August 30, 2002

Mr. Steven T. Miller
Director -- Exempt Organizations
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Mr. Miller:

We enclose a copy of an article, which you may have already seen, that appeared last Sunday in the *Washington Post* concerning the flow of political "soft money" through IRC Section 527 and Section 501(c)(4) organizations.

We know that your office's current business plan for guidance on exempt organization matters includes the subject of Section 501(c)(4) social welfare organizations. Considering that a number of existing and new 501(c)(4) entities may be vehicles for political spending, particularly after the McCain-Feingold legislation becomes effective on November 6, 2002, this seems an opportune time for the Service and Treasury to directly address political activities of social welfare organizations.

In our experience, there seem to be a number of features inherent in the Section 501(c)(4) exemption that would tend to inhibit the use of social welfare organizations as an alternative political spending vehicle compared with Section 527 political organizations. Those features include:

- The application of federal gift tax to a donor's contributions exceeding $11,000 per year.

- The requirement that political activities be less than a primary part of the organization's overall activities.

- The tax under Section 527(f) on the lesser of political expenditures or investment income during the entity's tax year.

However, questions persist among practitioners concerning the application of these rules. If, as seems likely, the trend described in the *Post* article is real, it will severely exacerbate the problems and could lead to increased abuses of 501(c)(4) status.

Therefore, we suggest that it would be important for precedential guidance to be issued addressing the following questions:

1. Are donors expected to pay gift tax on their large contributions made to Section 501(c)(4) organizations? Will the IRS enforce the gift tax requirement on donors who fail to do so? Does Rev.Rul. 82-216, 1982-2 Cum.Bull. 220, still apply?

2. How can a Section 501(c)(4) organization demonstrate that its political activities are less than a primary part of its total activities for a given tax year, under Rev.Rul 81-95, 1981-1 Cum.Bull. 332? May a 501(c)(4) organization look only at its expenditures, classify them as political and nonpolitical, or partisan and nonpartisan, and continue to qualify for exemption so long as all nonpartisan, nonpolitical expenditures cumulatively exceed 50 percent of total expenditures?

3. How are overhead, administrative, and fundraising costs treated for purposes of the primary versus secondary calculation? Are they disregarded? Must they be allocated proportionately between political, partisan and nonpolitical, nonpartisan programs? May they be treated as entirely nonpolitical, nonpartisan expenditures?

4. Where a Section 501(c) organization sponsors a Section 527 separate segregated fund, Reg. Sec. 1.527-6 allows the parent organization to avoid the Section 527(f) tax on indirect expenses (e.g., overhead, record-keeping, fundraising) and on expenditures allowed by the Federal Election Campaign Act or a similar state statute. Do those expenditures nevertheless count as political, partisan expenditures when making the primary versus secondary calculation, or are they disregarded? Or may they safely be treated as nonpartisan, nonpolitical expenditures?

5. A Section 501(c)(4) organization needs to make a number of judgment calls about certain borderline activities that may or may not be treated as partisan, political programs. Among those programs are:

a. Preparation and distribution of voter guides, based on responses to candidate questionnaires or upon a compilation of information from other sources.

b. Preparation and distribution of incumbents' voting records (legislative scorecards), including posting such records on the internet.

c. Broadcast advertisements containing issue advocacy and identifying incumbents who are candidates for public office.

d. Targeted voter registration and get-out-the-vote activities.

We know the Service has already gone to great lengths to try to answer some of these classification questions in recent Continuing Professional Education texts, but the CPE analysis has left substantial gaps, and in any event is not precedential. The proper classification of such activities is a critical matter affecting the exemption not only of Section 501(c)(3) charities, which are absolutely prohibited from political intervention, but also these Section 501(c)(4) social welfare organizations, which are required to maintain such activities at a less-than-primary level.

It seems clear that unless the Service and Treasury move quickly to define the operating parameters for Section 501(c)(4) organizations in the political field, soft money forces will move rapidly to avoid the recently enacted Section 527 disclosure regime by operating aggressively in the fashionable attire of a Section 501(c)(4) entity.

Very truly yours,

Gregory L. Colvin

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Enclosure

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