

**EFFECTS OF THE OMNIBUS BUDGET RECONCILIATION ACT OF 1987
ON THE DISCLOSURE RESPONSIBILITIES AND LOBBYING AND POLITICAL
ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS**

I. INTRODUCTION AND SCOPE

- A. The Code provides that an entity may qualify as a § 501(c)(3)¹ organization only if:

"no substantial part of [its] activities . . . is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)), and [it] does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." § 501(c)(3).

See also Treas. Reg. § 1.501(c)(3)-1(c)(3); B. HOPKINS, THE LAW OF TAX EXEMPT ORGANIZATIONS chs. 13 and 14 (5th ed. 1987). This reflects a long-standing Congressional judgment that the double federal tax benefits of deductions for contributions to, and exempt status for, the organization should be denied with respect to political and substantial lobbying activities by these organizations. Subcomm. on Oversight of the House Ways and Means Comm., 100th Cong., 1st Sess., Report and Recommendations on Lobbying and Political Activities by Tax-Exempt Organizations 37 (Comm. Print 100-12 June 8, 1987).

- B. Although Congress continues to adhere to this policy, id., it became concerned about various problems of implementation and enforcement. These allegedly included: (1) willful efforts by tax-exempt organizations to ignore or evade rules constraining political and lobbying activities; (2) lack of certainty in the non-profit community as to the scope of the statutory language proscribing such activities; and (3) the inability of the IRS (and the public) to monitor or enforce rules against such activities.

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1. Except as otherwise noted, all citations are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated under it.

- C. In response, the Subcommittee on Oversight of the House Ways and Means Committee held hearings in March of 1987. The Staff of the Joint Committee on Taxation prepared materials for the use of the members at those hearings. Staff of the Joint Committee on Taxation, Lobbying and Political Activities of Tax-Exempt Organizations (JCS-5-87, March 11, 1987). The hearings themselves are reported in Lobbying and Political Activities of Tax-Exempt Organizations: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 100th Cong., 1st Sess. (1987). The Subcommittee subsequently issued its report, noted at ¶ I.A, p. 1 above.² The Report's recommendations were generally adopted and expanded upon by the House Committee on the Budget, were subsequently also adopted with some modifications by the Conference Committee, and were incorporated into the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330 (1987) [hereinafter referred to as "OBRA"], which was enacted into law on December 22, 1987. Because the Senate Finance Committee Report is silent with respect to all of the relevant provisions, and the Conference Committee Report deals only with new § 4955, virtually all of the legislative history resides in the House Budget Committee Report cited at ¶ II.A.2, p. 4 below.
- D. The statutory changes will be analyzed under two main headings:
1. those imposing additional disclosure requirements on non-profits, primarily intended to make it easier to detect and monitor political and lobbying activities; and
 2. those modifying and clarifying the rules affecting proscribed political and lobbying activities.

The first is considered in ¶ II, p. 3 below; the second is considered in ¶ III, p. 15 below. Where relevant, mention is made of new or strengthened penalties, and new or enhanced enforcement powers given to the IRS.

2. All references to page numbers within this outline are to the author's original page numbers, inside angle brackets at the bottom right-hand side of each page.

II. DISCLOSURE REQUIREMENTS

Four new sets of rules were adopted affecting information disclosure by certain charitable organizations: (1) rules requiring disclosure of the non-deductibility of certain amounts paid to such organizations (discussed at ¶ II.A, p. 3 below); (2) rules mandating such organizations to make available certain information for public inspection (discussed at ¶ II.B, p. 7 below); (3) rules increasing the information required to be disclosed on certain tax forms and applications filed by such organizations (discussed at ¶ II.C, p. 9 below); and (4) rules compelling disclosure of the availability of free governmental information or services (discussed at ¶ II.D, p. 13 below).

A. Disclosure By Certain Tax-Exempt Organizations of Non-Deductibility of Contributions.

1. Prior Law. There was no requirement under prior Federal law that a tax-exempt organization state in its solicitations for donations whether such amounts were deductible as charitable contributions.
2. Abuses or Inadequacy of Prior Law. Some tax-exempt organizations, such as § 501(c)(4) lobbying organizations and § 527 political organizations, are allowed, within limitations, to engage in political and lobbying activity. Contributions to such organizations, however, are not tax-deductible. In some instances, these organizations were suggesting or implying in fundraising appeals that contributions were deductible.

The Report of the House Budget Committee on the Revenue Bill of 1987, which subsequently became part of OBRA, states:

"By virtue of this lack of disclosure or use of misleading statements, organizations that are allowed (within limitations) to engage in lobbying or political campaign activities are able to attract support from donors who then claim tax benefits that are available under law only for contributions to charitable organizations, which are precluded from engaging in any political campaign activities and are limited as to the extent of permissible lobbying activities." H.R. Rep. No. 391, 100th Cong., 1st Sess., pt. 2, at 1606-07, reprinted in 1987 U.S. Code Cong. & Admin.

News 2313-1186, 2313-1187 [hereinafter referred to as the "House OBRA Report"].

The House OBRA Report noted that such conduct in effect "siphon[s] off tax benefits that are targeted to charitable organizations" and leads to donors unknowingly making improper claims for charitable deductions. House OBRA Report at 1607.

3. Disclosure Required Under OBRA.

- a. General Rule. New § 6113 requires that each "fundraising solicitation" by or on behalf of an organization which is subject to § 6113:

"shall contain an express statement (in a conspicuous and easily recognizable format) that contributions or gifts to such organization are not deductible as charitable contributions for Federal income tax purposes." § 6113(a).

The requirement is not satisfied by stating that the contributions are deductible only to the extent allowed by law, by stating that the contributor should consult with a tax advisor as to deductibility, or by making no statement at all. House OBRA Report at 1610. On the other hand, payments to noncharitable entities may sometimes be deductible as business expenses, rather than under § 170. No disclosure statement is necessary to deal with such cases. House OBRA Report at 1608 n. 3.

- b. Organizations Subject to the Requirements of § 6113. Subject to an exception for small organizations (discussed at § II.A.3.c.2, p. 6 below), two types of entities are subject to this new rule:

- (1) Any organization described in §§ 501(c) (other than in § 501(c)(1)) or 501(d) and which is exempt from federal income tax, other than an organization described in § 170(c). § 6113(b)(1)(A). The disclosure requirement thus applies:

"to fundraising solicitations by or on behalf of social welfare organizations (sec. 501(c)(4)); labor unions (sec. 501(c)(5)); trade as-

sociations (sec. 501(c)(6)); social clubs (sec. 501(c)(7)); and [to a certain extent to] fraternal organizations (secs. 501(c)(8), (c)(10))." House OBRA Report at 1608.

I.R.S. News Release IR-88-31 (Feb. 10, 1988) confirms that the § 6113 applies to "labor unions, trade associations, social clubs, political organizations, political action committees and other noncharitable organizations." It also says that:

"the statement that a contribution or gift is not deductible as a charitable contribution for federal income tax purposes must be included in a conspicuous and easily recognizable format on billings of membership renewals and membership solicitations."

A special rule for fraternal organizations is set forth in § 6113(b)(3).

- (2) Any § 527 political organizations. § 6113(b)(1)(B).

There is a five-year "look-back" rule, making these rules applicable to organizations which were described in §§ 6113(b)(1)(A) or (B) at any time during the five-year period ending on the date of the fundraising solicitation, or which are "successors" to such organizations. § 6113(b)(1)(C).

c. Organizations Not Subject to the Requirements of § 6113.

- (1) The disclosure requirement does not apply to organizations, such as those described in § 501(c)(3), which are eligible to receive tax-deductible contributions. Congress was, however, concerned that some such entities were not adequately advising contributors about the proper amount to claim as a tax deduction, e.g., in connection with fundraising events like auctions, shows, banquets, and athletic events. House

OBRA Report at 1607-08. In response to these concerns, the IRS has stepped up its audit activity of such instances, and has issued further guidance on how to determine the proper amount of a charitable deduction. See IR-88-120 (August 4, 1988) and Pub. 1391, Deductibility of Payments Made to Charities Conducting Fund-Raising Events (reprinting Rev. Rul. 67-246, 1967-2 C.B. 104). See also Special Report, IRS Official Explains New Examination-Education Program on Charitable Contributions to Tax-Exempt Organizations, BNA DAILY TAX REP., Sept. 26, 1988, at J-1 - J-3 (interview with Assistant Commissioner Brauer; Q's & A's -- drafted by ABA Tax Section's Exempt Organization Committee -- attached for further "guidance"). The IRS has recently confirmed, nevertheless, that neither an organization's failure to comply with Rev. Rul. 67-246, nor even its providing incorrect information about deductibility of payments, will result in any sanctions against the organization under the current state of the law. TAM 8832003 (May 6, 1988).

- (2) The disclosure requirement does not apply if the soliciting organization normally does not have gross receipts in excess of \$100,000. § 6113(b)(2).
- d. Definition of Fundraising Solicitation. § 6113 applies to any solicitation of contributions made in writing, by television, by radio, or by telephone. § 6113(c)(1). It does not apply to face-to-face oral solicitations, but it would apply to any written materials distributed at the time of the oral solicitation. House OBRA Report at 1610. A de minimis exception is provided for fundraising solicitations which are "not part of a coordinated fundraising campaign soliciting more than 10 persons during the calendar year." § 6113(c)(2).

IR-88-13 (January 27, 1988), after describing the new requirements, gave an example of non-compliance which would be deemed to fit within the "reasonable cause" exception:

"[W]hen an organization had on hand at the time of the enactment of the law a printed supply of time-sensitive fund-raising solicitations without the disclosure statement, the costs to add a statement of nondeductibility would be a financial hardship, and the organization distributes them before April 1, 1988."

1. **Prior Law.** Certain information about tax-exempt organizations was (and continues to be) available through requests to the IRS; other information was (and continues to be) available at the offices of tax-exempt organizations. Thus:
 - a. The annual information return (Form 990) of a tax-exempt organization was (and continues to be) disclosable to the public through requests to the Service, except for the names of contributors. § 6104(b); Treas. Reg. § 6104(b)-1
 - b. An exemption application filed by a tax-exempt organization, and the Service determination of its exempt status, were (and continue to be) disclosable to the public through requests to the Service. § 6104(a)(1)(A); Treas. Reg. §§ 301.6104-1, 301.6104(a)-1, 301.6104(a)-5(a), 301.6104(a)-6.
 - c. Private foundations were (and still are) required to make their annual information returns (Form 990-PF) available for public inspection at their principal office. § 6104(d); Treas. Reg. § 301.6104(d)-1.
2. **Abuses and Inadequacy of Prior Law.** The House OB-RA Report states that the prior procedure under which the public could obtain copies of annual information returns and exemption applications of tax-exempt organizations only through requests to the Service:

"[did] not result in full and timely public disclosure of the activities of charitable organizations, as needed to facilitate ac-

countability of such organizations to the public from whom they solicit tax-deductible funds." House OBRA Report at 1612.

The Committee believed that the abuses outlined in § III.A.2, p. 3 above (relating to solicitation and receipt of contributions by certain exempt organizations), could be curtailed by making information returns and exemption applications more readily available to the public. The major aim of the expanded availability of information returns and exemption applications is thus to help insure that the "double tax benefits of deductibility of contributions and exemption from income tax are limited to organizations whose assets are devoted exclusively to charitable purposes" and not to political campaign activity or prohibited lobbying. House OBRA Report at 1612.

3. Inspection Requirements Under OBRA. The main thrust of the new rules is to make more information available at the offices of the tax-exempt organization, rather than only via requests to the IRS.
 - a. Annual Information Returns. New § 6104(e) requires that tax-exempt organizations (other than private foundations) must make available for inspection, during regular business hours by any individual at the organization's principal office, a copy of its three most recent annual information returns. If the organization regularly maintains regional or district offices having at least three employees, the returns must be made available at each such office as well. §§ 6104(e)(1)(A), (B). Names of contributors to the organization need not be disclosed. § 6104(e)(1)(C). Private foundations remain subject to the prior law requirement that their current annual return be made available for public inspection at their principal office. § 6104(d).
 - b. Exemption Applications. A tax-exempt organization must make available for inspection, during regular business hours, at the same offices described above, a copy of its application for recognition of exemption under § 501, along with any supporting papers, and any determination letter or other document issued by the Service with respect to such

application. § 6104(e)(2)(A). This rule does not apply to organizations, such as churches, which are not required to file, and in fact have not filed, annual returns or exemption applications. However, if such an organization has nonetheless filed an exemption application, the exemption application disclosure rule applies. See Caplin & Drysdale, Impact of the Omnibus Budget Reconciliation Act of 1987 on Tax-Exempt Organizations 2 n. 2 (1988) (unpublished memorandum) [hereinafter referred to as the "Caplin & Drysdale Memorandum"].

- c. Penalties. § 6652(c) was amended by OBRA to provide that any person under a duty to comply with the inspection provisions who, without reasonable cause, fails to make annual information returns available for public inspection, is subject to a penalty of \$10 for each day the disclosure requirement is not satisfied. A maximum penalty of \$5,000 applies for all failures to disclose any one annual information return, but there is no maximum penalty for failure to disclose an exemption applications. §§ 6652(c)(1)(C), (D); 6652(c)(3). Additional penalties of \$1,000 with respect to each return or exemption application may be assessed if the failure to permit public inspection was willful. § 6685.
 - d. Effective Date. The new provisions generally apply to returns for years beginning after December 31, 1986. OBRA § 10702(b)(1). They apply to exemption applications after January 20, 1988, unless the exemption application was submitted to the IRS before July 16, 1987, and the organization does not have a copy of the application. OBRA § 10702(b)(2).
- C. Additional Information on Annual Returns and Exemption Applications of § 501(c)(3) Organizations.
- 1. Prior Law.
 - a. Annual Information Returns. Except for churches, religious organizations, and a very few other entities, any organization that is tax-exempt under § 501(a) must file an annual information return -- Form 990 -- with the Service, setting forth, among other things, the

organization's items of gross income, receipts, and disbursements. § 6033(a). A § 501(c)(3) organization must also provide additional information relating to contributions received by the organization and to compensation paid to its employees. § 6033(b). The Form does not request information about relationships with other exempt organizations, except as to "common membership, governing bodies, trustees, officers, etc." Form 990 (1987), Part VII, question 80.

An organization which, without reasonable cause, failed to file a required annual information return was subject to a penalty of \$10 per day for each day the failure continued, with a maximum penalty of \$5,000 with regard to any one return. In addition, the organization's managers were subject to a similar penalty if, without reasonable cause, they refused to file the return after demand from the IRS. §§ 6652(c)(1), (2).

- b. Exemption Applications. The exemption application for § 501(c)(3) organizations asks whether the applicant controls, is controlled by, or is financially accountable to, another organization; whether the applicant is "the outgrowth of another organization"; and whether the applicant has "a special relationship" (such as interlocking directorships) with another organization. Form 1023 (Rev. April 1984), Part III, questions 5 and 6. The application form and instructions do not require more detailed information about affiliated or predecessor organizations.

- 2. Abuses and Inadequacy of Prior Law. The House Budget Committee believed that the disclosures required on exemption applications and annual returns were not sufficient to allow the Service to determine whether tax-deductible contributions were being diverted to noncharitable uses. The Committee noted, "[i]n particular," that the returns did not require sufficient information as to whether the charitable organization was affiliated with other types of exempt organizations which are permitted to carry on substantial lobbying or political activities. Thus:

"[f]or example, full disclosure is not spe-

cifically required with respect to the sharing of salaried employees, office space, mailing lists, or other expenses, or the sale, lease, loan, contribution or grant, or other transfer of funds and assets between such organizations, even though these types of relationships or transactions may give rise to abuses of tax-exempt status as a charitable organization and diversion of tax-deductible contributions to political campaign expenditures or other impermissible uses." House OBRA Report at 1616.

Under prior law, there was also no penalty for failing to include required information on Forms 990 or 990-PF. The House Committee observed that the "mere filing of a return without fully and accurately furnishing the required information does not serve the enforcement and accountability objectives of the return requirement." House OBRA Report at 1616. A subsequent report, prepared by the General Accounting Office at the request of House Subcommittee on Commerce, Consumer, and Monetary Affairs, found that almost one-half of all Form 990's filed were incomplete, and lacked one or more supporting schedules. General Accounting Office, Availability and Completeness of Returns for Tax-Exempt Organizations (GAO/GGD-88-128 September 1988).

3. Disclosure Required Under OBRA.

- a. Annual Information Returns. § 6033(b) was amended to provide that the annual return filed by a tax-exempt organization described in § 501(c)(3) must include such information as may be required by the IRS with respect to "direct or indirect transfers to, and other direct or indirect transactions and relationships with" any other organization described in § 501(c)(3) (other than another § 501(c)(3) organization) and with any political organization described in § 527. § 6033(b)(9). The regulations are to prescribe the required information to prevent "diversion of funds from the organization's exempt purpose" and the "misallocation of revenues or expenses" between organizations. § 6033(b)(9)(A) and

(B). Broad authority is granted to adopt other so-called legislative regulations. § 6033(b)(10).

- b. Penalties. OBRA amended § 6652(c) to impose penalties on a tax-exempt organization which, without reasonable cause, fails to include any information required on a filed return, or furnishes incorrect information. The penalty is \$10 for each day during which the failure continues, but not more than the lesser of (1) \$5,000 or (2) 5 percent of the organization's gross receipts for the year. § 6652(c)(1)(A). If the organizations's managers refuse to furnish the required information after written demand by the IRS, they are subject to a similar penalty (not to exceed \$5,000 on all persons with respect to one return), unless the failure is due to reasonable cause. § 6652(c)(2)(B). Thus, to avoid the possibility of penalties, if a question on the annual information return is inapplicable to an organization, the organization might well so indicate on the return, rather than leaving a question unanswered or a line on the return blank. Caplin & Drysdale Memorandum at 4.
- c. Effective Date. The additional information must be furnished on annual returns for years beginning after December 31, 1987. The penalty for failure to provide required or correct information applies to returns for years beginning after December 31, 1986. OBRA §§ 10703(b), 10704(d)(1).
- d. Exemption Applications. OBRA did not amend the statute with respect to information required to be included in exemption applications. The legislative history, however, requests the Service to revise Form 1023 or its instructions to provide more detailed information:

"relating to whether the applicant is controlled by or is the outgrowth of another organization, or has a special relationship with another organization, . . . [or] was controlled by or had interlocking boards of directors with any other exempt organization within the last five years, and whether the appli-

cant has taken over or plans to take over any assets (such as mailing lists or intangible assets) of any other exempt organization." House OBRA Report at 1618.

As of the end of October, 1988, no revisions to Form 1023 or its instructions had been issued.

D. Disclosure That Certain Information or Services Sold By Tax-Exempt Organizations Are Available Free from the Federal Government.

1. Prior Law. There was no tax penalty if a tax-exempt organization selling information or services to the public failed to disclose that such information or services could be obtained free (or for nominal charge) directly from the Federal Government.
2. Abuses or Inadequacy of Prior Law. The House Committee was informed that some tax-exempt organizations were selling, "often at a considerable profit," information or services readily available to the public from the federal government either free of charge or for a nominal charge.

"For example, . . . certain organizations offer to furnish the forms needed to obtain a social security number or earnings record, charging up to \$10, even though the forms could be obtained simply by telephoning or writing the nearest social security office." House OBRA Report at 1618.

The organizations failed to disclose that the information was available free or for a nominal charge. The committee concluded that such failure was "misleading and . . . an abuse of the organization's tax-exempt status." House OBRA Report at 1619.

3. Disclosure Required Under OBRA.

- a. General Rule. New § 6711 imposes a penalty on any tax-exempt organization that intentionally offers to sell:

"specific information or a routine service for any individual which could be readily obtained by such individual free

of charge (or for a nominal charge) from an agency of the Federal Government"

without making "an express statement (in a conspicuous and easily recognizable format) that the information or service can be so obtained." The penalty is only imposed if the failure to disclose is due to "intentional disregard" of the disclosure requirement. § 6711(a). [Query: is ignorance of this provision an excuse?]

- b. Statutory Interpretation. Although the terms "specific information" and "routine service" are ambiguous, the legislative history states that "[t]he disclosure requirement applies only with respect to information or services that are specific to a potential purchaser," such as obtaining a social security identification number for the individual. It continues:

"Thus, the disclosure requirement does not apply, for example, with respect to furnishing copies of newsletters issued by Federal agencies or providing copies of or descriptive material on pending legislation. The disclosure requirement does not apply with respect to providing services which are not routine; for example, the requirement does not apply to offers of services such as the preparation of income tax returns or grant applications, or the furnishing of hospital or other health-care services, even though some individuals may be entitled to obtain such services free of charge from Federal agencies." House OBRA Report at 1619-20.

See generally IRS and Joint Committee Officials Discuss New Exempt Organization Disclosure Requirements, 38 TAX NOTES 1159-61 (March 14, 1988).

- c. Penalty. The intentional failure to disclose subjects the organization to a penalty equal to the greater of (1) \$1,000 for each day the failure occurred or (2) 50 percent of the aggregate cost of solicitations made by the organization which failed to include the required disclosure. § 6711(b).

- d. Effective Date. The new provisions apply to offers after January 31, 1988. OBRA § 10705(c).

III. POLITICAL CAMPAIGN ACTIVITIES AND LOBBYING ACTIVITIES OF § 501(c)(3) ORGANIZATIONS

A. Clarification of Prohibited Political Campaign Activities.

1. Prior Law. An organization did not qualify for tax-exempt status as a charitable organization, and was not eligible to receive tax-deductible contributions, unless the organization did "not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." E.g., §§ 501(c)(3), 170(c)(2)(D). The quoted language was added as part of the 1954 Internal Revenue Code. Treasury regulations interpreted it as covering such activities either on behalf of or in opposition to any candidate for public office. Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii). See generally Cummings, Political Expenditures, Tax Mgmt. (BNA) 231-3rd (1988), at A-30 et seq.
2. Inadequacy of Prior Law. The House Committee felt that the statutory language:

"should be clarified to make specific reference to such activities in opposition to, as well as such activities on behalf of, a candidate for public office. This clarification reflects the present-law interpretation of the statute." House OBRA Report at 1621.
3. Definition of Prohibited Political Activity Under OBRA. The relevant Code provisions were amended to add the parenthetical phrase "(or in opposition to)" to the pre-existing statutory language. §§ 170(c)(2)(D); 501(c)(3); 504(a)(2)(B); 2055(a)(2) and (3); 2106(a)(2)(A)(ii) and (iii); 2522(a)(2); 2522(b)(2) and (3).

B. Status of Organization After Loss of Exemption Under § 501(c)(3) Because of Certain Activities.

1. Prior Law. Prior law provided (and still provides) that a charitable organization might lose its tax-exempt status under § 501(c)(3) because of its lobbying or political-campaign activities. See Cummings, Political Expenditures, Tax Mgmt. (BNA) 231-3rd (1988), at A-47 et seq. A distinction existed, however, under the pre-OBRA version of § 504(a), as to qualification as a § 510(c)(4) (social welfare) organization following such loss of § 501(c)(3) status:

- a. If § 501(c)(3) status was lost by virtue of lobbying activities, the organization could not be treated thereafter as a tax-exempt social welfare organization.
- b. If, however, § 501(c)(3) status was lost through prohibited political campaign activities, the organization was sometimes eligible to be automatically reclassified as tax-exempt under § 501(c)(4).

2. Abuses or Inadequacy of Prior Law. There was no logical rationale for the above distinction.

"If . . . an organization could simply convert from one category of tax-exempt status to another, the revocation of its exempt status under section 501(c)(3) would not constitute a sufficient penalty (particularly if the organization did not plan to seek tax-deductible contributions thereafter) for violating the flat prohibition on political campaign activities, or operate as a sufficient deterrent to dissuade charitable organizations from engaging in such prohibited activities." House OBRA Report at 1622.

3. Change in Law Under OBRA. § 504(a)(2) was amended to deny § 501(c)(4) status to any § 501(c)(3) organization losing its exemption by virtue of political-campaign activities. The House OBRA Report adds that:

"the Treasury Department may issue regulations as necessary or appropriate to prevent the avoidance of the rule, e.g., as where the disqualified organization directly or indi-

rectly transfers all or part of its assets to an organization controlled (directly or indirectly) by the same persons who controlled the transferor." House OBRA Report at 1622.

C. Excise Taxes on Political Expenditures of Charitable Organizations.

1. Prior Law. As mentioned in § III.B.1, p. 16 above, under prior (and present) law, any § 501(c)(3) organization, whether or not a private foundation, ceases to qualify for tax-exemption and for eligibility to receive tax-deductible contributions if it engages in political-campaign activities. Under prior (and present) law a private foundation (but not a public charity) is also subject to various excise-tax "penalties" under § 4945 for engaging in certain types of lobbying or political activities. See also § 6684.
2. Abuses or Inadequacy of Prior Law. For § 501(c)(3) organizations other than private foundations, the pre-OBRA sanctions for engaging in political activities -- loss of tax-exempt status and eligibility for tax-deductible contributions, but no excise taxes -- were sometimes either too harsh or too weak:
 - a. The IRS might "hesitate to revoke the exempt status of a charitable organization . . . in circumstances where that penalty may seem disproportionate," such as "where the expenditure was unintentional and involved only a small amount" and the organization subsequently corrected its procedures. House OBRA Report at 1623-24.
 - b. Conversely, "revocation of exempt status may be ineffective as a penalty or as a deterrent, particularly if the organization ceases operations after it has diverted all its assets to improper purposes." House OBRA Report at 1624.

The latter may have been more significant than the former. In the months preceding the enactment of OBRA, there was considerable concern among members of Congress that organizations claiming tax-exempt status had been engaging in prohibited political activities. The most celebrated instance of this abuse was the National Endowment for the Preservation of Liberty (NEPL). NEPL was an exempt organization which supported the Administration's policy toward Nicaragua. NEPL allegedly received funds from the sale of arms to Iran and used them to finance the campaigns of conservative members of Congress and to fund advertisements against members of Congress who opposed aid to the Contras. Among the members opposed by NEPL was Congressman J.J. Pickle, the Chairman of the Subcommittee on Oversight which held the hearings (see ¶ I.C, p. 2 above) which ultimately led to the relevant OBRA legislation. The Service revoked NEPL's exempt status after its president, Carl Channell, pleaded guilty to conspiracy to defraud the government by using tax-deductible contributions to fund the Contras. See The Political Activities of Exempt Groups -- What the Experts Say, 34 TAX NOTES 1147-49 (March 23, 1987).

3. Excise Taxes On Political Expenditures Under OBRA.
 - a. General Rule. New § 4955, entitled "Taxes on Political Expenditures of Section 501(c)(3) Organizations," was added by OBRA. It provides that a charitable organization that makes a "political expenditure" is subject to essentially the same first-tier and second-tier excise taxes to which private foundations have been (and continue to be) subject under § 4945. § 4955(a), (b). The adoption of the excise tax sanction "does not modify the present-law rule that an organization does not qualify for tax-exempt status as a charitable organization, and is not eligible to receive tax-deductible contributions," if it engages in political-campaign activities. House OBRA Report at 1624. The § 4955 excise tax may be avoided if the "taxable event" was "not willful and flagrant" and has been "corrected." § 4962(a), (c). § 4962(c) was added in Conference. See H.R. Conf. Rep. No. 100-495, 100th Cong., 1st sess. 1020, reprinted in 1987 U.S. Code Cong. & Admin. News 2313-1760, 2313-1767 [hereinafter referred to

as the "Conference OBRA Report"].

- b. Definition of Political Expenditures Subject to the Excise Tax. The House bill imposed the excise tax on two categories of expenditures, the first of which (called the "general" rule) applies to all charitable entities, but the second of which (styled "other expenditures") would have applied only in more limited situations:
- (1) All § 501(c)(3) entities are subject to the excise tax with respect to "any amount paid or incurred . . . in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." The quoted language was accepted in Conference and was enacted as § 4955(d)(1).
 - (2) A more limited group of charitable organizations -- those "formed, or availed of, substantially for purposes of promoting the candidacy or potential candidacy of an individual for public office" -- would also have been subject to the excise tax with respect to five additional types of expenditures enumerated in the bill. House OBRA Report at 1627. As modified by the Conference Agreement, this provision is § 4955(d)(2).

The Conference Agreement modified the House Bill by narrowing the definition of the organizations subject to excise tax on the second (and expanded) types of expenditures. They include only entities either formed or "effectively controlled by" a candidate, and only if such entities are "primarily" formed or availed of to promote such candidacy.

- c. Statutory Interpretation. The legislative history gives some guidance as to the interpretation of "effectively controlled by," "primary" purpose, and the scope of the enumerated additional categories of expenses. Thus:

(1) The Conference Report states that:

"an organization is to be considered as effectively controlled by a candidate or prospective candidate only if the individual has a continuing, substantial involvement in the day-to-day operations or management of the organization. An organization is not to be considered as effectively controlled by a candidate or a prospective candidate merely because it is affiliated with such candidate, or merely because the candidate knows the directors, officers, or employees of the organization. Likewise, the effectively controlled test is not met merely because the organization carries on its research, study, or educational activities with respect to issues in which the individual is interested or with which the individual is associated." Conference OBRA Report at 1021.

(2) The legislative history states that:

"the determination of whether the primary purposes of an organization . . . are promoting the candidacy or prospective candidacy of an individual for public office is to be made on the basis of all relevant facts and circumstances." House OBRA Report at 1021.

Various relevant factors are set forth in the Conference OBRA Report at 1021-22.

(3) The five categories of additional expenses which are subject to the excise tax, under § 4955(d)(2), are:

"(A) Amounts paid or incurred to such individual for speeches or other services;

"(B) Travel expenses of such individual;

- "(C) Expenses of conducting polls, surveys, or other studies, or preparing papers or other materials, for use by such individual;
- "(D) Expenses of advertising, publicity, and fundraising for such individual.
- "(E) Any other expense which has the primary effect of promoting public recognition, or otherwise primarily accruing to the benefit, of such individual."

Some additional guidance on the intended scope of these categories is provided by the House OBRA Report at 1627 and the Conference OBRA Report at 1021.

- d. Enforcement. The House Committee directed the Service to report periodically to the committee concerning its enforcement of the prohibition against political campaign activities. House OBRA Report at 1627-28. See also ¶ III.D.3, p. 22 below.
- D. Additional Enforcement Authority in the Case of Flagrant Political Expenditures by Charitable Organizations.
- 1. Prior Law. The Service did not have authority to make immediate "termination" tax assessments or to seek a court injunction against continuing political expenditures of a charitable organization even if the organization was flagrantly violating the prohibition on any political campaign activities. The Service does, however, have such authority in other areas of the tax law.
 - 2. Abuses and Inadequacy of Prior Law. The House Committee found that certain organizations which engaged in prohibited political activities (and thus ceased to qualify for tax-exempt status and eligibility to receive tax-deductible contributions) nonetheless continued to represent themselves as eligible to receive tax-deductible contributions and then used these funds for prohibited activities. Under prior law, the Service might not be able to revoke an organization's exemption status until the organization filed its information return and the return was selected for audit.

House OBRA Report at 1628-29. As the legislative history stated:

"By that time, all contributions received by the organization (for which the donors have claimed charitable deductions) and its other assets may have been spent on nonexempt activities, and the organization may have ceased operations. As a result, the subsequent issuance of the exemption revocation does not have a deterrent effect on the organization or operate as an effective penalty, particularly since the organization no longer may have any assets out of which tax liabilities could be collected." House OBRA Report at 1629.

3. Enforcement Authority Under OBRA.

- a. Determination and Assessment of Income Tax. New § 6852 authorizes the IRS to make an immediate determination and assessment of income tax, or of the excise tax on political expenditures for the current or preceding taxable year of a charitable organization described in § 501(c)(3) if the Service finds that (i) the organization has made political expenditures, and (ii) such expenditures constitute a flagrant violation of the prohibition against political expenditures.
- b. Authority to Enjoin Flagrant Political Expenditures of § 501(c)(3) Organizations. New § 7409 authorizes the Service to seek an injunction from a federal district court prohibiting a charitable organization from making any further political expenditures. The injunction action may be instituted only if the Service notifies the organization of its intention to seek an injunction if the making of the political expenditures does not immediately cease, and only if the Commissioner of Internal Revenue has personally determined that (1) the organization has flagrantly participated or intervened in a political campaign, and (2) injunctive relief is appropriate to prevent future political expenditures.

E. Excise Tax on Disqualifying Lobbying Expenditures of Certain Charitable Organizations.

1. Prior Law. A charitable organization (including a private foundation) ceases to qualify for tax-exempt status under § 501(c)(3), or for eligibility to receive tax-deductible contributions, if more than an insubstantial part of its activities consists of carrying on propaganda or otherwise attempting to influence legislation, except as provided in § 501(h). A private foundation is subject to an excise tax equal to ten percent of any expenditure to carry on propaganda or otherwise to attempt to influence legislation or for any other noncharitable purposes. § 4945. If the foundation is liable for the excise tax, any manager of the foundation who, without reasonable cause, agreed to making the expenditure knowing it was a taxable expenditure is subject to an excise tax equal to 2-1/2 percent of the expenditure (not to exceed \$5,000 per expenditure).

Certain tax-exempt charities may elect to have the amount of permitted lobbying expenditures they may make measured under the arithmetical tests of § 501(h). If lobbying expenditures exceed the amounts allowed under § 501(h), a tax equal to twenty-five percent of the excess lobbying expenditures is imposed on the organization. If the electing organization's lobbying expenditures are normally more than 150 percent of the allowed amounts, the organization is disqualified from tax-exempt status.

2. Abuses or Inadequacy of Prior Law. The House OBRA Report noted that:

"revocation of exempt status may be ineffective in the case of certain charitable organizations as a penalty or as a deterrent to engaging in more than insubstantial lobbying activities, particularly if the organization ceases operations after it has diverted all its tax-deductible contributions and exempt income to improper purposes but before it has been audited and any income tax liability has been assessed." House OBRA Report at 1631.

It was believed that a more effective sanction against prohibited lobbying activities would be to supplement the sanction of revocation of exempt

status with an excise tax similar to the excise taxes applicable to private foundations and § 501(h)-electing organizations.

3. Excise Taxes Disqualifying Political Expenditures Under OBRA.

- a. General Rule. New § 4912, added by OBRA, imposes a 5-percent excise tax on the lobbying expenditures of certain charitable organizations if the organization ceases to qualify for tax-exempt status under § 501(c)(3) by engaging in more than an insubstantial amount of lobbying activities. § 4912(a). The excise tax does not apply to (i) organizations that have made the 501(h) election; (ii) organizations not eligible to make the 501(h) election; and (iii) private foundations (which are subject to the § 4945 excise tax), § 4912(c)(2).
- b. Managers' Liability. The Conference Agreement modified the House Bill to provide that if an organization whose exempt status has been revoked is liable for the new excise tax on disqualifying lobbying expenditures, a tax equal to five percent of such lobbying expenditure is imposed on any manager of the organization who agreed to the making of such expenditures "knowing that such expenditures are likely to result" in revocation of the organization's exempt status, unless the manager's agreement was not willful and was due to reasonable cause. § 4912(b). The House Bill would have imposed the tax on a manager who agreed to the making of such expenditures knowing that such expenditures "could" result in revocation of the organization's tax-exempt status. A manager is liable for the excise tax only if the Service demonstrates that the manager knew the expenditures constituted lobbying expenditures, knew that the organization was likely to lose its tax exempt status as a result of the expenditures, and only if the manager failed to obtain an opinion of counsel that would protect the manager under the reasonable cause exception.