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By Electronic Mail

Ms. Mai T. Dinh
Assistant General Counsel
Federal Election Commission
999 E Street, N.W.
Washington, D.C. 20463

Re: Supplemental Comments on Notice 2005-20: Definition of Electioneering Communication

Dear Ms. Dinh:

These supplemental comments are submitted in response to the opportunity accorded witnesses at the October 20, 2005, hearing on Notice 2005-20.

My comments will address five topics that arose during the hearing: (1) the diversity of forms of section 501(c)(3) organizations; (2) lobbying not related to an organization's exempt purpose; (3) funding sources for section 501(c)(3) organizations; (4) sanctions under section 4955; and (5) the Political Intervention Project undertaken by the Internal Revenue Service during the 2004 campaign.

I. Types of Section 501(c)(3) Organizations

By exempting section 501(c)(3) organizations from the electioneering communication provisions, the regulations have exempted three types of entities–public charities, private foundations, and donor advised funds. Public charities are section 501(c)(3) organizations that satisfy one of the public support tests of section 509 of the Internal Revenue Code of 1986, as amended (the "Code" or "IRC"). Private foundations may have only one contributor or a very limited number of contributors and, in consequence, do not satisfy the public support tests of section 509. Donor advised funds are treated as public charities based on the totality of the

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contributors. These structures have become quite controversial because a single contributor can establish a fund within the organization and that contributor can exercise considerable direction over the use of that particular fund. In effect, donor advised funds offer the benefit of public charity status while also permitting a sole contributor to exercise considerable, and some would say undue, continuing control over the use of the fund. The Senate Finance Committee has expressed its concern over this blend of features in donor advised funds.

These three types of section 501(c)(3) organizations have somewhat unanticipated applications. For example, a company foundation may be either a private foundation or a public charity depending upon how the money is raised. If the parent company is a corporation, the parent will be treated as a single contributor and the foundation will be a private foundation. If, however, employees or others contribute individually, a company foundation might qualify as a public charity. If the parent company is a partnership, contributions will be treated as having been made by the individual partners, and the entity will be a public charity.

As a tax matter, allowing a corporate entity to form and fund a company foundation using its treasury funds and enjoying the benefit of a corporate deduction under section 170 for a charitable contribution poses no problems. The situation might well be viewed differently under federal election law.

II. Tax Law Imposes No Requirement That Lobbying Be Substantially Related to a Section 501(c)(3) Organization's Exempt Purpose

As discussed in my original comments, lobbying is a permissible but limited activity for a section 501(c)(3) organization, not an activity that itself supports exemption.

It is also important to understand that tax law imposes no requirement that lobbying activity be in any way related to an organization's exempt purpose. The lobbying limitations are matters of amount, not matters of any relationship to the organization's exempt purpose. Claims that organizations cannot pursue their exempt purposes unless they can lobby are thus overdrawn and inconsistent with the structure of the exemption provisions of federal tax law.

The only area of tax law that defines a "substantially related" test is the definition of unrelated trade or business income. If a trade or business is "substantially related" to an organization's exempt purpose, the income from that trade or business will not be taxable because it will not be treated as "unrelated." No such provision applies to lobbying.

III. Sources of Funding for Section 501(c)(3) Organizations

Section 501(c)(3) organizations may accept donations from any person, foreign or domestic, including taxable corporations, section 501(c)(5) labor unions, any other exempt entity, including section 527 organizations and section 501(c)(4) organizations, and foreign persons.

Each of these entities may claim a charitable contribution deduction under section 170. A section 501(c)(5) labor organization that has unrelated business taxable income may make a contribution to a section 501(c)(3) organization and use the section 170 charitable contribution deduction to reduce its unrelated business taxable income. The same is true in the case of a section 527 that has earned unrelated business income.

There is no guidance from the IRS on the consequences to the section 501(c)(3) organization from accepting money from a candidate committee or a political party.

Permitting section 501(c)(3) organizations to accept donations from any person makes sense as a matter of tax law. It is quite another matter when considered under federal election law. It would indeed be unfortunate if the FEC's current regulatory exemption of section 501(c)(3) organizations from the electioneering communication provisions resulted in restrictions on permissible donors to section 501(c)(3) organizations.

IV. Sanctions under Section 4955

Section 4955 imposes monetary sanctions on both the organization and its managers if the organization participates or intervenes in a political campaign. Section 4955(a)(1) imposes a tax equal to 10 percent of the amount of any political expenditure on the organization. Section 4955(a)(2) imposes a tax of 2.5 percent of the amount of the political expenditure on any organization manager "who agreed to the making of the expenditure." This amount is capped at $5,000. § 4955(c)(2). If the organization does not "correct" its political expenditure, a second tax equal to 100 percent of the amount of the political expenditure is imposed on the organization. § 4955(b)(1). If an organization manager does not agree to part or all of the correction, an additional tax equal to 50 percent of the amount of the political correction is imposed on the manager. § 4955(b)(2). This amount is capped at $10,000. § 4955(c)(2). Thus, the maximum amount for which an organization manager could be liable is $15,000. If more than one manager of an organization is liable for either the first-tier tax under § 4955(a)(2) or the second-tier tax under § 4955(b)(2), then the managers will be jointly and severally liable but the amounts are not increased. § 4955(c)(1). For purposes of section 4955, a "correction" is defined as recovering any money that can be recovered, establishing safeguards to prevent future political expenditures, and taking any other corrective action required under regulations. § 4955(f)(3).

Sanctions are imposed on an organization manager only if the organization acted "knowingly and willfully." The IRS has the burden of proof in establishing that the organization manager's conduct was knowing and willful. § 7454(b), which applies under Treas. Reg. §53.4955-1(b)(3) & (4).

Both the first-tier and the second-tier tax may be abated if the political expenditure was "not willful and flagrant" and the political expenditure was corrected. § 4962(a) & (c); § 4963.

V. IRS Enforcement: The Political Intervention Project

The Tax Exempt/Government Entities ("TE/GE") Division of the IRS launched the Political Intervention Project ("PIP") during June 2004 . It is far from clear what statutory authority the TE/GE Division relied upon in doing so. Virtually everything that is publicly known about PIP is based on the report prepared by the Treasury Department Inspector General. *Memorandum for Commissioner, Tax Exempt and Government Entities Division, from Pamela J. Gardiner, Deputy Inspector General for Audit, Final Audit Report–Review of the Exempt Organization Function Process for Reviewing Alleged Political Campaign Intervention by Tax Exempt Organizations (Audit # 200510008)(February 17, 2005)("TIGTA Report")* (2005 TNT 33-42).

The purposes of PIP, the nature of the problem causing the IRS to launch PIP, and the scope of the problem being addressed remain unclear. For instance, it is not clear whether the project permitted more efficient examination of campaign participation or intervention by exempt entities. It is not clear whether the IRS intends to issue guidance based on the results of the PIP examination. It is not clear whether the IRS will use the PIP experience to develop updated audit guidelines. Indeed, there is little information on what the IRS is in fact doing. No one expects the IRS to reveal what organizations it is examining since this would violate the requirement of section 6103 relating to the confidentiality of taxpayer information.

According to the TIGTA Report, PIP began in June 2004 at the initiative of the Commissioner, TE/GE Division. PIP was discontinued as of December 1, 2004. According to the TIGTA Report, "[t]he main goal of the PIP was to establish a 'fast track' process to respond quickly to referrals of potential political intervention during the 2004 election year and prevent recurring violation by the same organizations." Procedures for implementing PIP were developed in late July 2004. These procedures called for completing classification of cases in 7-10 days rather than the non-PIP standard, which requires only that the process of considering referrals begin within 60 days of receipt but not establishing any time limit on completing classification of a case. These procedures also called for the Exempt Organization Unit's Exempt Organization Referral Committee to determine which cases should be worked as correspondence examination and which cases should be worked as field examinations. Finally, the PIP procedures involved drafting contact letters for nonchurch section 501(c)(3) organizations and for section 501(c)(3) churches. The distinction is based on the special audit requirements applicable in the case of church audits. These contact letters were approved for issuance as of September 15, 2004, and the first contact letters were issue on September 21, 2004.

The Exempt Organization Referral Committee consisted of three members, all of whom were "experienced EO function technical employees (e.g., senior examiners, classification specialists, or group managers)." The TIGTA Report described the Committee's function as "considering, in a fair and impartial manner, whether information items were referred have examination potential." This decision was made on a "reasonable belief" standard, which the

TIGTA Report describes as demonstrating that "a violation of the tax laws may have occurred or its appears likely that an examination will lead to the discovery of a violation."

The TIGTA Report found that the expedited classification and examination schedules could not be met at least in part because of inadequate resources. The TIGTA Report concluded that "the expedited periods for classification and examination were unrealistic."

It is not clear that any program like that attempted in 2004 will be attempted in the future. What is now known about the PIP process strongly suggests that it did not provide a model for enhanced enforcement in the future. PIP does not support claims that the IRS can administer section 501(c)(3) in a manner that makes the exemption for section 501(c)(3) organizations from the electioneering communications of federal election law a wise policy.

Thank you for the opportunity to submit these supplemental comments.

Sincerely,

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