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Regulation of Political Organizations and the Red Herring of Tax Exempt Status

Abstract - Congressional codification of section 527 in 1975 largely reflected the IRS's treatment of political organizations at the time, including that contribution income was not taxable income, and did not provide a significant tax subsidy. In 2000, Congress amended section 527 to impose reporting obligations and, simultaneously, made section 527 voluntary, thus reviving pre-1975 law. The lack of a significant subsidy undermines the effectiveness of imposing burdens on section 527 organizations where there is a choice of tax treatment. The lack of a significant subsidy also raises the constitutional bar to imposing any burdens on section 527 organizations.

INTRODUCTION

Political activity by exempt organizations is much in the news. The 2004 presidential election cycle introduced the electorate to ACT (Americans Coming Together), Moveon.org, and Swift Boat Veterans for Truth, all political organizations organized under section 527 of the Internal Revenue Code of 1986 (the "Code").¹ In this election year, new political organizations are being formed and will raise and spend considerable sums to influence the outcome of elections.² Congress is considering legislation that would treat certain section 527 organizations as political committees under the Federal Election Campaign Act ("FECA") and, thus, subject donors to these groups to contribution limits,³ thereby restricting the ability of such section 527 organizations to raise money.

This article is about the tax treatment of political organizations and efforts to subject them to additional regulation. This article does not take sides in the campaign finance debate about whether to treat section 527 organizations as political committees under the FECA, but rather examines questions raised by present law and the possible outcomes of increased

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¹ All section references in this article are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

² The Code defines a political organization as "a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function" (sec. 527(e)(1)).

³ The current limit on individual contributions to political committees, not including committees controlled by candidates or committees of political parties, is \$5,000 each calendar year (2 U.S.C. 441a(a)(1)(C)).

regulation. The article's central points are that codification of section 527 did not provide a significant tax subsidy to political organizations and that, since changes to the law in the year 2000, organization under such section is elective. Both points should be considered by policymakers, as both points have implications for tax policy, campaign finance reform, and constitutionality. To the extent section 527 offers only a limited subsidy and such section is voluntary, organizations may choose not to organize under such section if the burdens of doing so become too great. In addition, to the extent section 527 offers only a limited subsidy, any restrictions imposed under such section are subject to a greater constitutional burden.

ABSENCE OF A TAX SUBSIDY

Background

"[T]ax exemptions . . . are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income" (*Regan v. Taxation With Representation of Washington*, 1983). Thus, the Supreme Court opined on the meaning of a tax exemption in upholding the constitutionality of the rule that no substantial part of a section 501(c)(3) organization's activities may consist of lobbying. The notion of a tax subsidy was important to the case in that the provision of a subsidy by Congress—income tax exemption and eligibility to receive deductible contributions—justified the imposition of a restriction on a fundamental right—freedom of speech in the form of lobbying.

Although tax exemption reflexively is considered to be a subsidy, there are reasons other than subsidy for conferring a

statutory tax exemption, such as the structure of an organization. Take, for example, the case of social clubs—e.g., golf and country clubs, hobby clubs, and similar organizations—which are organized under section 501(c)(7) of the Code. In general, social clubs are funded exclusively by and expend funds exclusively for the benefit of the club's members. Under general tax principles, the club is not considered to have income because there is no shift of benefit from the members to the organization—"the organization merely facilitates a joint activity of its members" (Joint Committee on Taxation, JCX-29-05, 28). Accordingly, Congress explained the 1916 exemption for social clubs (in the context of imposing tax on their investment income in 1969) as follows: "the tax exemption operates properly only when the sources of income of the organization are limited to receipts from the membership [and not, for example, investment income]. Under such circumstances, the individual is in substantially the same position as if he had spent his income in pleasure or recreation (or other benefits) without the intervening separate organization" (S. Rep. No. 91-552). In other words, the exemption for social clubs is not a subsidy, but reflects the operation of general tax principles.⁴

Thus, the nature and extent of any subsidy should not be established merely by reference to an organization's tax exempt status under the Code. That is, just because the Code provides for full or limited tax exemption of an organization does not mean that the organization has received a subsidy. Rather, the existence of any subsidy should be established by comparing the tax treatment of an organization under the general principles of tax law (and general Code rules) versus

⁴ Congress also may decide to confer tax exempt status for administrative convenience and not to provide a subsidy as such. This also contributed to the exemption for social clubs; for example, Congress said in 1916 that "the securing of returns from them has been a source of annoyance and expense and has resulted in the collection of either no tax or an amount which is practically negligible" (H.R. Rep. No. 922, at 4).

the tax treatment of such organization irrespective of the specific Code-based exemption.⁵ Any positive difference in tax treatment may be viewed as a provision by the Congress of a subsidy to the organization, as posited by the *Regan* Court, in the amount of tax it otherwise would have had to pay on its income.

Section 527 organizations are an example of a class of organization with a tax-exempt status under the Code where the exemption conferred was not intended to provide a subsidy. Rather, the tax treatment provided under section 527 substantially reflects the tax treatment of political organizations by the Internal Revenue Service ("IRS") prior to enactment of section 527, and was intended to resolve uncertainty in application of the law to political organizations. In other words (except with respect to application of the gift tax to contributors), section 527 is mostly a codification of the result that generally inured at the time under application of normal tax principles to political organizations by the IRS.

Present Law Tax Treatment

The present law tax treatment of section 527 organizations may be summarized

as follows. A section 527 organization is subject to tax on "political organization taxable income." Political organization taxable income is defined as gross income less deductions (not including the net operating loss deduction or deductions allowed to corporations under sections 241 through 249). Not included in an organization's gross income is any "exempt function income" that is segregated for use only for the "exempt function" of the organization.⁶ Exempt function income is defined in section 527(c)(3) as a contribution⁷ of money or other property; membership dues, a membership fee or assessment from a member of the political organization; proceeds from a political fundraising or entertainment event, or proceeds from the sale of political campaign materials, which are not received in the ordinary course of any trade or business; or proceeds from the conducting of any bingo game that would be exempt from the unrelated business income tax.⁸ Section 527 organizations are not subject to the unrelated business income tax.⁹ Deductions related to the production of exempt function income are not allowed. There is a specific deduction of \$100. The tax is paid at the highest corporate rate,¹⁰ except that net capital gains generally are

⁵ How a subsidy is measured depends on the base against which a rule is assessed. This article asks whether section 527 of the Code provides a subsidy as compared to the law in effect before section 527 was enacted. This approach is especially pertinent considering that, since burdens were imposed on section 527 organizations and treatment under section 527 became voluntary in 2000, whether section 527 provides favorable tax treatment is relevant as a practical matter as organizations decide whether to opt in or opt out, i.e., the base for comparison is how the organization would be treated outside of section 527.

⁶ Exempt function is the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed (sec. 527(e)(2)).

⁷ A contribution includes "a gift, subscription, loan, advance, or deposit, of money, or anything of value, and includes a contract, promise, or agreement to make a contribution, whether or not legally enforceable" (secs. 527(e)(3) and 271(b)(2)).

⁸ Bingo game proceeds were added to the definition of exempt function income in 1978, generally effective for taxable years beginning after December 31, 1974.

⁹ There is no reason for them to be subject to unrelated business income tax because income other than exempt function income is subject to tax.

¹⁰ For section 527 organizations that are principal campaign committees, the graduated corporate rates apply. As originally enacted in 1975, the graduated corporate rates applied to all section 527 organizations (the surtax exemption generally available to taxable corporations was not available to section 527 organizations). In

subject to tax at the capital gains rate (secs. 527(b)(2) & 1201(a)).

In short, section 527 provides a limited federal income tax exemption. The only amounts specifically exempt from tax are "exempt function income," and such income must be segregated for use and used only for an exempt function. All other income, including investment income and exempt function income that is not spent on an exempt function, is subject to tax at the highest corporate rate (less applicable deductions). Although political organization taxable income does not benefit from the corporate marginal rates, section 527 otherwise generally preserves the tax treatment that would apply to the income if it were incurred by a taxable corporation—e.g., the alternative tax that applies in the case of capital gains.

Historical Tax Treatment

How does the tax treatment provided by section 527 compare to the tax treatment provided prior to the enactment of section 527 in 1975? The tax treatment of political organizations dates at least to 1939, when the IRS declared that "a political gift received by an individual or by a political organization is not taxable income to the recipient" (I.T. 3276). In the late 1940s, the IRS provided in an unpublished directive to the field that political parties and political organizations were not required to file federal tax returns (Ann. 73-84). So, for a period of years, political organizations were entitled generally to full federal income tax exemption.

However, with respect to non-contribution income, the IRS position began

to change as the IRS learned that some political organizations generated investment income with unexpended funds. The IRS also started to consider whether contribution income that was diverted for a non-political purpose should be subject to tax. The IRS required in private rulings that certain political organizations with investment income (mostly interest income) file tax returns (Streng, 1976, footnote 21). Such a position reflects a change in understanding that a political organization is not necessarily a short-lived conduit, but may have a sustained existence and conduct investment activities. In 1954, the IRS reiterated the 1939 ruling that political gifts are not taxable income, but also provided that if such gifts were diverted for other purposes then they are taxable ("[w]here a political gift is received by an individual or a political organization and it is held or used for the purposes intended, i.e., for present or future expenses of a political campaign or for some similar purposes, it is not taxable income to the recipient" (Rev. Rul. 54-80)).

In 1967, the IRS argued in *Communist Party of the USA v. Commissioner* that political parties were taxable associations and that member dues were taxable income, although the court never ruled on the questions. In 1968, the IRS articulated formally that income on unexpended funds "may" be reported on a return (Rev. Proc. 68-19); and finally, in 1973, the IRS provided that political organizations must file income tax returns despite the longstanding IRS practice to the contrary, and that unincorporated political organizations may be treated for tax purposes as corporations, trusts, or possibly partner-

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1978, Congress changed the rule to provide that political organization taxable income generally was subject to the highest corporate rate of tax. In 1981, Congress reintroduced graduated rates, but only for section 527 organizations that are principal campaign committees. In providing that the highest rate of tax applies, and not the graduated rates, Congress treats the political organization taxable income of section 527 organizations worse than the equivalent income of a taxable corporation. It could be argued that this generally is the right result, however, because if exempt function income were taken into account, the organization generally would be subject to the highest marginal rate. Therefore, it makes sense to apply such rate at the outset to political organization taxable income. But as is discussed below, contribution income has not been treated as taxable income in any event and so would not be taken into account in applying the corporate graduated rates.

ships depending on the facts and circumstances (Ann. 73–84). The IRS explained in 1974 that political organizations were not tax exempt organizations because there was no provision in the Code providing a specific basis for exemption (Rev. Rul. 74–21).

In short, before Congress intervened in 1975, the IRS position essentially was that political organizations were taxable, but, dating from the 1939 ruling, that political gifts were not taxable income. The net effect was to provide for tax on the investment income of political organizations—the same general result provided by the Congress in enacting section 527.

Scope and Rationale for Excluding Political Gifts from Income

The scope of the historical IRS position that political gifts are not taxable income is not entirely clear, as the IRS rulings that provide for exemption do not consistently describe the amounts excluded. For example, exemption is provided for “political gifts” received by a “political organization” (I.T. 3276), “political gifts” received by a “political organization” held for “expenses of a political campaign or some similar purpose” (Rev. Rul. 54–80), “political funds” collected “for” a “candidate” and used for “expenses of a political campaign or some similar purpose” (Rev. Rul. 71–449), “donations received by [political] committees and parties” (Ann. 73–84), and “campaign contributions” (Rev. Rul. 74–21). At least as of 1968, “political gifts” also included “proceeds derived from fund-raising dinners” received by “political candidates” (Rev. Proc. 68–19; Gen. Couns. Mem. 33622). The IRS argued in *Communist Party* that political gifts subject to the exclusion did not include member dues; however, the court did not rule on the question and

noted that the significance of this distinction should have a proper hearing (*Communist Party*, footnote 2).

The general rule seems to have been that political funds provided to a political organization were excludable; however, the contributions and the political organizations under consideration then were not as broad as the contributions and political organizations that are made and that exist today.¹¹ For example, one could argue that, in general, political organizations before 1975 typically were political parties or candidate committees and that the IRS rulings extended to gifts to these types of political organizations and not to today’s independent political organizations (i.e., those not explicitly tied to a candidate or campaign). This raises the question whether independent political organizations would or should be treated differently than other political organizations for purposes of determining whether a political gift is taxable income. Although it is difficult to apply the IRS pre-1975 position to the political organizations of 2006, given that in general, the IRS position before codification of section 527 was to tax the investment income of a political organization and not other income (unless it was diverted for a non-political purpose), and Congress codified this position, it may be reasonable to assume, though the premise has not been tested, that contributions to political organizations as now provided by the Code are largely coextensive with income that would be considered by the IRS under pre-1975 law to be exempt from taxation.

The rationale for excluding contributions from taxable income also is not clear. In enacting section 527, Congress opined that the IRS historical practice of not requiring tax returns of political organizations “[p]resumably . . . resulted from the belief that virtually all of the receipts of

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¹¹ As discussed below, this potentially becomes an important issue after the year 2000 changes to section 527, which, as argued below, revived the relevance of this body of law.

political organizations were from gifts and that these organizations would not have taxable income" (S. Rep. No. 93-1357, 25). However, the IRS explicitly rejected the notion that political contributions were excludable as gifts under section 102, stating in 1974 that "the precise justification for excluding political campaign expense contributions from gross income has never been clearly articulated. It is clear however, that the justification for excluding political campaign expense contributions from income is not that the contributions are gifts within the context of Code [section] 102" (Gen. Couns. Mem. 35664).

Instead, the exclusion is based on a conduit theory—namely that the political organization is in a quasi-trust relationship with its contributors and, thus, the organization should not have income with respect to its contributions (Gen. Couns. Mem. 35462). In 1990, in another context, the IRS noted that Congress misunderstood the basis for excluding contribution income, yet the IRS still characterized codification of the exemption for contribution income as "essentially codify[ng] the conduit concept." The IRS stated that its adoption of a conduit approach for this type of income "could be said to represent a unique case, however, and legislative codification was ultimately felt to be necessary" (Gen. Couns. Mem. 39813, footnote 35).¹² Although it is somewhat specious for the IRS to argue that Congress codified the conduit concept if Congress thought that the basis for the exclusion was a gift rationale, in any event, the result of the codification is clear—contributions to political organizations are not, and historically have not been, taxable income.

Tax Treatment if Section 527 Was Repealed

Fast forward to today, and pose a hypothetical question: what would be the result if Congress repealed section 527 of the Code? The answer is that, from a tax perspective, in substance, not much would change. The investment income of political organizations would continue to be subject to tax. Other income that does not meet the current definition of exempt function income would continue to be subject to tax, though at lower rates than under section 527 (except in the case of principal campaign committees, which currently benefit from the graduated rates). So at least for non-exempt function income, there would continue to be taxation. The more favorable rates available to a non-section 527 political organization, and the ability to be taxed other than as a corporation, point to, at least with respect to such income, better treatment outside of section 527 than within.

The main question then would be the taxation of exempt function income, i.e., the income that explicitly is made exempt under current law. As noted above, exempt function income currently is of four kinds: (1) contributions of money or other property; (2) membership dues, a membership fee or assessment from a member of the political organization; (3) proceeds from a political fundraising or entertainment event, or proceeds from the sale of political campaign materials, which are not received in the ordinary course of any trade or business; or (4) proceeds from the conducting of any bingo game that would be exempt from the unrelated business income tax.

¹² The basis of the exclusion is clouded further by use of both terms "gross income" and "taxable income" when the exclusion is described. If political contributions are not gross income, this would support a conduit theory of exclusion; if political contributions are gross income but are not taxable income, this would support a gift theory of exclusion. The 1939 ruling provided that political gifts are not taxable income. The 1954 ruling was broadly cast as a ruling about what is included in gross income, but the language of the ruling addresses whether the income is taxable income to the organization. The later rulings consistently describe the exclusion as from gross income. Nonetheless, this underlines the IRS's 1974 statement quoted above that the basis for the exclusion was never clearly articulated.

The latter three arguably would be subject to tax if the specific exemption provided by section 527 was repealed. However, this largely depends on the scope of the pre-1975 exclusion for political gifts. For example, the IRS argued in *Communist Party* that membership dues or fees were not excludable political gifts but were taxable income to the organization. However, member fees or dues may not be taxable income under general tax principles in some circumstances, for example, as described above, in the case of a social club. And, as noted above, the court did not rule on the question and indicated that the distinction between campaign contributions and member dues should be studied further. Proceeds from political fundraising or from sales of political materials could be subject to tax much like other proceeds from conducting a trade or business are subject to tax. Whether they would be is not entirely clear, however, because the IRS in 1968 treated proceeds derived from fundraising dinners the same as other political gifts, i.e., as excludable from income (Rev. Proc. 68-19; Gen. Couns. Mem. 33622). Bingo game proceeds likely would be considered taxable, as they were prior to their inclusion in the definition of exempt function income in 1978, or it is possible such proceeds could be viewed as a type

of "political gift" subject to the same exclusion as political fundraising.

In any event, likely the most significant source of income for political organizations, contributions of money or other property, would continue to be exempt from tax under the IRS's longstanding position, taken in 1939 and reiterated in 1974, that "political gift[s]" and "campaign contributions are not includible in the gross income of the organization." This position of the IRS could, of course, be revisited by Congress (or for that matter the IRS)¹³ if Congress were to provide specifically that contribution income is not excluded,¹⁴ but for purposes of evaluating whether section 527 provides a subsidy as compared to pre-section-527 law, the answer with respect to contributions is that it does not.¹⁵

Constitutional Significance of Subsidy and the Mobile Republican Assembly Cases

Consideration must be given to the district and appellate court decisions in *National Federation of Republican Assemblies v. United States* and *Mobile Republican Assembly*, in which a challenge to the constitutionality of the year 2000 changes to section 527, specifically to the disclosure rules of section 527(j), was considered.¹⁶ In an opinion vacated on

¹³ Because of the IRS's historical position on treating political gifts and contributions as excludable, absent a specific provision by Congress that such amounts are taxable income, the IRS could be hard-pressed independently to change course.

¹⁴ If, contrary to pre- and post-section-527 codification, contributions to political organizations were treated as taxable income, without modification, section 162(e) generally would apply and deny the political organization any deduction for its expenses. This would treat political organizations, for whom political activity is in effect the "trade or business" of the organization, worse than other taxable organizations that generally are permitted to deduct trade and business expenses. Because political organizations have long been viewed as not taxable on their contributions, the implications of applying section 162(e) in this context have not generally been considered, but should be if subjecting contribution income to tax ever becomes a serious legislative initiative. Application of section 162(e) generally is not problematic so long as political contributions are not treated as gross income, which is consistent with the Congressional statement that "political activity (including the financing of political activity) as such is not a trade or business which is appropriately subject to tax" (S. 93-1357, 25).

¹⁵ For a different approach and view of this issue, see Tobin (2003).

¹⁶ The district court decision was *National Federation of Republican Assemblies v. United States*, 218 F. Supp.2d 1300 (S.D. Ala 2002). The appellate court decision was *Mobile Republican Assembly v. United States*, 353 F.3d 1357 (11th Cir. 2003). In this article, the decisions will be referred to generically together as *Mobile Republican Assembly*.

appeal, the district court concluded that the IRS's historical position that political contributions were excludable from gross income was incorrect, and that section 527 provided a subsidy with respect to such income. Because section 527 provided such a subsidy, the court viewed the new section 527(j) disclosure of contribution rules as a condition of tax exemption and, therefore, within Congress's power under the Supreme Court's analysis in *Regan*. As noted above, the Court held in *Regan* that Congress could impose restrictions on a fundamental right (free speech) as a condition of tax exemption, where the exemption provides a subsidy. However, the district court also concluded that to the extent a restriction imposed by Congress "goes beyond the cancellation of a subsidy and imposes an additional exaction," *Regan* is inapposite and the constitutionality of the provision must be supported, or not, elsewhere (e.g., *Buckley v. Valeo*). The district court went on to hold that the penalty on undisclosed expenditures imposed an exaction in excess of the subsidy, that the *Regan* analysis did not apply to that extent, and that that portion of section 527(j) relating to expenditures was unconstitutional under *Buckley* and the First Amendment. The appellate court disagreed with the district court's characterization that any part of section 527(j) was an additional exaction, but rather viewed the entire disclosure regime as imposition of a condition of a tax subsidy provided by Congress. This mattered because as part of an overall tax subsidy (and not part of a penalty regime), the Anti-Injunction Act barred suit, permitting the appellate court to vacate the district court's opinion with orders to dismiss the case on jurisdictional grounds.

Technical aspects of the holding aside, under the appellate court's view, *Regan* applied to all of the burdens imposed under section 527(j) (not just the contribution disclosure requirements), meaning that Congress was permissibly placing

conditions on the exercise of a fundamental right because such conditions were requisite to a "voluntary tax subsidy." The appellate court did not, however, analyze the extent to which section 527 actually provides a subsidy—or how such a subsidy should be measured. As noted above, the *Regan* court said that a subsidy can be viewed as the amount of tax an organization would have had to pay on its income. And as argued above, with respect to contribution income (and perhaps other exempt function income), section 527 does not provide a subsidy in this sense. In any event, under both the district and appellate courts' analyses, the extent to which section 527 provides a subsidy is relevant in the constitutional context—the more limited is the subsidy, the greater is the constitutional burden on any restriction. It could be argued that the outcome of the case might have been different (and the disclosure regime of section 527(j) held unconstitutional) if the nature of the subsidy provided by section 527 had been more closely examined.

Treatment of Contributions Under the Gift Tax

The question of subsidy is not complete without consideration of the treatment to contributors to a section 527 organization under the gift tax. Section 2501(a)(4), enacted in conjunction with section 527, provides that the gift tax does "not apply to the transfer of money or other property to a political organization (within the meaning of section 527(e)(1)) for the use of such organization." At the time, Congress decided that it was "inappropriate to apply the gift tax to political contributions because the tax system should not be used to reduce or restrict political contributions" (S. Rep. No. 1357, 32). This gift tax exemption, although not directed to the tax treatment of the organization, could and perhaps should be considered as a subsidy to the organization because it

arguably makes it easier for section 527 organizations to raise funds and so to conduct their activities.¹⁷

Apart from the question of whether, as a practical matter, the gift tax exemption results in additional contributions to political organizations, to test for the existence of a subsidy, one needs to query whether repeal of the Code-based rule would change the tax treatment of such transfers. This is a somewhat open question. Prior to codification of section 527, the IRS took the position that gifts (in excess of the annual exemption amount) to political organizations were subject to the gift tax (Rev. Rul. 72-355). However, in *Stern v. United States*, the Fifth Circuit held that under the facts of the case, political contributions were not taxable gifts because the contributions fit within a regulatory exception to imposition of the gift tax (namely on transfers that are bona fide, at arm's length, and free from any donative intent). Although the holding is fact specific, the case called into question the IRS's position on imposing gift tax on political contributions.

Enactment of section 2501(a)(4) of the Code made the question moot as to tax years after 1974, but the issue received further hearing in *Carson v. Commissioner*.

In *Carson*, the IRS again asserted that, with respect to tax years before 1975, political contributions (the direct payment of campaign expenses and contributions to campaign funds) were subject to the gift tax. However, the Tenth Circuit agreed with the Tax Court's holding that "campaign contributions . . . , when considered in light of the history and purpose of the gift tax, are simply not 'gifts' within the meaning of the gift tax law." In 1982, the IRS acquiesced in the *Carson* result, but not in the reasoning of the case. The IRS explained its acquiescence as resulting from its defeats in *Stern* and *Carson*, and thereby acknowledged that enactment by Congress of section 2501(a)(4) did not represent a "change from the law applicable to transfers made prior to the effective date of [section 2501(a)(4)]" (Rev. Rul. 82-216).¹⁸

On the one hand, the IRS acquiescence in *Carson* can be viewed on its own terms, namely that codification of the gift tax exemption for transfers to political organizations merely clarified existing law and, therefore, does not reflect provision of a subsidy by Congress for such transfers. On the other hand, prior to its defeats in *Stern* and *Carson*, the IRS had long held that such transfers were subject

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¹⁷ Relevant to the question of subsidy is whether the gift tax exemption for contributors results in more contributions to section 527 organizations than would occur absent the exemption. Although it is beyond the scope of this article, it would be instructive to consider whether the absence of a gift tax exemption for gifts to section 501(c) organizations (other than to section 501(c)(3) organizations, transfers to which are exempt from gift tax) has limited the ability of such organizations to raise money. For example, many section 501(c)(4) organizations (social welfare organizations) conduct political activities, such as seeking to influence ballot measures or referenda, that are very similar in nature to section 527 activities (though are not within the definition of an exempt function activity under section 527). These organizations manage to attract contributions to fund these activities without the benefit of a gift tax exemption on gifts to the organization.

In other words, the gift tax exemption is not necessary to the ability of a class of organization to raise funds. This could be for any number of reasons: (1) the gift tax could be unevenly enforced; (2) contributors may be indifferent to the gift tax; (3) transfers may be structured in such a way as to fit within an exception to the gift tax. For example, as discussed below, in *Stern v. United States*, the court held that the transfer fit within an exception to the gift tax. It is reasonable to suppose that if the gift tax applied to gifts to political organizations, contributors would endeavor to find ways to avoid its imposition (some of the possibilities are illustrated in Rhomberg (2003)). There also are serious constitutional issues raised if the gift tax were imposed on gifts to political organizations, concerns that exist under the present law imposition of gift tax on gifts to 501(c) organizations for the purpose of conducting political activities (Rhomberg, 2004).

¹⁸ The IRS's refusal to agree to the reasoning of *Carson* was due to its concern that the *Carson* rationale could be extended to exempt from the gift tax any transfer, not just a political contribution, "for the purpose of advancing the donor's social, political, or charitable goals."

to the gift tax. Absent enactment of section 2501(a)(4), it is impossible to know whether the IRS would have continued to assert its position, or even whether the result in *Carson* might have been different, as the case would have been litigated with a different legal background. In enacting section 2501(a)(4), Congress made its position clear, but noted that "there is some uncertainty in the law as to whether political contributions are properly taxable as gifts" (S. Rep. No. 1357, 32). Thus, on balance, it is hard to state definitively whether the Code-based gift tax rule is a clarification of the law or a Code-based benefit to contributors to political organizations.¹⁹

Summary

In summary, as compared to the law before 1975, section 527 does not provide a subsidy with respect to a political organization's contribution income. Section 527 arguably provides a subsidy to political organizations by not subjecting to the federal income tax any such organization's membership dues and fees or assessments, proceeds from political fundraising or entertainment events, proceeds from the sale of political campaign materials that are not received in the ordinary course of any trade or business, and proceeds from the conducting of any bingo game that would be exempt from the unrelated business income tax, if only because the historical position on these items was not

entrenched at the time of codification. Any subsidy that section 527 provides should be measured against the comparatively less favorable tax treatment that section 527 organizations have with respect to the rate of tax (whether through utilization of the corporate marginal rates, or through choice of entity), as compared to a political organization not taxed under section 527.

In short, the notion that section 527 provides a tax subsidy is exaggerated. Enactment of section 527 and section 2501(a)(4) was driven not by any intention to provide a subsidy to political organizations; rather, as it has done with respect to other organizations over the years, Congress decided to provide clarity to the tax treatment of political organizations and transfers thereto. The tax treatment Congress provided, except with respect to the gift tax, was markedly similar to that prevailing under the law at the time. Absent section 527, there likely would be little gain to the federal government in the sense, as articulated by the Court in *Regan*, of retaining cash payments that, absent section 527, otherwise would be made by political organizations. This has implications for political organizations that, as argued below, may opt out of treatment under section 527, and also raises the constitutional burden under *Regan*.

SECTION 527 IS VOLUNTARY

Enactment of section 527 in 1975 was a non-event from the standpoint of making

¹⁹ Hypothetically, if Congress repealed section 2501(a)(4), but did not affirmatively subject contributions to political organizations to the gift tax, without more, under *Stern*, *Carson*, and Revenue Ruling 82-216, contributions to political organizations arguably would still be exempt from gift tax. In addition, donors likely would respond by structuring transfers to political organizations in such a way so as to escape gift tax (see generally Rhomberg (2003)). If Congress repealed section 2501(a)(4) while also affirmatively providing that some or all contributors to political organizations are subject to the gift (or other) tax, there would be questions about the constitutionality of such an exaction on political speech—it could be viewed as a discriminatory limit on free speech with no significant countervailing governmental interest (apart from the desire to raise revenue). As a practical matter, an affirmative imposition of the gift tax on political contributions generally would affect contributors to political organizations that are not FECA political committees and would not affect contributors to certain FECA political committees because the FECA limitations on contributions to FECA political committees would in some cases ensure that any such contributions are below the annual exclusion amount for purposes of the gift tax.

changes to the tax (or campaign finance) laws. Although section 527 was important to provide clarity and certainty, it did not usher in any substantive change to the taxation of political organizations.²⁰ Section 527, as enacted, also was primarily a tax statute, meaning that the substance of the law was driven by tax considerations. The operative question at that time was what should be the tax treatment of political organizations.

This all changed in 2000, when Congress made significant modifications to the structure and substance of section 527. As has been well documented, the 2000 law was the result of the actions of so called "stealth" section 527 organizations during the presidential primary elections. The term "stealth" organization arose because section 527 organizations that primarily engaged in issue advocacy and, thus, were not considered political committees as defined by the FECA (and, thus, were not subject to FECA disclosure, contribution, or expenditure rules) emerged to influence the primary elections through hard-nosed advertisements.²¹ The organizations were considered stealthy because information about their contributors, unlike FECA political committees, was not made public so they could operate virtually anonymously.

The Congressional response was to add notification and disclosure requirements to section 527 organizations that were not required to report under the FECA. Although these rules were modified in 2002 legislation,²² the new regime requires that an organization notify the IRS within 24 hours of its formation that it is a political

organization and that it disclose all contributors making contributions of \$200 or more and all expenditures (including to whom made) of \$500 or more. The year 2000 (and 2002) changes to section 527 were not driven by tax policy, but reflected concerns with the types of organizations not covered by the campaign finance rules. Instead of amending the FECA, however, FECA-like disclosure rules were imposed through the tax Code.

The implications of the 2000 law for tax policy are significant. The 2000 law introduced voluntariness to the tax treatment of political organizations under section 527. Prior to 2000, the critical language of section 527 was that of section 527(a), which has never changed, and which reads in part: "A political organization shall be subject to taxation under this subtitle only to the extent provided in this section." This language is pretty clear. Read alone, it provides that if an organization is a political organization, then it is subject to tax only as provided by section 527. In other words, section 527 is not voluntary but provides the exclusive means of taxation of a political organization (as defined in section 527(e)(1)). The IRS confirmed this in nonprecedential guidance issued on June 19, 2000 (FSA 200037040).²³ That section 527 was historically not voluntary made sense as a general matter because prior to 2000, section 527 was exclusively about tax treatment and was enacted with the purpose of providing certainty.

The meaning of the quoted language in section 527(a) is modified, however, by the year 2000 law's addition of section 527(i). Section 527(i)(1) provides in part that "an

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²⁰ Codification of the rule that transfers to political organizations are not subject to the gift tax could be viewed as a change favorable to political organizations depending on whether it is viewed as a clarification of existing law or a change in law.

²¹ See, e.g., Hill (2000) and Briffault (2005, 959).

²² For a description of the 2002 modifications, see Joint Committee on Taxation (JCS-1-03, 293-9). The author worked on the 2002 legislation.

²³ The FSA was published September 15, 2000, after the effective date of the 2000 law. But the FSA's issue date of June 19 indicates that its discussion is relevant with respect to the pre-2000 section 527, and nothing in the FSA can be read to the contrary.

organization shall not be treated as an organization described in this section . . . unless it has given notice to the Secretary . . . that it is to be so treated." This language by its terms places a condition on any organization being described in section 527. Failure to meet the condition, i.e., to file the requisite notice, means that the organization is not treated as a political organization under section 527. So, although on the one hand, section 527(a) provides that a political organization is subject to tax under section 527, whether a political organization is in fact subject to the rules of section 527 depends, under the language, and general rule, of section 527(i)(1), on whether the organization files a notice with the Secretary. The year 2000 law, thus, provided for two types of political organization—one that is treated under the rules, including the disclosure rules, of section 527, and one that is not subject to those rules. Accordingly, as indicated above, the 2000 law revives the pre-1975 authorities, at least with respect to political organizations that do not file the section 527(i) notice.

Whether Congress intended to make section 527 voluntary in adding section 527(i)(1) to the Code is not clear.²⁴ The manifest purpose of section 527(i) was to force political organizations to declare their presence to the IRS and, because the notice is made publicly available, to the public. Congress may have assumed that the benefits of tax status under section 527 were so significant that organizations

would demonstrably prefer to be treated under section 527 than not to be so treated and, thus, did not consider the question of whether section 527 should be elective. Given that sections 527(i) and 527(j) are burdens and not benefits, it also may be a sensible result to make section 527 status elective. If the reporting rules, and their attendant penalties, applied to an organization because of its activities (i.e., by meeting the definition of a political organization per section 527(e)(1)), it would be harder to view such requirements as a condition of tax exemption instead of as a burden of engaging in political speech, a result that affects the constitutional analysis.²⁵

In addition, if in 2000 Congress had introduced a disclosure regime and retained the mandatory aspect of section 527, political organizations would, as a general matter, have been treated worse than other organizations with a Code-based exemption. In general, other exempt organizations elect into a Code section by holding themselves out as meeting the requirements of the Code, and then filing the applicable information return. But if an organization decides not to rely on an exemption provision, it can always file a tax return. Indeed, the notion that an exempt organization can have its exempt status revoked rests on the fundamental concept that exempt status is voluntary and elective. Until 2000, political organizations were an exception to this rule; but with the imposition of

²⁴ The 2000 law was introduced and passed in the House of Representative on June 27, 2000; it passed the Senate without amendment on June 29, 2000, and was signed by the President on July 1, 2000. There was no formal legislative history of the bill. For a description of the law, see Joint Committee on Taxation (JCS-2-01, 79-81).

²⁵ As discussed above, in *Mobile Republican Assembly*, the appellate court concluded that section 527 provided a "voluntary tax subsidy" and, so, the court applied the *Regan* doctrine to the section 527 disclosure regime, the implicit (if not the technical) result being that *Regan* permits Congress to impose burdens on a fundamental right as a condition of such a voluntary tax subsidy. The *Regan* doctrine, however, may not be apposite to the imposition of the disclosure rules (or of any limit, including contribution limits), if such limits were mandatory for all political organizations. As mandates, it could be hard to show that any such limits were a condition of tax-exempt status; rather they would appear to be simply requirements for engaging in a certain threshold of political activities because they would apply to any political organization, whether treated as a section 527 organization or not.

notice and reporting requirements, they, like other "exempt" organizations, were provided the choice of organizing under section 527 or not.²⁶

Notwithstanding that there are reasons for making section 527 elective in connection with imposing a disclosure regime, it may have been that this was not the intended result. The language of section 527(i)(4) is one indication. Section 527(i)(4) describes the effect of a failure to file the notice referred to in section 527(i)(1). It provides that: "In the case of an organization failing to meet the requirements of [section 527(i)(1)] for any period, the taxable income of such organization shall be computed by taking into account any exempt function income (and any deductions directly connected with the production of such income) . . ." Some might argue that the reference to the "requirements" of section 527(i)(1) should be read as an implicit indication that Congress intended that the section 527(i)(1) notice be mandatory for all political organizations, i.e., as a requirement in an absolute sense.²⁷ However, by its terms, section 527(i)(1) merely provides that an organization is not treated as a section 527 organization unless it files a notice with the IRS, that is, filing the notice is a requirement of being treated as a section

527 organization, but is not a requirement of being a political organization (as defined in section 527(e)(1)).²⁸ To read the section 527(i)(4) reference to "requirements" as a mandate that all political organizations must file the section 527(i)(1) notice would be to read language into section 527(i)(1) that is not there.

The language of section 527(i)(1) providing for elective treatment as a section 527 organization also affects the workings of section 527(i)(4) in ways not generally considered, but with significant implications. The purpose of the language in section 527(i)(4) is to describe what happens in the event that a section 527 organization does not file a notice. If section 527 was mandatory, section 527(i)(4) would provide that a political organization (i.e., not just a section 527 organization) that fails to file the 527(i) notice is subject to the income tax rule provided therein. However, because section 527 is voluntary, the result is different.

Section 527(i)(4) is subject (i.e., subordinate) to the general language of section 527(i)(1), which provides that absent a notice, the organization is not treated as an organization described "in this section," including presumably for purposes of section 527(i)(4). In other words, a political organization can be subject to the rule

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²⁶ Indeed, the accepted label of political organizations as "exempt" organizations is somewhat misleading in that it implies a subsidy of some kind. Yet, as argued above, Congress did not provide a subsidy in the sense of substantially changing the tax treatment of political organizations from what prevailed already. Political organizations are best viewed as a unique type of organization, with respect to which Congress has provided detailed rules, just as Congress provides detailed rules for the taxation of insurance companies, real estate investment trusts, banks, or other specific types of organization. (Interestingly, in considering whether to add bingo game proceeds to the definition of exempt function income in 1978, the Ways and Means Committee distinguished in its report on the bill between "exempt organizations" and "political organizations" and other organizations such as social clubs that are taxable on investment income (H.R. Rep. 95-1608). In this context, making the tax treatment of political organizations mandatory in 1975 was not an exception to how other exempt organizations generally are treated, but rather reflected the imposition of clarifying rules as to how a precise type of organization should be taxed.

²⁷ Section 527(i)(3) also refers to the notice "required" under section 527(i)(1).

²⁸ The section 527(i)(1) language is similar to that of section 508, which provides that an organization "shall not be treated as an organization described in section 501(c)(3) . . . unless it has given notice to the Secretary, in such manner as the Secretary may by regulations prescribe . . ." Treatment as a section 501(c)(3) organization of course is voluntary and elective. The notice referred to in section 508 is a requirement of recognition of exemption under such section and not an absolute requirement of organizations that are organized and operated exclusively for the activities described in section 501(c)(3).

of section 527(i)(4) only if it has filed the section 527(i) notice and, thus, elected to be treated as a section 527 organization. This reading does not render section 527(i)(4) as surplusage, however, because the language has an effect for an organization that did not file the notice within the requisite time frame, but later decided to file the notice. That is, section 527(i)(4) is of fairly limited application in that it describes the tax consequences to a political organization that files the 527(i)(1) notice late by detailing the tax treatment of the organization for the time prior to the time it filed the notice.²⁹

In addition, the language of section 527(i)(4) may not have the effect that it has been given.³⁰ Section 527(i)(4) says that the "taxable income of such organization shall be computed by taking into account any exempt function income." It does not, however, follow that exempt function income necessarily is taxable income. Rather, exempt function income must only be "taken into account." Thus, if an organization is subject to the rule of section 527(i)(4), the organization must look to general tax law to determine whether any items of exempt function income are taxable income to the organization. As discussed earlier, some types of exempt function income could be taxable income to the organization, but, under longstanding IRS rulings, political gifts and contributions would be excludable from the gross or taxable income of the

organization.³¹ Thus, the practical effect of section 527(i)(4) is, for organizations that initially failed to file a section 527(i) notice but subsequently did so, to subject exempt function income, other than contribution income to tax.

In summary, the year 2000 changes to section 527, prompted by campaign finance concerns, converted a section that prescribed the tax treatment of every political organization, as defined therein, into a section that imposed burdens and prescribed tax treatment only on political organizations that elected to be treated under section 527. In 1975, Congress had preempted the law in this area, but in 2000 the pre-1975 law was resuscitated for organizations that opt out of section 527 treatment.

SIGNIFICANCE

The importance of section 527 not providing a significant subsidy and the section being voluntary becomes apparent as policymakers seek to impose greater restrictions on certain section 527 organizations. The target is groups that do not meet the current FECA definition of a political committee but that are considered by the IRS as section 527 organizations, so-called "independent section 527 organizations."³² So long as independent section 527 organizations fall outside the FECA definition of a political committee, such organizations are

²⁹ Section 527(i)(4) also provides for the tax treatment of an organization that does not timely file a new section 527(i) notice when there is a material change in the information originally provided in the notice.

³⁰ See Rev. Rul. 2003-49, Q-20 & A-20 (providing that if an organization fails to file the section 527(i)(1) notice, the taxable income of the organization includes its exempt function income); *Mobile Republican Assembly* (district court concluding, in footnote 20, that section 527(i)(4) "expressly subjects political contributions to income taxation").

³¹ If the result were different, notwithstanding the parenthetical of section 527(i)(4) allowing "deductions directly connected with the production of [exempt function] income," expenses connected with contribution income generally would not be deductible because of section 162(e). Thus, if contribution income were taxable income, no offsetting deduction would be available and political organizations would, unlike most other organizations, be subject to tax on their gross income and would have to set aside an amount each year of contribution income to pay income tax.

³² This would include, for example, organizations mentioned in the Introduction—Americans Coming Together, Moveon.org, and Swift Boat Veterans for Truth.

not subject to the contribution limits that apply to political committees and may be funded by unlimited amounts from any one source. Some believe that unlimited contributions to independent section 527 organizations is a serious loophole in the campaign finance system and, thus, seek to treat independent section 527 organizations as political committees.

One such effort is a bill, H.R. 513 of the 109th Congress, which passed the House of Representatives on April 5, 2006 (the Senate counterpart is S. 1053). Section 2 of H.R. 513 would amend the FECA to provide that an "applicable 527 organization" is a political committee, subject to the contribution limits and other rules of the FECA. The bill defines an applicable 527 organization as, in general, "a committee, club, association, or group of persons that . . . has given notice to the Secretary of the Treasury under section 527(i) of the Internal Revenue Code of 1986 that it is to be treated as an organization described in section 527 of such Code . . ."³³ Under this language, if an otherwise applicable political organization files a section 527(i) notice with the IRS, then it becomes a

political committee under the FECA; but if the organization does not file such a notice, then it is not a political committee under the FECA.

If the H.R. 513 language is enacted, independent section 527 organizations would be presented with a clear choice—opt into section 527 and face FECA regulation, or opt out of section 527 and escape not only FECA regulation, but also the disclosure rules of section 527.³⁴ Because, as explained above, section 527 is voluntary,³⁵ how would an organization that meets the definition of political organization under section 527(e)(1) but that does not file the section 527(i) notice be treated for tax purposes? Absent additional guidance by the Congress or the IRS, the tax treatment of such an organization should largely follow the pre-1975 law articulated by the IRS, i.e., the organization's investment income would be subject to tax, contribution income would not be taxable,³⁶ other exempt function income may or may not be subject to tax, other income would be subject to tax (with offsetting deductions allowed), the marginal rates would be available to the organization, and the

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³³ The bill then carves out a number of specific types of organizations from the definition of an applicable 527 organization.

³⁴ Under present law, organizations may already be opting out of section 527 status in order to avoid its disclosure rules. Because of the language of section 527(i)(1) discussed above, an organization that does not file the section 527(i) notice is not a political organization for purposes of section 527, with the result that the disclosure requirements and penalties of section 527(j) do not apply to such organizations, but as discussed below, the gift tax exemption for contributors still is available. As discussed above, imposition of the disclosure rules on organizations that conduct political activities raises constitutional issues to the extent such rules cannot be justified by relying on the argument that the disclosure is a condition of a subsidy, if in fact, little subsidy actually is provided. As additional restrictions are placed on an organization by virtue of its activities, it also becomes harder to argue that the restrictions are a condition of tax exemption rather than a condition on engaging in the activity itself.

³⁵ Even assuming that section 527 were construed to be mandatory, if the H.R. 513 language is enacted, political organizations still would be able to avoid political committee status by not filing the section 527(i) notice. The result of such failure would be determined under section 527(i)(4), which (assuming it is construed to apply to all political organizations not just those filing the section 527(i)(1) notice), as discussed above, provides that the organization must take exempt function income into account in determining taxable income. This rule, however, may not prove especially significant because, construed to exclude contributions from gross income, section 527(i)(4) essentially places a nonfiling section 527 organization on the same footing as a taxable organization.

³⁶ As discussed above, section 527(i)(4) applies only to an organization that has filed a notice pursuant to section 527(i)(1), and, for such organizations, applies to the period prior to the filing of the notice by providing that exempt function income be "taken into account" for such period. Section 527(i)(4) does not, however, have the effect of making exempt function income taxable income.

organization could seek to be taxed as other than a C corporation.

In addition, without amendment to section 2501(a)(4) (which is not provided by H.R. 513), contributions to the entity would continue to be exempt from the gift tax. This result flows from the language of section 2501(a)(4), which provides a gift tax exemption for transfers "to a political organization (within the meaning of section 527(e)(1))." An organization can be a political organization "within the meaning of section 527(e)(1)" without being treated as a section 527 organization by reason of filing the section 527(i) notice. In other words, the gift tax exemption looks to an organization's activities—i.e., exemption is based on whether the organization is "organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function"—and does not depend on whether the organization is treated as a section 527 organization.³⁷

The choice presented by the language of H.R. 513 also has implications for organizations exempt from tax and described in section 501(c). Under present law, a section 501(c) organization, (such as a social welfare organization (section 501(c)(4)), a labor union (section 501(c)(5)), or a trade association (section 501(c)(6))) is subject to tax under section 527(f)(1) if the section 501(c) organization expends any amount for an exempt function (within the meaning of section 527). Thus, in general, if a social welfare organization spends money to influence the outcome of a presidential election, the social welfare organization

is subject to tax on the lesser of its investment income or the amount so expended. However, under section 527(f)(3), this tax may be avoided if the organization establishes a separate segregated fund from which all of its exempt function expenditures are made. The separate segregated fund is treated as a separate section 527 organization, and is subject to its disclosure and tax rules.

The use of separate segregated funds by section 501(c) organizations provides a way to make expenditures for an exempt function without subjecting the sponsoring section 501(c) organization's investment income to tax. The language of H.R. 513 would directly affect whether section 501(c) organizations would establish separate segregated funds,³⁸ as doing so would (unless they fall within one of the exceptions) convert the fund into a FECA political committee. The choice presented for section 501(c) organizations is more complex than that presented for political organizations, as the section 501(c) organization could have more detrimental tax consequences,³⁹ and also contributors would lose the gift tax exemption (because section 501(c) organizations are not political organizations within the meaning of section 527(e)(1)). However, the desire to avoid FECA political committee treatment could trump tax considerations, and drive political activities outside of the section 527 umbrella.

Even assuming that the language of H.R. 513 is not enacted, the issues raised by its language highlight the difficult questions presented both under present

³⁷ See Rev. Rul. 2003-49, Q-23 & A-23 (transfer to a political organization are not subject to the gift tax regardless of whether the organization has filed the section 527(i)(1) notice).

³⁸ Section 5 of H.R. 513 provides that no provision of the bill shall be construed "as affecting the determination of whether a group organized under section 501(c) of the Internal Revenue Code of 1986 is a political committee" under FECA. It is not clear whether this language is intended merely to provide that the status of a section 501(c) organization is not affected by the bill or whether it is intended to provide that a separate segregated fund of a section 501(c) organization is not subject to the bill. However, if the latter reading were correct, this result could be achieved more directly by explicitly excepting separate segregated funds of section 501(c) organizations from the definition of an "applicable 527 organization."

³⁹ However, to the extent a section 501(c) organization has relatively low amounts of investment income, the tax imposed by section 527(f)(1) would not be a deterrent not to use a separate segregated fund.

law and for those who seek to impose curbs on independent section 527 organizations. To the extent policymakers make section 527 more burdensome, organizations will simply opt out of all of the rules of section 527—including the disclosure rules that policymakers value. To the extent policymakers seek to avoid this result and decide to make section 527 mandatory, the constitutional burden increases as restrictions placed on political activities may be viewed as such, and not as conditions of tax exemption. Even if Congress or the IRS revisited the question of whether political gifts should be excludable from income (e.g., for political organizations that do not file a section 527(i)(1) notice), this could be overly punitive since, without amendment to section 162(e), no offsetting deduction would be allowed with the result that, in order to pay taxes, the political activities of an organization, activities that are protected by the First Amendment, would be severely constrained.

What are the options available to those who want to affect the use of independent section 527 organizations? One option would be explicitly to provide that a political organization as described in section 527(e)(1) (subject to some exceptions) is a FECA political committee, irrespective of whether the organization files notice with the IRS. Under this approach, the FECA contribution limits would be imposed on independent section 527 organizations and most of the campaign finance rules embedded in section 527 would become moot,⁴⁰ leaving section 527 to

deal mostly with the tax treatment of political organizations. Even this approach, however, would drive money to section 501(c) organizations, which may engage in political activities unless such activities become a primary purpose of the organization.⁴¹ Section 501(c) organizations may be reluctant to form separate segregated funds (and, thus, have the fund to become a FECA political committee). Such an approach could be overbroad. For example, if organizations were made political committees based solely on their activities, subject to exceptions contained, for example, in H.R. 513, then every bank account, association among friends, or organized activity with \$25,000 or more would become a FECA political committee and face sanctions under the FECA for failing to file or heed the contribution and other limitations. These issues aside, directly imposing the FECA contribution and other limits on independent section 527 organizations would undoubtedly immediately be subject to a constitutional challenge,⁴² but unless and until the Supreme Court decides the constitutionality issue, there is no way to be certain. So long as unlimited contributions to independent section 527 organizations are a source of concern to a majority in Congress, the best approach may be to test the premise directly.

CONCLUSION

Codification of section 527 was not intended to and did not provide a significant subsidy to political organizations.

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⁴⁰ The section 527(i) notice and section 527(j) disclosure rules do not apply to political organizations that are required to report under the FECA as a political committee.

⁴¹ As new and existing section 501(c) organizations adapted to absorb additional political activities without jeopardizing exempt purposes, the IRS would be placed in the very difficult position of determining whether political activities amounted to the primary purpose of the section 501(c) organizations, and the exemption standards for such organizations, already difficult to apply in some cases, would come under increasing pressure. The section 527(f)(1) tax on section 501(c) organizations that engage in section 527 activities need not be an impediment if investment income of the organization can be kept to a minimum.

⁴² A discussion of the constitutional implications of imposing contribution and other limits on independent section 527 organizations is beyond the scope of this article (but see generally, Briffault (2005), Polsky and Charles (2005), Kingsley and Pomeranz (2004).

Rather, Congress intended to and did clarify the tax treatment of such organizations in a manner generally consistent with their treatment at the time. In 2000, Congress made section 527 a voluntary section and imposed new burdens on organizations electing to be treated under such section. In doing so, Congress resuscitated the pre-1975 law on the tax treatment of political organizations. The issue of whether section 527 provides a tax subsidy also became relevant in that organizations will compare tax treatment within and without section 527 in determining whether to organize under such section, especially if independent section 527 organizations are made FECA political committees. The question of subsidy also is important in assessing the constitutionality of any existing or additional burdens placed on section 527 organizations. These points should be considered by policymakers as efforts to regulate section 527 organizations continue.

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