DISCLOSING DONORS TO SOCIAL WELFARE POLITICAL ACTIVITY

Responding to Roger Colinvaux, Social Welfare and Political Organizations: Ending the Plague of Inconsistency

*Response by Kenneth A. Gross**

Professor Roger Colinvaux diagnoses anonymous political speech through Internal Revenue Code § 501(c)(4) organizations as a cancer threatening our exempt organization and political systems.[1] He also proposes well-considered prescriptions to eliminate inconsistencies in the disclosure and financing rules governing tax-exempt organizations that currently incentivize engaging in political activity through § 501(c)(4) social welfare organizations rather than § 527 political organizations. I would offer some refinements for consideration.

Colinvaux discusses two types of organizations that feature in political activity: § 527 political organizations and § 501(c)(4) social welfare organizations. Inconsistent rules governing the two types of organizations encourage strategic behavior that undermines faith in exempt organizations. This strategic behavior largely involves choosing one form of exempt organization over another to thwart transparency in the funding of political activity.

The first major inconsistency is in the requirements governing donor disclosure. By operating as a § 501(c)(4) social welfare organization rather than a § 527 political organization, a politically active nonprofit may avoid the requirement to publicly disclose its donors. The second inconsistency is that § 501(c)(4) organizations are subject to different tax treatment than § 527 organizations. For example, a § 527 organization's investment income, donations of appreciated property, and spending on non-exempt functions are taxed differently than those of a similarly situated § 501(c)(4) organization.

Therefore, to discourage an organization from avoiding donor disclosure via § 501(c)(4) status, I would propose we first amend the

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1. Roger Colinvaux, *Social Welfare and Political Organizations: Ending the Plague of Inconsistency*, 21 N.Y.U. J. LEGIS. & PUB. POL'Y 481 (2018).

Tax Code to remove material differences in tax treatment between § 501(c)(4) and § 527 organizations. We could then apply a specific dollar limit on political activity by § 501(c)(4) organizations, require non-profit organizations that exceed this limit to file and disclose donors as a § 527 organization would, and thereby limit the influence of dark money on our elections.

Placing these limitations on § 501(c)(4) organizations would increase transparency in elections. The organizations typically used as vehicles for third-party political expenditures are § 501(c)(4) social welfare organizations, § 501(c)(6) trade associations, and § 527 political organizations. These organizations make independent expenditures, avoiding coordination with campaign committees and thereby remaining exempt from prohibitions and limitations applicable to those committees. This is where mega-donations have become part of the campaign finance system. Unlimited independent expenditures have been permissible since the Supreme Court decided *Buckley v. Valeo*[2] in 1976, but in 2010, *Citizens United v. Federal Election Commission*[3] allowed corporate and labor money to fuel these expenditures,[4] opening the door for Super PACs.[5] Super PACs are political organizations that may be funded with unlimited individual, corporate, or labor union monies.

When large donors make contributions to § 501(c)(4) non-profits, it results in a lack of donor disclosure that can have a corrosive impact on democracy. Congress attempted to deal with the lack of donor disclosure in 2000, requiring all § 527 organizations to disclose donors and expenditures to the Federal Election Commission ("FEC"), a state election commission, or, by default, the Internal Revenue Service ("IRS").[6] However, the rise of politically active § 501(c)(4) organizations has frustrated this intent because the law change in 2000 only covered donor disclosure of donations to § 527 organizations and not § 501(c)(4) organizations.

According to FEC rules, a § 501(c)(4) organization must disclose its expenditures if it makes electioneering communications or independent expenditures.[7] However, the donations to § 501(c)(4) organizations for these types of expenditures are not required to be dis-

2. 424 U.S. 1, 51 (1976).
3. 558 U.S. 310 (2010).
4. *Id.* at 365-66.
5. *See* SpeechNow.org v. FEC, 599 F.3d 686, 689, 696 (D.C. Cir. 2010).
6. Act of July 1, 2000, Pub. L. No. 106-230, § 2, 114 Stat. 477, 479-80.
7. 11 CFR 104.4 and 109.10.

closed.[8] A § 501(c)(4) organization is no longer required to even identify large donors on its Form 990 annual disclosure.[9] Previously, § 501(c)(4) organizations were required to disclose the identity of those donors to the IRS on Form 990, but the IRS did not disclose the identities of those donors to the public.[10]

Putting the IRS in a position to enforce campaign finance disclosure has done more harm than good. The arbitrary and ambiguous rules governing political activity by § 501(c)(4) organizations—and their inconsistent application—provided a basis for politically active § 501(c)(4) organizations to fight enforcement of these rules. These groups could have operated as § 501(c)(4) organizations without approval, and probably did. The groups did not resist scrutiny of their § 501(c)(4) status to avoid potential tax liability. It was about disclosure. Instead, the IRS's attempted enforcement resulted in a scandal, culminating in last year's settlement with Tea Party groups that had argued that the IRS was using inappropriate criteria to screen applications for tax-exempt status, disproportionately affecting conservative groups.[11] Former Attorney General Jeff Sessions agreed to pay the targeted Tea Party groups.[12] Moreover, Congress saddled the IRS with

8. In *CREW v. FEC* (16-0259), the U.S. District Court for the District of Columbia held that an FEC rule impermissibly narrowed disclosure requirements for non-political committees, including § 501(c)(4) organizations, under the Federal Election Campaign Act ("FECA"), and issued an order vacating that rule effective September 19, 2018. FECA requires non-political committees making reportable political expenditures to disclose donors who contribute "for the purpose of furthering an independent expenditure." 52 U.S.C. § 30104(c) (2012). However, the vacated rule only required those non-political committees to disclose donors who contributed "for the purpose of furthering the reported independent expenditure," effectively only requiring disclosure of the rare donors who made earmarked contributions. *See* 11 CFR 109.10(e)(1)(vi). An appeal has been filed and litigation is ongoing.

9. Pursuant to a revenue procedure announced on July 16, 2018, § 501(c)(4) organizations will no longer be required to identify donors when filing returns for taxable years ending on or after December 31, 2018. *See* Rev. Proc. 2018-38, 2018-31 I.R.B. 280, 2018 WL 3609023. The revenue procedure does not affect the requirement that § 501(c)(4) organizations collect and retain donor information, making it available to the IRS upon request. *Id.* This is an unfortunate development. Among other concerns, even the non-public disclosure of donors to the IRS may have discouraged foreign funds from entering the electoral system.

10. *Id.*

11. *See* Press Release, U.S. Dep't of Justice, Attorney General Jeff Sessions Announces Department of Justice Has Settled with Plaintiff Groups Improperly Targeted by IRS (Oct. 26, 2017), https://www.justice.gov/opa/pr/attorney-general-jeff-sessions-announces-department-justice-has-settled-plaintiff-groups.

12. *Id.*

a conflicting mandate not to clarify its position on politically active § 501(c)(4) organizations.[13]

As Colinvaux discusses in his article, the decisions regarding the Tea Party groups' submissions for § 501(c)(4) status did not impact the tax liability of the groups in any reported cases. The decisions simply came down to a question of disclosing the identity of donors to politically active § 501(c)(4) organizations. Unfortunately, we cannot remove the IRS from political regulation and enforcement completely. The IRS has historically policed lobbying and political activity by § 501(c)(3) charitable organizations and has defined non-deductible lobbying for for-profit corporations.

As Colinvaux notes, however, we could relieve the IRS of its current responsibility for determining for disclosure purposes the much muddier issue of how much political speech is too much. I propose we give the IRS a bright-line rule to make that determination and make the tax ramifications of whether an organization operates as a § 501(c)(4) organization or a § 527 political committee negligible.

Colinvaux discusses percentage tests, under which a § 501(c)(4) organization conducting political activity that exceeds a certain percentage of its overall expenditures would lose its § 501(c)(4) status and, thus, become a taxable entity. I would borrow a percentage test from the law of § 501(c)(3) charitable organizations and subject § 501(c)(4) organizations to the rough equivalent of a lobbying safe harbor in § 501(h). The so-called § 501(h) election allows a § 501(c)(3) organization to engage in a limited amount of lobbying activity based on a bright-line test.[14] Similarly, we could permit a § 501(c)(4) organization that is organized and operated "exclusively for the promotion of social welfare"[15] to conduct political activity up to a ten percent cap, to a maximum of $100,000, without jeopardizing its status as a § 501(c)(4) organization. However, rather than losing its tax-exempt status, a § 501(c)(4) organization that exceeded the cap would file and disclose donors as a § 527 organization would. This would limit political speech funded by undisclosed donors but would also allow a bona fide social welfare organization to continue engaging in *de minimis* political activity related to its cause. Of course, only electoral political activity would be capped. Lobbying activity would remain unlimited for a § 501(c)(4) organization.

13. *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, tit. I, § 127, 129 Stat. 2433 (2015).

14. I.R.C. § 501(h) (2012).

15. Treas. Reg. § 1.501(c)(4)-1(a)(ii) (as amended in 1990).

For this to work, where possible, the Tax Code would have to treat § 501(c)(4) social welfare organizations and § 527 political organizations equivalently. When a § 501(c)(4) organization exceeds the spending cap and the IRS takes action, disclosure would be the only consequence.

The easiest change would be to tax a § 527 political organization's investment income the same as that of a § 501(c)(4) organization. Currently, a § 527 organization pays tax on its net investment income. In addition, donations of appreciated property to a § 501(c)(4) organization should be taxed like donations of appreciated property to a § 527 organization. Donating appreciated property to either type of organization should be a realization event for the donor. The donor would pay tax on the unrealized gain, and the donee would receive the property with a stepped-up basis. Finally, a § 527 organization's spending on a non-exempt function should not trigger adverse tax consequences. As long as the § 527 organization is disclosing its donors, there is no reason to penalize it. However, both § 501(c)(4) and § 527 organizations should continue to pay tax on unrelated business income.

A few issues would remain. For example, the IRS would still essentially be enforcing election law. The IRS would still determine what constitutes political activity when applying the ten percent *de minimis* threshold, much like its current role of determining what constitutes lobbying activity when regulating § 501(c)(3) organizations. However, the only implication of an IRS determination of what constitutes political activity would be donor disclosures. As recently as the *Citizens United* case, the Supreme Court endorsed disclosure of political activity in an eight-to-one determination (Justice Thomas dissenting).[16]

Furthermore, the FEC does well at administering a disclosure regime but has had difficulty enforcing limits and prohibitions on § 501(c)(4) organizations. This is largely due to the ideological split of the FEC and its structure. The FEC requires a bipartisan vote on an enforcement action, or to issue a regulation or opinion. Ideally, the FEC would administer this disclosure regime as well. However, a limited role for the IRS resulting in additional disclosure may take some of the politics out of the regulation of mega-donor disclosure. Democracy cannot operate in an effective manner when disclosure is ob-

16. 558 U.S. at 371; *id.* at 373 (Roberts, C.J., concurring); *id.* at 385 & n.1 (Scalia, J., concurring); *id.* at 395-96 (Stevens, J., concurring in part and dissenting in part); *id.* at 480 (Thomas, J., concurring in part and dissenting in part).

scured. With equivalent tax liability between § 501(c)(4) and § 527 organizations, the IRS would be in a much stronger position to enforce disclosure of political donations.