IRS LETTER RULINGS

Letter Ruling Alert

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Charities and Election-Year Politics: The Transformation of a Public Figure's Charity Fund-Raising Letter into a Charity-Sponsored Campaign Advertisement

In a year where heated partisan campaign politics have dominated public consciousness, there has been heightened potential for charities to engage in activities that may be construed as political campaign participation or intervention, prohibited under section 501(c)(3). There has been strong economic incentive to capitalize on the election year political fervor by using prominent political candidates as charity fund-raising spokespeople. There has also been a lack of clarity in the IRS's definition of political campaign intervention. Combined, these factors have left charities grappling with the distinctions between appropriate fund-raising endorsements by candidates and prohibited political campaign interventions. TAM 200044038 (July 24, 2000) (p. 373) provides some guidelines for evaluating election-year fund-raising efforts for charities that have been walking this tightrope. It highlights those factors, particularly the type of language and messages, that transform a perfectly acceptable charity solicitation by a prominent public figure into a charity-funded political candidate campaign advertisement.

This TAM also calls into question whether a single incident of this sort of political activity will cause the Service to revoke section 501(c)(3) status. The facts as characterized by the Service easily support a finding that the exempt organization's direct mail fund-raising campaign supported a particular political candidate and his party. Nevertheless, as has often been its practice, the Service did not mention revocation of the organization's exempt status, implying that the 10-percent tax imposed by section 4955 is a sufficient sanction.

The Facts

The ruling addresses the fund-raising activities of a section 501(c)(3) organization with the educational purpose of sponsoring research on social and economic issues.[1] In April 1995, an advertising company specializing in direct mail contacted the exempt organization to determine whether it would be interested in a fund-raising package signed by *A*, a prominent public figure. *A* had signed fund-raising letters for the organization in the past. In the same month, *A* announced his candidacy for public office.

The initial agreement between the parties provided that *A* would sign the organization's fund-raising letter in return for *A*'s one-time use of the donor-mailing list generated by the direct mail campaign. The parties also agreed that *A*'s signature on the organization's fund-raising letter did not constitute *A*'s endorsement of the organization, or the organization's endorsement of *A*.

The organization often purchased the signatures of prominent public figures in exchange for a one-time use of its donor mailing lists. The advertising agency that brokered the fund-raising agreement between *A* and the organization reported that all matters related to the mailings in question were handled in the same fashion as the organization's other fund-raising mailings using high-profile signatures.

Numerous versions of a fund-raising letter written on *A*'s stationary and signed by *A* were produced for prospective and previous donors. Although various versions of the letter contained different statements by *A*, the overall tone and language of the letters was similar. In all, the exempt organization mailed 2,733,165 letters.

Pursuant to the agreement, the organization turned over a mailing list of over 43,000 donors to *A* for his one-time use. However, *A*'s campaign used the list repeatedly, contrary to the provisions of the agreement. Once this breach was discovered, a new agreement provided the organization with one-time use of 35,000 names from *A*'s campaign donor list as additional compensation.

The organization's principal officers ratified the fund-raising transactions in question. The officers were aware that such letters could have tax ramifications, and they consulted with counsel knowledgeable in tax issues about the letters in question. The counsel verbally approved the letters as being consistent with applicable tax requirements. Counsel also produced a brief memo in which he reviewed other legal issues connected with using the signature of *A*, an active candidate for political office.

In the TAM, the Service addressed six separate issues: (i) whether the exempt organization intervened in a political campaign within the meaning of section 501(c)(3) by sending out the fund-raising letters signed by *A*, an active candidate for political office; (ii) whether the exempt organization intervened in a political campaign by providing *A* with donor mailing lists; (iii) whether the exempt organization's actions constituted a private benefit to *A*; (iv) whether the sanctions for political activity in section 4955 applied to the organization; (v) whether the section 4955 sanctions applied to its managers; and (vi) whether section 7805(b) relief should be granted.

Service Ruling and Rationale

Fund-Raising Letters

The Service found that the exempt organization had engaged in political campaign intervention within the meaning of section 501(c)(3) when it mailed fund-raising letters written and signed by *A*.

Section 501(c)(3) describes a tax-exempt charitable organization, in part, as one "which 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 political candidate for public office." Under section 4955, organizations are taxed at a rate of 10 percent on each expenditure that constitutes a political campaign intervention. Organization managers who knowingly participate in such political expenditures are taxed 2.5 percent of such expenditures.

In applying these restrictions to the fund-raising package in question, the Service recognized that the exempt organization had a legitimate fund-raising purpose in sending out letters written and signed by *A*, a declared candidate for public office. However, the Service noted that the organization's legitimate purpose in sending out such letters did not prevent the mailings from constituting political intervention. The Service cited Rev. Rul. 67-71, 1967-1 C.B. 125, in which it ruled that an organization's objective and unbiased evaluation and recommendation of candidates, intended to educate and inform the public, constituted campaign activity. The Service also note that the Second Circuit arrived at a similar conclusions in *Association of the Bar of the City of New York v. Commissioner*, 858 F.2d 876 (1988, *cert. denied*, 490 U.S. 1030 (1989) (finding that non-partisan ranking of judicial candidates was political intervention). The Service also cited its reasoning in Rev. Rul. 76-456, 1976-2 C.B. 151, which explained that an organization promoting ethical campaign conduct would participate in a political campaign if it solicited endorsements of its ethics code from candidates.

The fund-raising letters would not amount to "express advocacy" as defined by federal election law. Nevertheless, the Service indicated that such efforts could amount to political campaign intervention under section 501(c)(3) based on their overall impact, including a bias in favor or against any particular candidate. In support, the Service cited its reasoning in Rev. Rul. 86-95, 1986-2 C.B. 73, in which it explained that an exempt organization conducting public forums involving candidate statements could intervene in a political campaign by showing bias or preference for or against a particular candidate.

The Service also distinguished the activities of the exempt organization from the facts of Rev. Rul. 80-282, 1980-2 C.B. 178, where an exempt organization's member newsletter, which listed candidate voting records on selected legislative issues along with an explanation of the organization's stance on such issues, did not amount to political intervention. Unlike the newsletter, the fund-raising letters in question were widely distributed to the public (more than 2 million sent) and directly coincided with an election.

Aside from the timing of the letters, the Service found the letters' contents to be the most determinative factor in finding the exempt organization had participated in a political campaign. The letters contained statements about *A*'s intentions if elected, which were indistinguishable from his campaign promises.[2] Other statements used political jargon to identify and criticize the political party and policies of *A*'s opponent.[3] The Service suggested that the use of political jargon such as: "Conservative," "Liberal," and "Leftist" were employed to imply support for *A* and attack his opponent. Finally, other language in the letters attacked *A*'s opponent directly.[4] The Service reasoned that such statements by *A* constituted political participation and could be attributed to the exempt organization, on whose behalf *A* wrote the fund-raising letters. The Service also found that the exempt organization intervened in a political campaign by distributing campaign statements. It compared the situation to an organization inviting a candidate to speak as an expert or public office holder and needing to require the candidate to limit her discussion to that capacity. In short, the Service concluded that the content, authorship, and timing of the letter would cause the recipient to perceive the letter as an endorsement of the candidate and his political policies.

Name List Transfers

The Service concluded that the exempt organization's transfer of its list of 43,000 donors to *A* for one-time use in exchange for *A*'s signature was an appropriate and legitimate business transaction. However, the Service declined to address whether one-time use of *A*'s campaign mailing lists was adequate compensation for *A*'s excessive use of the organization's 43,000 donor list. If all these exchanges were for fair market value, the exempt organization did not advance *A*'s campaign. Because the Service lacked information concerning the valuations of the various mailing lists in question, it could not establish whether such transactions constituted political participation or intervention by the exempt organization.

Private Benefit

The Service found it unnecessary to address whether or not the provision of mailing lists for campaign use by a candidate constituted prohibited private benefit under reg. 1.501(c)(3)-1(d)(1)(ii), since it found that the organization had participated in a political campaign.

Section 4955(a)(1)

The Service found that the section 4955 tax on political expenditures applied to the exempt organization's direct mail fund-raising campaign, because sending the letters constituted participation or intervention in a political campaign.

Section 4955(a)(2)

The Service found that the section 4955(a)(2) tax imposed on organization managers of 2.5 percent of any political expenditure did not apply to the managers in this situation because there was no evidence to indicate that the managers agreed willfully and without reasonable cause to expenditures knowing they were political interventions.

Section 4955(a)(2) imposes tax on managers who knowingly and willfully agree to a political expenditure, without

reasonable cause. Based on the facts provided, the Service reasoned that the manager had not met the "knowingly" requirement under reg. section 53.4955-1(b)(1). The organization's managers had sufficient experience to understand that there could be tax implications to the fund-raising program. However the managers submitted the entire mail packet and the related agreement to the organization's legal counsel, who was experienced with tax issues. Both the managers and legal counsel attested that legal counsel gave oral approval of the documents, although counsel did not provide written approval due to time restraints and the lack of legal authority. Counsel also provided a brief legal memo addressing some of the potential legal implications of the fund-raising program.

The Service suggested that the brief memo might constitute a reasoned legal opinion, protecting the managers from the political expenditure tax under reg. section 53.4955-1(b)(7) which provides a safe harbor for managers who rely on a reasoned legal opinion that the expenditure is not political. However, even without his safe harbor, the Service found that the memo and the oral opinion of counsel precluded a finding that the managers knew the expenditure was political, and that their agreement was willful and not due to reasonable cause.

Section 7805(b) Relief

The Service declined to provide relief available under section 7805(b) for its adverse ruling that the organization had violated provisions of sections 501(c)(3) and 4955 on the basis of two previous rulings obtained by the organization and the Service's examination of prior year returns. The ruling does not discuss the facts of the previous rulings obtained by the organization, or the Service's reasoning in denying section 7805(b) relief.

Discussion

This ruling is significant for its analysis of candidate fund-raising letters as political campaign intervention. The TAM targets the timing of the fund-raising letters signed by a candidate (during the course of the election campaign) as objectionable. However, the TAM also concedes that charities can call on candidates for public office to speak in their individual capacities, provided that the organization "ensure[s] that the candidate speaks only in his or her individual capacity and that no campaign activity occurs in connection with the event." This reasoning suggests that candidate speech on behalf of a charity, during the course of an election, does not automatically constitute political participation. Conceivably, a charity could send fund-raising letters written and signed by a candidate during an election period, provided that the content of the letter is narrowly tailored so that the letter's recipients would not perceive it as a campaign statement.

Rather, it was the content of the letters, signed and timed as they were, that resulted in campaign intervention. Charities wishing to avoid this result should be aware of content in a fund-raising letter signed by a candidate that sounds like campaign promises or resolutions or that either criticizes the policies or platforms of opposing candidates or political parties directly, or indirectly through the use of jargon typically associated with specific political parties and their candidates.

This is not the first instance in which the Service has objected to the content of fund-raising letters as causing prohibited political intervention. In TAM 9609007 (December 6, 1995), the Service scrutinized fund-raising letters (written and signed by the charity itself) that made direct and implied derogatory statements about a particular party and its candidates, and favorable statements about an opposing party and its candidates.[5] The organization insisted that its voter registration efforts were nonpartisan. However, its fund-raising letters indicated that it sought to register supporters of a particular political party. The Service therefore concluded that the organization had engaged in impermissible campaign intervention. TAM 200044038 serves to both amplify and clarify this ruling, by providing specific examples and helping to define the scope of fund-raising speech that may constitute campaign intervention.

Assuming the Service's characterizations of the facts in TAM 200044038 are accurate, its penalty choice is not well-explained. The Service concluded that the organization engaged in campaign intervention, which is a violation of section 501(c)(3) but imposed only the section 4955 tax and did not seek revocation. The regulations under reg. section 53.4955-1(a) make clear that the existence of the excise tax does not change the requirements for exemption.

Legislative history provides the only guidance in determining when to seek the section 4955 tax and forego revocation. This history suggests that when Congress enacted the section 4955 tax, it did not intend the tax as a substitute of revocation of exempt status in a situation such as this. The 1987 House Budget Committee Report specified that the tax should replace revocation only in instances where the violation was unintentional, involved only a small amount, and the organization had subsequently corrected the violation and adopted procedures to assure that similar expenditures would not be made in the future.

This case does not seem to be consistent with that standard. The organization undertook significant expense, sending out 2 million letters, which clearly promoted the campaign promises of one candidate and opposed the policies of another. The exempt organization took no steps to correct the political endorsements contained in its fund-raising letters. Still, the Service's failure to mention the consequence of revocation in the instance of a one-time error is relatively unsurprising. In TAM 9609007, the Service found that the charity's long-standing practice of sending fund-raising letters in favor of one party and its candidates had been violating the section 501(c)(3) prohibition against public intervention for years. Nevertheless, the Service imposed the section 4955 excise tax and never mentioned revocation of exempt status.

In the absence of further comments from the organization, there is no way of knowing exactly how the Service is applying its discretion these cases. Conventional wisdom among practitioners suggests that the Service rarely discusses revocation where acts of political intervention are isolated, or relatively insignificant in relation to the organization's overall activity. Another possible theory is that this is a form of back-door section 7805(b) relief. If previous rulings and or audits covered situations with very similar activity, the Serv-

ice may have been loathe to revoke exemptions, when they had let non-compliance go in prior years.

In summary, TAM 20044038 provides a list of red flags for charities enlisting candidates for public office in fund-raising activities. It remains unclear whether the failure to seek indicates that the isolated nature of the political participation, or the previous failures to enforce the rules when reviewing the same organization's activities, estopped the Service from seeking the harsh penalty.

Endnotes

[1]A Tax Analysts article has suggested that the TAM addresses the Heritage Foundation and its fund-raising letters signed by Bob Dole, and sent after Dole had announced his candidacy for the 1996 presidential election. Fred Stokeld, "Heritage Foundation is EO Described in TAM on Political Intervention." (*See* p. 250 in this edition.)

[2]The Service cites examples such as:

"I want to start by abolishing the Departments of Education, Housing and Urban Development, Energy and Commerce."

"But I am committed to giving you the reform you want and America needs."

"I will use the results — and your support — to keep the political heat turned up in Washington."

[3]The Service cites examples such as:

"But with [*A*'s opponent] in the White House, true reform will not come easily. It requires all who want it to work together."

"The Liberals spent the last years tinkering, spending and writing laws to create a 'Great Society' but all we have gotten is debt and despair."

"Their thirst for special interest legislation cracks the fragments of our cultural unity. Rather than 'one nation under God' we have become a nation of unconnected special interest groups."

[4]The Service cites examples such as:

"But with well organized liberals in the Senate and [*A*'s opponent] in the [executive branch] — true reform will not come easily."

"Already [*A*'s opponent] and the special interests who profit from the current system (like the National Education Association) are fighting pitched battles to protect the turf that has made many of them too rich and powerful."

[5]The Service cited the following as one example of the organization's objectionable messages:

How much of a difference can you and *O* make this year? Thanks to your support, "*O* voters" have held the balance of power in four U.S. *GG* races, five *PP* races, and over 30 state and local races. Just last year in *D*, *E* won by 6,000 votes, becoming *L*, after *O* registered over 21,000.