NEW YORK
CITY BAR

COMMITTEE ON
NON-PROFIT ORGANIZATIONS

February 24, 2014

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Mr. John Koskinen
Commissioner of the Internal Revenue Service
CC:PA:LPD:PR (REG-134417-13)
Room 5205
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington, D.C. 20044

Re: Notice of Proposed Rulemaking, REG-134417-13

Dear Commissioner Koskinen:

The Committee on Non-Profit Organizations (the "Committee") of the Association of the Bar of the City of New York respectfully submits comments in response to the Notice of Proposed Rulemaking ("NPRM") issued by the U.S. Treasury Department and the Internal Revenue Service ("IRS") on November 29, 2013. The Committee applauds the U.S. Treasury Department and the IRS for undertaking an effort to bring clarity and precision to regulations governing political candidate-related activity. For decades, Section 501(c) organizations and the lawyers who represent them have sought clarity in this area. At the same time, the Committee cautions the Treasury Department against adopting the regulations in their current form because they are over-inclusive in sweeping into the definition of these activities a number of nonpartisan, educational activities regularly engaged in by Section 501(c) organizations and under-inclusive in leaving a number of important questions unanswered. The Committee encourages the Treasury Department to expand and refine the proposed regulations and issue a revised version with a period for further public notice and comment.

We respectfully recommend three modifications to the proposed rules: (1) there should be a single definition of candidate-related political activities for all Section 501(c) organizations; (2) the rules should limit the *amount* of candidate-related political activities permitted; and (3) nonpartisan activities should not be limited and should not be included in the definition of candidate-related political activities.

The Committee is a diverse 42-member committee of the Association of the Bar of the City of New York. Some members are law firm attorneys representing non-profits, some are in-house counsel at nonprofit organizations, and a few are legal scholars. The Committee's members represent multi-million dollar institutions and tiny organizations, institutions that have been serving New York for more than a century and fledging groups "operating on a shoestring." Social welfare organizations that are exempt from taxation under Section 501(c)(4) of the Internal Revenue Code as well as charitable and educational organizations exempt under Section 501(c)(3) are among the organizations represented by Committee members, and among these are organizations that advocate on matters of great importance to New Yorkers and the community at large.

I. Background

Many Section 501(c) organizations, including Section 501(c)(4) organizations, have struggled to understand the amount and nature of activity relating to candidates and elections permitted under the tax law. This lack of clarity burdens organizations and has the effect of holding some organizations back from engaging in permissible, First Amendment-protected activity, and leading other organizations to jeopardize their exempt status by engaging in too much restricted activity.

In the wake of the Supreme Court's 2010 decision in *Citizens United v. FEC,*[1] there has been a sharp increase in the use of Section 501(c) organizations to engage in political candidate-related activity. Various groups and commentators have raised concerns about the current lack of public disclosure of the identity of individuals who donate funds to Section 501(c) organizations for expenditure on political campaigns. Without a clear test for determining which activities are prohibited, either completely or largely, there is a potential for the abuse of Section 501(c). The Committee shares the view of many that there is a need for clear rules and enforcement activity against organizations that abuse the IRS rules governing political activity. At the same time, the Committee believes that rules and enforcement activity should be carefully developed in order to ensure that they do not sweep in unintended restrictions on the activities of advocacy organizations as they do their work in furtherance of their legitimate missions.

II. Specific Comments.

The Treasury Department is to be commended for developing rules governing candidate-related activities that move for the first time away from the use of facts and circumstances tests. However, we urge further rule-making that, while maintaining its commitment to the use of bright line rules, addresses the following considerations.

[1] 558 U.S. 310 (2010).

A. **All Section 501(c) Organizations Should Have Bright Line Rules.**

The Treasury Department should formulate its test for election- and candidate-related political activity in such a way that it can be applied to all Section 501(c) organizations, not just Section 501(c)(4) organizations. There are a variety of reasons to adopt this approach.

First, if the bright line rules set forth in the NPRM apply only to social welfare organizations, contributors seeking to avoid election law disclosure requirements may simply take their contributions to other Section 501(c) organizations, in particular Section 501(c)(5) organizations (labor organizations), Section 501(c)(6) organizations (trade associations) and Section 501(c)(8) organizations (fraternal benevolent associations). It is not only social welfare organizations that are in need of bright line rules: all Section 501(c) organizations need clarity.

Second, the application of a bright line rule solely to social welfare organizations creates a risk that the regulations will become de facto rules for other Section 501(c) organizations in a haphazard fashion. This risk would arise because some organizations subject to the vaguer facts and circumstances test, seeking to anticipate IRS determinations, would exercise caution by drawing direction from the Section 501(c)(4) bright line rules. Such an outcome could have the unplanned consequence of causing Section 501(c) organizations to modify their conduct in unintended ways. For example, a Section 501(c)(3) organization might back away from educational, nonpartisan, election activities, even though such activities are permitted under Section 501(c)(3), because under the proposed bright line Section 501(c)(4) rules such activities are defined as candidate-related political activity and charitable organizations are prohibited from political activity. The Committee advocates avoiding this result by engaging in a comprehensive process to develop rules applicable to all Section 501(c) organizations. (The Committee notes, as discussed in greater detail below, that we believe the regulations should not sweep nonpartisan, educational, voter-related activities into the definition of candidate-related political activity for social welfare organizations.)

Finally, the application of bright line rules to social welfare organizations and a facts and circumstances test to other Section 501(c) organizations likely will lead to confusion and increased legal costs for organizations that operate several affiliated Section 501(c) organizations, including a social welfare organization. In fact, many advocacy organizations operate through related Section 501(c)(3) and Section 501(c)(4) organizations. It will be extraordinarily difficult for these organizations to navigate two separate tests as they engage in their work.

For these reasons, the Committee urges the Treasury Department and the IRS to issue clear definitions of political activity and, absent a compelling reason for different definitions applicable to different subsections of Section 501(c), urges the Treasury Department and the IRS to implement one definition of political activity that applies across all subsections of Section 501(c).

B. **Provide Clear Rules Regarding the Permissible Amount of Candidate-Related Political Activity**

The Committee recommends that the Treasury Department take this opportunity to provide clear rules outlining the *amount* of political activity permitted under Section 501(c)(4).[2] A bright line definition of activities that must be limited in order to maintain tax-exempt status is of little use without a clear rule setting a ceiling on the level of such activities permitted. The need for such a clear rule is increasingly clear given the growth in the use of Section 501(c)(4) organizations to engage in candidate-related activities.

Assuming the Treasury Department revises its definition of candidate-related political activities to remove nonpartisan educational activity, as recommended below, the Committee advocates limiting candidate-related political activity to an insubstantial part of a social welfare organization's overall activities.[3] Congress granted civic leagues and organizations exemption from Federal income taxes under Section 501(c)(4) of the Internal Revenue Code so long as they met certain requirements, including, among other things, that they be "operated *exclusively* for the promotion of social welfare."[4] The current regulation implementing Section 501(c)(4), adopted in 1959, states that an organization is operated exclusively for the promotion of social welfare if it is engaged *primarily* in promoting the common good and general welfare of the people.[5] In our view, the use in the regulations of the term "primarily" is inconsistent with statutory strictures of Section 501(c)(4) if it permits more than minor and insubstantial candidate-related political activities.

Restricting social welfare organizations to insubstantial amounts of political activity is consistent with the approach Congress and the Treasury Department have taken with Section 501(c)(3) organizations that engage in lobbying. We think the analogy provides a solid framework for restricting political activities by social welfare organizations. Social welfare organizations that wish to devote more than an insubstantial amount of time and effort to activities aimed at influencing the election or appointment of candidates to public office may establish a separate, segregated fund under Section 527 of the Internal Revenue Code, just as Section 501(c)(3) organizations that wish to engage in more than an insubstantial amount of lobbying may establish social welfare organizations, which can engage in unlimited lobbying. Shifting activities to a separate segregated fund under Section 527 would close up the disclosure loophole that social welfare organizations active in political campaigns have opened up.

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[2] Further, if the Treasury Department promulgates definitions applicable to subsections of Section 501(c) other than Section 501(c)(4), as recommended in Part II.A, the Committee recommends that Treasury promulgate clear rules outlining the amount of such activity permitted to organizations exempt under those other subsections of Section 501(c) as well.

[3] While the Committee has not adopted a precise position as to what percentage is insubstantial, in our view, such a percentage, under the generally-accepted meaning of "insubstantial," could not exceed 10 to 20 percent of total activities. This amount does not include other, nonpolitical, activities not in furtherance of social welfare such as unrelated business income generating activities. Were such activities included, a higher percentage would be warranted.

[4] 26 U.S.C. 501(c)(4).

[5] 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i)

The Committee also recommends that the Treasury Department adopt a clear, quantifiable expenditure test for determining whether a Section 501(c)(4) organization's activities exceed an insubstantial amount, and allow Section 501(c)(4) organizations to elect the expenditure test as an alternative to the facts and circumstances test for measuring the amount of its political activity. Along these lines, the Treasury Department should look to Internal Revenue Code Sections 501(h) and 4911 and the Treasury regulations promulgated thereunder in considering whether the permissible expenditure percentage should decrease as an organization increases in size. A social welfare organization's political expenditures should be measured using a rolling multi-year average, comparable to the rolling four-year average used to determine permissible levels of lobbying by charitable organizations under Section 501(h). This approach would take into consideration the possibility of a spike in an organization's political activity during an election year, and it would protect organizations with a model record of compliance from losing their tax exempt status on the basis of a single violation of the rules.

The Committee further recommends that the Treasury Department make clear how any percentage expenditure limit on political activities interacts with the overall limit on activities, such as unrelated business income generating activities, a Section 501(c)(4) organization may undertake that are not directly in furtherance of its social welfare mission.

C. **Do Not Limit Nonpartisan Educational Activity**

As noted earlier, the Committee commends the Treasury Department for defining political candidate-related activity using a bright line rule. However, we are concerned that the definition in the NPRM is over-inclusive in that it includes nonpartisan, educational activities such as preparing voter guides and hosting candidate forums. The IRS already has recognized many of these activities as educational and beneficial to the community and permissible for Section 501(c)(3) organizations. *See, e.g.*, Rev. Rul. 74-574, 1974-2 C.B. 161; Rev. Rul. 78-248, 1978-1 C.B. 154; Rev. Rul. 80-282, 1980-2 C.B. 178; Rev. Rul. 86-95, 1986-2 C.B. 73, Rev. Rul. 2007-41, 2007-1 C.B. 1421.

The proposed rule includes the following activities as candidate-related political activity subject to limits even when carried on in a nonpartisan manner:

1. Engaging in voter education, including creating and distributing nonpartisan voter guides, and conducting get-out-the-vote and voter registration drives.
2. Hosting nonpartisan candidate appearances, including candidate forums and candidates appearing in a non-candidate capacity.
3. Issuing nonpartisan communications that mention the name of a candidate within 30 days of a primary and 60 days of a general election, even if the communications do not contain express advocacy or its functional equivalent regarding the candidate and instead are issue advocacy communications in furtherance of the organization's mission.

4. Making contributions to other Section 501(c) organizations that engage in candidate-related political activity, even if the contributions are restricted to or used for non-political activities.

These proposed restrictions are not necessary for achieving the goal of clarity, and they have the potential to undermine Section 501(c)(4) organizations by barring or limiting activities that promote social welfare and the public good, such as efforts to increase public participation in government and to inform the electorate. Further, these rules would have the anomalous effect of restricting Section 501(c)(4) organizations from undertaking activities that Section 501(c)(3) organizations may undertake without limit.[6] This result could cause particular confusion for advocacy organizations that operate through related Section 501(c)(4) and Section 501(c)(3) organizations. The Committee also recommends that the Treasury Department reconsider its decision to include in its definition of "candidate" individuals under consideration for non-elective appointment to office Lobbying for the appointment of an individual to office involves the same activity as lobbying for legislation or policies, which Section 501(c)(4) organizations may engage in without limit.

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The Committee thanks the Treasury Department and IRS for inviting comments on the NPRM and looks forward to participating and offering its comments to further drafts of the NPRM and any other guidance that may be helpful as the rulemaking process unfolds.

Sincerely,

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Peggy J. Farber
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cc: Vaughn J. Buffalo, Subcommittee on Taxation
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[6] For example, under these rules, an organization formed to enhance civic awareness and whose activities primarily consist of preparing nonpartisan voter guides covering a broad range of issues of relevance to the general electorate would be ineligible for exemption from tax under Section 501(c)(4) but may be eligible for exemption under Section 501(c)(3).