters constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Code.

Issue 4: Section 4955

[74] Does the section 4955 tax on political expenditures apply to the organization for the facts involved in issues 1 and 2, above?

[75] We find campaign intervention or campaign participation under section 4955 for the same reason as discussed under issue 1, above.

[76] Section 4955(a) of the Code imposes a tax on each political expenditure. Section 4955(d)(1) defines the term "political expenditure" to include any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including [*42] the publication or disbursement of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

[77] Accordingly, we hold as follows:

The A/X direct mail fund raising letters constitute intervention or participation in a political campaign within the meaning of section 4955(a)(1) of the Code.

Issue 5: Section 4955(a)(2) tax on organization managers

[78] Section 4955(a)(2) of the Code imposes a tax of 2 1/2 percent on the agreement of any organization manager to the making of any expenditure, knowing that it is a political expenditure, unless such agreement is not willful and due to reasonable cause. The language of this provision is very similar to the language of the provisions imposing taxes on a foundation manager under section 4941(a)(2) for self-dealing, under section 4944(a)(2) for jeopardizing investments, and under section 4945 for taxable expenditures. The language of each of these provisions contains a "knowing" clause; the tax is imposed only if the manager KNOWS that the expenditure is a prohibited expenditure (e.g., a political expenditure, a taxable expenditure, etc.). Each of these provisions contains a savings [*43] clause under which the tax will not be imposed where the action or agreement of the manager/foundation manager "is not willful and is due to reasonable cause."

[79] Similarly, section 53.4955-1(b) of the Foundation and Similar Excise Tax Regulations has provisions concerning the tax imposed under 4955(a)(2) that closely mimic the language of the Regulations under 4941, 4944, and 4945 with respect to the tax imposed on the foundation manager under those provisions.

[80] Section 53.4955-1(b)(4) of the Regulations addresses the "knowing" clause. Under this provision, the manager must have actual knowledge that the expenditure is a political expenditure. Evidence tending to show that the manager has reason to know that a particular expenditure may constitute a political expenditure is relevant in determining whether the manager has actual knowledge. Section

53.4955-1(b)(5) defines a manager's agreement as "willful" if it is voluntary, conscious, and intentional. A political expenditure is not willful if the manager does not know that it is a political expenditure. Section 53.4955-1(b)(6) provides that a manager's actions are due to reasonable cause if the manager has exercised his or [*44] her responsibility on behalf of the organization with ordinary business care and prudence.

[81] Section 53.4955-1(b)(7) provides a safe harbor if the manager relies on the advice of counsel, expressed in a reasoned written legal opinion, that an expenditure is not a political expenditure.

[82] By virtue of section 53.4955-1(b)(8), the burden of proof regarding the issue of whether an organization manager has knowingly agreed to the making of a political expenditure is placed on the Secretary under section 7454(b) of the Code.

[83] *Rev. Rul. 78-76, 1978-1 C.B. 377*, provides an example of the imposition of the tax under 4941(a)(2) on the participation of a foundation manager in an act of self-dealing defined in section 4941. The trustee of a trust that is a private foundation, representing both himself and the private foundation, willfully and without reasonable cause sells property he owns to the private foundation knowing that the sale is an act of self-dealing under section 4941.

[84] The tax under 4941(a)(2) of the Code was imposed on foundation managers in *Madden v. Commissioner, T.C. Memo 1997-395*. In that case [*45] the Court held that payments made to a janitorial and maintenance company which was a disqualified person with respect to the private foundation were self-dealing under 4941. Further, the Court imposed the tax under section 4941(a)(2) on the foundation managers. The Court concluded that the foundation managers possessed actual knowledge of sufficient facts concerning the transactions to establish that the arrangements with the disqualified person (maintenance company) were self-dealing transactions. The Court also noted that the foundation managers failed to obtain the advice of counsel with respect to the payments.

[85] The tax under section 4945(a)(2) was imposed on the foundation manager in the case of *Thorne v. Commissioner, 99 T.C. 67 (1992)*. The Court found that the manager knowingly made a taxable expenditure when he failed to exercise expenditure responsibility with respect to certain grant recipients. The Court reached this conclusion in spite of the manager's claim of reliance on the advice of counsel. The foundation manager received no written opinion of counsel and the Court also indicated that the record did not support a finding that the foundation [*46] manager received an oral opinion of counsel. As to a second grantee organization involving a taxable expenditure, the organization was not even formally organized at the time of the purported investigation of it. Further, because the foundation manager was himself a lawyer, the court concluded that he was aware that grants had to conform to certain requirements.

[86] The Request for Technical Advice Memorandum raises as issue 5 the following question:

Does the section 4955 tax on political expenditures apply to managers who knowingly participated in the acts involved in

An organization manager's agreement to an expenditure is ordinarily not considered knowing or willful and is ordinarily considered to be due to reasonable cause if the manager, after full disclosure of the factual situation to legal counsel (including house counsel), relies on the advice of counsel expressed in a reasoned written legal opinion that an expenditure is not a political expenditure under section 4955 (or that expenditures conforming to certain guidelines are not political expenditures).

[90] One could make the argument that the Memo dated May 25, [*47] 1995, addressed to M as Vice President & Treasurer of the X is just such a reasoned written legal opinion of counsel. The Memo

addresses two separate and distinct tax issues. The second is clearly identified in the subject heading of the memo as "A as Signatory." Beginning at the bottom of page 2 of the letter and following to the end on page 4, X's tax counsel discusses the issue of whether there is a section 501(c)(3) problem.

[91] The May 25, 1995, memo is relatively brief and does not discuss all the tax issues related to the A/X letters in terms of campaign intervention or participation. Nevertheless, it could be argued that the memo does qualify as a written legal opinion described in section 53.4955-1(b)(7) of the Regulations. It is reasoned. It discusses various aspects of using the signature of a politician INCLUDING ONE WHO IS AN ACTIVE CANDIDATE FOR POLITICAL OFFICE in terms of whether the release of the mailing list to the A's campaign is appropriate as quid pro quo. It discusses the chances of success of an IRS challenge to the list transfer. It discusses the value to the organization of list names and mentions the United Cancer Council case pending in the Tax Court as [*48] supporting the proposition that the mailing list has value to the organization.

[92] In the end it makes little difference whether one would treat the May 25, 1995, memo as qualifying as a reasoned written legal opinion described in the Regulation cited above. That same Regulation also provides that the ABSENCE OF WRITTEN ADVICE OF COUNSEL meeting the precise definition of the Regulations does not, by itself, give rise to any inference that an organization manager agreed to the making of the expenditure knowingly, willingly, or without reasonable cause.

[93] The facts disclosed in this case indicate that this organization has received significant ongoing and intensive legal advice from qualified legal counsel knowledgeable in tax matters. It is the statement of the organization's legal counsel that he rendered his legal opinion on this matter verbally. He indicated that he reviewed the A letter line by line. He reviewed the A letter text and the use of A's signature. His verbal approval of the A letter included review of the format, text, and related materials. In light of the verbal legal opinion expressed by X's tax counsel taken in conjunction with the Memo of dated May 25, 1995, [*49] it is very difficult to say that X's managers either (1) knew that the expenditure to which the managers agree is a political expenditure or (2) that the agreement is willful and not due to reasonable cause. The test applied under section 53.4955-1(b)(4) in determining whether an organization manager is considered to have agreed to an expenditure knowing that it is a political expenditure, is as follows;

(A) The manager has actual knowledge of sufficient facts so that, based solely upon these facts, the expenditure would be a political expenditure;

(B) The manager is aware that such an expenditure under these circumstances may violate the provisions of federal tax law governing political expenditures; and

(C) The manager negligently fails to make reasonable attempts to ascertain whether the expenditure is a political expenditure, or the manager is aware that it is a political expenditure.

[94] In this regard, the actions of X's managers may be contrasted with the foundation manager in *Rev. Rul. 78-76* and the *Madden* case, *supra*, where the foundation manager(s) (1) had knowledge of the elements [*50] making up a self-dealing transaction, (2) were aware of the specific payments being made (which were later determined to constitute self-dealing, and, (3) failed to consult qualified legal counsel (consulting only a non-lawyer in *Madden*). Thus, the actions of such foundation Manager(s) were determined to constitute participation in self-dealing acts.

[95] In summary, even if one were to reach the conclusion that the exception provided by section 53.4955-1(b)(7) was not available for X's benefit in this case, there is a lack of support to suggest that X's managers agreed to an expenditure "KNOWINGLY" or that such agreement is "willful and is not due to reasonable cause." To the contrary, the information that does exist in the file on this matter suggests that X's managers agreed to the expenditure in question without knowing it was a taxable expenditure and

that it was not willful because they did not know that it was a political expenditure.

[96] Accordingly, we hold as follows:

The tax imposed under section 4955(a)(2) on the management does not apply to the managers of X in that the participation of such managers in the acts described above, as a political expenditure, [*51] was not knowing, and it is excused as not willful and is due to reasonable cause, for the reasons stated above.

Issue 6: Section 7805(b) Treatment:

[97] To what extent should any adverse conclusion of law under section 501(c)(3) or section 4955 be made prospective or retroactive, in recognition of the technical advice of 1979, the ruling letter of December 10, 1991, the examination of prior years returns, or for any other reason by virtue of the application of section 7805(b) of the Code?

[98] The Commissioner, Tax Exempt and Government Entities Division (T) declines to grant relief in this case pursuant to section 7805(b) of the Code.

[99] CONCLUSION

1. The A/X direct mail fund raising letters constitute intervention in a political campaign within the meaning of *section 501(c)(3) of the Internal Revenue Code* (whether or not the letters were sent in cooperation with the candidate).

2. We lack sufficient information regarding the values of the exchanges to X versus the value of A's signature to X to establish that the providing of the donor's list from the A/X direct mail fund raising effort to A constituted campaign intervention within the [*52] meaning of section 501(c)(3) of the Code.

3. Resolution of the private benefit issue is unnecessary in light of our determination under issue 1 that the A/X fund raising letters constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Code.

4. The A/X direct mail fund raising letters constitute intervention in a political campaign within the meaning of section 4955(a)(1) of the Code.

5. The tax imposed under section 4955(a)(2) on the management does not apply to the managers of X in that the participation of such managers in the acts described above, as a political expenditure, was not knowing, or if knowing, it is excused as not willful and is due to reasonable cause for the reasons stated above.

6. The Commissioner, Tax Exempt and Government Entities Division (T) has denied the requested relief under section 7805(b).

[100] A copy of this technical advice memorandum is to be given to the organization. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

