CENTER for COMPETITIVE POLITICS

Congress shall make no law...

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Statement of

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on

"IRS Abuses: Ensuring that Targeting Never Happens Again"

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United States House of Representatives
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Mr. Chairman and members of the Committee, thank you for the opportunity to testify on behalf of the Center for Competitive Politics[1] today on this important subject.

While investigations are ongoing and we still do not yet know the full extent of wrongdoing, we know enough to make recommendations to ensure that nonprofit groups are never targeted again. The most important of these recommendations is to get the IRS out of the speech police business as soon as possible.

Given the importance of First Amendment rights and the effect of tax compliance on revenue collections, the IRS is the last agency that should act as the speech police. As a revenue-collecting agency, the IRS is incompetent at regulating political speech, which, in turn, undermines its primary function of collecting revenue. Its continued work in this area could cost the government tens or even hundreds of billions in tax revenue if a lack of trust in the IRS causes tax compliance to fall by even a tiny amount.

The Internal Revenue Service is primarily a tax collection agency. It knows little about nonprofit advocacy and even less about First Amendment protections for free speech. This incompetence was on clear display when the IRS proposed regulations last November attempting to define political activity, which generated over 150,000 public comments. Organizations and citizens across the political spectrum were nearly unanimous in criticizing the proposal for seeking to regulate too much activity.[2]

[1] The Center for Competitive Politics is a nonpartisan, nonprofit 501(c)(3) organization that promotes and protects the First Amendment political rights of speech, assembly, and petition. It was founded in 2005 by Bradley A. Smith, a former Chairman of the Federal Election Commission (FEC). In addition to scholarly and educational work, the Center is actively involved in targeted litigation against unconstitutional laws at both the state and federal levels.

[2] According to a recent analysis by the Center, 87% of public comments sampled wrote to the IRS in opposition to this rulemaking, and 94% of those sampled either opposed or partially opposed the proposal. The Center's analysis of comments from organizations, experts, and public officials found that 97% of these commenters submitted statements to the IRS in varying degrees of opposition to the rulemaking, with 64% of organizations, experts, and public officials firmly in opposition. For more

In fairness to the career staff at the IRS, this is extremely difficult work. The tax laws are complicated, but the relationship of campaign finance laws and the First Amendment is even more complex and raises very difficult constitutional issues. This difficulty is one reason why the IRS should not be involved in this type of political regulation.

The outrageous treatment of groups on the basis of their ideology came about in part because the current IRS guidance, known as the "facts and circumstances" test, is so vague. The vagueness in these rules allowed the IRS to delay tax-exempt applications that should have been granted. We believe the rules are unconstitutional under the landmark *Buckley v. Valeo* decision. In that ruling, the Supreme Court wrote:

> "In short, the supposedly clear-cut distinction between discussion, laudation, general advocacy, and solicitation puts the speaker in these circumstances wholly at the mercy of the varied understanding of his hearers and consequently of whatever inference may be drawn as to his intent and meaning.
>
> Such a distinction offers no security for free discussion. In these conditions it blankets with uncertainty whatever may be said. It compels the speaker to hedge and trim."[3]

This is precisely the problem with the IRS guidance today. Advocacy places nonprofit organizations in "circumstances wholly at the mercy of the varied understanding of his hearers" – in this case, IRS agents!

The Court's solution to the deficiencies in the Federal Election Campaign Act was simple and elegant: "in order to preserve the provision against invalidation on vagueness grounds, [the law requiring organizations to register as political committees and therefore to disclose all of their donors to the government] must be construed to apply only to expenditures for communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office."[4] This is the rule that ought to have been adopted by the IRS 38 years ago following the *Buckley* ruling. Yet, while the Federal Election Commission (FEC) immediately complied with this ruling, the IRS did not. The fact that the IRS did not respond to the *Buckley* decision is more evidence of the agency's inexperience and incompetence in this area – it did not even recognize that *Buckley* had relevance to its regulations.

For political speakers, operating with very low thresholds to trigger status as regulated political committees, such bright lines are essential – there is little room for error. Charged with a task for which it lacks knowledge and expertise, and which is tangential to its core responsibilities, the IRS has yet to produce any type of bright line test similar to that used by the

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information, please *see*: Matt Nese and Kelsey Drapkin, "Overwhelmingly Opposed: An Analysis of Public and 955 Organization, Expert, and Public Official Comments on the IRS's 501(c)(4) Rulemaking," Center for Competitive Politics' Issue Review. Retrieved on July 29, 2014. Available at: http://www.campaignfreedom.org/wp-content/uploads/2014/07/2014-07-08_Issue-Review_Nese-And-Drapkin_Overwhelmingly-Opposed.pdf (July 21, 2014).

[3] *Buckley v. Valeo*, 424 U.S. 1, 43 (1976) (quoting *Thomas v. Collins*, 323 U.S. 516, 535 (1945)).

[4] *Buckley*, 424 U.S. at 44.

Federal Election Commission and required by the Supreme Court in *Buckley*, *FEC v. Massachusetts Citizens for Life*, and *FEC v. Wisconsin Right to Life*.[5] As a result, politically active groups can be reasonably sure they are complying with the Federal Election Campaign Act (enforced by the FEC), only to be left to guess whether they will be pursued by the IRS.

Not only has the IRS failed to develop or apply a bright line test for political advocacy, for social welfare and business associations, there is no clear guidance about the level of permissible political activity as a portion of the organization's budget. The only thing that is clear is that express advocacy counts as political activity, but how much a group can spend even on express advocacy remains an unanswered question.

Equally as important, the recent move into political regulation has embroiled the IRS in political fights the Service should avoid. Given that, from the 1930s through the 1970s, there was considerable history of presidents of both parties attempting to use the IRS to attack political enemies, the Service has long been particularly prickly – and justifiably so – about being dragged into political wars. By forcing the IRS back into the regulation of political activity, however, Congress placed the IRS in an awkward place it prefers not to be and should not be, of having to make audit and tax exemption decisions about politically or public policy oriented entities based on their political and public education activities.

Continued IRS Involvement in Policing Speech May Threaten Tax Compliance, and Could Cost Billions in Tax Collections

The collection of trillions of dollars in taxes each year is based on what the IRS calls the self-assessment feature of the tax laws, where citizens and businesses calculate and pay their taxes. If the agency develops a reputation as a partisan lapdog of the party in power, that could lead to more citizens cheating on their taxes, or simply failing to file, with potentially disastrous implications for the budget deficit. If the level of compliance with just the income tax laws alone were to drop just one percentage point due to a decline in the Service's reputation for fairness, that could cost the government over $170 billion in tax collections over a 10-year period.

A decline in income tax compliance of just 0.2 percentage points is equal to the amount spent by all candidates, parties, and independent groups in the 2012 elections.

Contributions to 501(c)(4) organizations are not tax deductible, and the tax liability of existing 501(c)(4)s wouldn't significantly change if they were reclassified as political committees. Since the IRS's regulation of these groups has essentially nothing to do with tax collection, efforts to increase IRS regulation of political speech makes little sense and is unrelated to the Service's mission of impartial revenue collection.

In any event, the Service has quickly learned that that is not possible to avoid politics once it is given the assignment to regulate overtly political activity. It has been buffeted by politicians from both parties with regularity for its disclosure and enforcement policies regarding

[5] 424 U.S. 1, 79-81; 479 U.S. 238, 253 n. 6 (1986); 551 U.S. 449, 470 (2007) ("…a court should find that an ad is the functional equivalent of express advocacy only if the ad is susceptible of no reasonable interpretation other than as an appeal to vote for or against a specific candidate.").

nonprofits. The IRS may be rapidly hitting the point at which it will be mired in regulatory gridlock – no new regulations or changes in existing regulations will be considered with good faith by members of Congress, each being viewed instead as a partisan scheme.

This dual regulatory scheme between the FEC and IRS has created confusion among nonprofit groups and the public. Further, it has embroiled the Service in political battles in such a way that it now cannot address substantial areas of its core mission because its actions are so suspect in Congress. Especially given the IRS scandal, it would be a mistake to continue to ask the IRS to play any role – let along an even greater role – in the enforcement of campaign finance laws.

Four Solutions to Avoid Future IRS Targeting Scandals

1) *Remove the IRS from the "Speech Police" business.*

We question whether the IRS should be engaged in regulating political or politically-related speech at all. If a nonprofit entity with a social welfare purpose (or any other nonprofit purpose) is a political committee ("PAC") under federal or state law, it ought to be regulated as a 26 U.S.C. ("IRC") § 527 organization. If it is not a political committee under federal or state law, it should not be regulated under § 527, but instead, under the appropriate part of 26 U.S.C. § 501(c).

This straightforward approach would harmonize the IRS's rules with those of the Federal Election Commission, the body entrusted by Congress with "exclusive jurisdiction" for civil enforcement of the nation's campaign finance laws.[6]

This approach would recognize that in a democracy, political education aimed at the public not only should but must fall within the definition of "social welfare" and "educational" activities that constitute exempt activities under § 501(c)(4). Nothing in the statute requires exclusion of these functions from the definition of social welfare. Finally, and most importantly, this straightforward approach offers real clarity without dragging the IRS further into the thicket of political regulation, a tangle from which it – and the Service's reputation for the neutral, nonpartisan collection of revenue – may never recover.

IRS National Taxpayer Advocate Nina Olson's 2013 report to Congress recommends getting the IRS out of political regulation. She wrote that "[t]he IRS, a tax agency, is assigned to make an inherently controversial determination about political activity that another agency may be more qualified to make." From her report:

> "It may be advisable to separate political determinations from the function of revenue collection. Under several existing provisions that require non-tax expertise, the IRS relies on substantive determinations from an agency with programmatic knowledge.

[6] 2 U.S.C. § 437c(b)(1).

> Potentially, legislation could authorize the IRS to rely on a determination of political activity from the Federal Election Commission (FEC) or other programmatic agency. Specifically, the FEC would have to determine that proposed activity would not or does not constitute excessive political campaign activity."[7]

In fact, no legislation is needed to make this change. The FEC already decides if a group conducts "excessive political activity" and can force (and has forced) such groups to register and report as political committees. The IRS could, through a rulemaking or even a revenue ruling, acknowledge that it will classify under § 527 any organization the FEC or equivalent state authority considers a political committee. The FEC's regulations on this point already comply with Supreme Court rulings.

When Congress established the FEC, it gave that agency "exclusive jurisdiction" over the nation's campaign finance laws. In keeping with this charter, the Commission was organized so that no one party could control it and use the policing of speech as a partisan weapon. Over the course of decades, the FEC has developed expertise in the area of political regulation and, sometimes with the prodding of the courts, in the limits the First Amendment places on such regulation.

Campaign finance law has become one of the most complex areas of constitutional law imaginable.[8] For example, the IRS faces far fewer issues regarding campaigns and elections in its everyday business than does the FEC. Its culture and expertise are therefore quite different from that of the FEC, which regularly faces these issues. Indeed, one reason for the frustration with the FEC among those who support more speech regulations has been the unwillingness of these advocates to accept the Constitutional restraints under which the FEC operates. Those who seek to push regulation onto other agencies often do so precisely because they seek to bypass such constitutional sensitivities that are, and ought to be, a hallmark of the FEC.

Few view the FEC as sensitive to the First Amendment. Yet for all its faults, it is better than most other agencies in that sensitivity. The other agencies simply do not have the expertise or agency culture and structure to enforce such laws against the backdrop of a complex layer of constitutional law. Enforcement of such complicated law is difficult, and Congress should not attempt to create new enforcement agencies or give the IRS or other agencies new powers that would stray from their mission.

Getting the IRS out of the speech police business is the only solution that can guarantee a similar harassment scandal will never happen again, protect against a decline in tax compliance, and restore the agency's reputation.

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[7] Nina Olson, "Special Report to Congress: Political Activity and the Rights of Applicants for Tax-Exempt Status," Taxpayer Advocate Service. Retrieved on July 29, 2014. Available at: http://www.taxpayeradvocate.irs.gov/userfiles/file/FullReport/Special-Report.pdf (June 30, 2013), p. 16.

[8] Indeed, at the oral argument in *McCutcheon v. FEC*, Justice Stephen Breyer offered a series of hypotheticals centered around naming a PAC after a candidate for office, a practice which, via FEC regulation, is illegal. Tr. of Oral Argument, *McCutcheon v. FEC*, 12-536 at 4 (Oct. 8, 2013); 11 C.F.R. 102.14 (2014). Justice Antonin Scalia noted that he felt that "this campaign finance law is so intricate that I can't figure it out." Tr. of Oral Argument, *McCutcheon v. FEC* at 17.

2) ***The provisions of 26 U.S.C. § 7217, which makes it illegal for certain executive branch personnel to either directly or indirectly request that the IRS audit or investigate a taxpayer, should be amended to apply to members of Congress and congressional staff.***

After the Watergate scandal, Congress passed legislation, codified at 26 U.S.C. § 7217, to make it illegal for "the President, the Vice President, any employee of the executive office of the President, and any employee of the executive office of the Vice President" as well as any cabinet level officer other than Attorney General "to request, directly or indirectly, any officer or employee of the Internal Revenue Service to conduct or terminate an audit or other investigation of any particular taxpayer." Clearly, the Congress has never found such behavior to be proper.

Since 2010, several Senators pressured the IRS to launch investigations of certain named groups, and this pressure clearly had an impact on the IRS and helped create the environment for the targeting scandal.

Congress should take steps to help ensure that this type of direct pressure on the IRS from Congress does not happen again. The best way to do that would be to amend 26 U.S.C. § 7217 to make it illegal for members of Congress and their staff to make similar requests of the IRS. This rule would not only safeguard nonprofit groups, but assure the public that members of Congress could not use their offices to demand that the IRS audit or investigate political opponents.

3) ***If the IRS continues to police political speech, a clear definition of political activity needs to be implemented.***

As demonstrated by recent events – and recognized by the Service itself – the facts and circumstances test is inefficient to administer, and allows far too much discretion in its application. But, if the IRS continues to police speech, then it needs a clear rule. In order to regain the public's trust, clarification via rulemaking must comport with *Buckley*, a unanimous Supreme Court decision that provides an elegant solution to the complex problem of regulating political speech and association. Moreover, instead of regulating yet more First Amendment activity, the new rule should be simple to follow and understand, and consistent with the Internal Revenue Code.

Such a rule should:

- clarify the definition of "political activity" under the IRC so that it comports with *Buckley*'s definition of political activity, and
- explicitly adopt *Buckley*'s "the major purpose" test for analyzing "primary purpose" under the IRC.

We are not alone in this view that the *Buckley* ruling is a sound guideline for defining political activity. The American Civil Liberties Union recommended to the Senate Finance Committee that:

> "Congress and/or the administration must formulate a qualitative definition of partisan political activity that is clear, easy to understand and

> easy to apply. To the extent the definition ranges beyond express advocacy for or against a candidate or party (and it should not range too far, if at all), covered activity must be clearly and narrowly delineated. The lodestar should be to limit IRS discretion, assuming tax exempt review remains at the IRS, to the greatest extent possible. These limits would provide greater clarity to tax exempt organizations, and would temper self-censorship and the chill on political speech currently created by vague and ill-defined rules and regulations."[9]

Writing a regulation in this fashion builds upon a large body of Court rulings and FEC regulations that are well understood. Adopting this approach will greatly reduce the risk of selective enforcement. Such a standard will also make compliance, monitoring, and auditing far simpler for covered organizations, watchdog groups, and the IRS, since nearly all expenditures for political activities are already publicly reported to both the FEC and equivalent state agencies.

Additionally, basing any new IRS rule in large part on existing FEC rules is in keeping with Congress's directive that "the [Federal Election] Commission and the Internal Revenue Service shall consult and work together to promulgate rules, regulations, and forms which are mutually consistent."[10]

4) ***If an application for 501(c)(4) tax-exempt status is delayed by the IRS for more than nine months, applicants should be permitted to petition the IRS to rule on their application in court, in alignment with statutory relief already offered to applicants for 501(c)(3) tax-exempt status.***

By providing applicants for 501(c)(4) status the same relief available to applicants for 501(c)(3) status, the agency would allow a court to decide the fate of applicants, who are often dependent on their (c)(4) status for fundraising purposes. Additionally, if the IRS is experiencing difficulty either working through an unexpectedly large number of applications or incurring trouble in evaluating a particular application, this remedy will ease the burden of the IRS while allowing an impartial court to provide a final decision for the applicant. A similar suggestion was also made by IRS National Taxpayer Advocate Nina Olson.

Conclusion

Americans' confidence in government has been rocked by information that the IRS systematically targeted groups based on their political beliefs. The best path forward requires getting the IRS out of the messy business of campaign finance regulation altogether. It is no wonder that people suspect corruption when they see a tax-collection agency under control of the President going after the President's political opponents.

[9] Laura W. Murphy, Michael W. Macleod-Ball, and Gabriel Rottman, "ACLU Statement for Hearing on 501(c)(4) Criteria," American Civil Liberties Union. Retrieved on July 29, 2014. Available at: https://www.aclu.org/files/assets/5-21-13_-_testimony_for_senate_finance_501c4_hearing_final.pdf (May 21, 2013), p. 5.
[10] 2 U.S.C. § 438(f).

The IRS does important work collecting the revenues needed to operate the government. This important function of the agency is threatened by its role as the speech police. For the sake of the IRS and the First Amendment, the IRS and Congress should work together so the agency can shed this role as soon as possible.

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David Keating is the President of the Center for Competitive Politics (CCP), the nation's largest organization dedicated solely to protecting First Amendment political rights.

In 2007, Mr. Keating founded the organization SpeechNow.org due to his frustration with the incessant attacks on the First Amendment. His goal was to give Americans who support free speech a way to join together, pool their resources, and advocate for federal candidates who agree with them – and work to defeat those who do not.

At that time, current campaign finance laws were restricting SpeechNow.org's ability to engage in independent expenditures due to burdensome contribution limits on their donors. This led to the court case, *SpeechNow.org v. FEC*, and the result was a ruling by the federal courts that such a law was indeed unconstitutional. This ruling created what has now become known technically as an Independent Expenditure Only Political Committee, or more informally as a Super PAC.

Prior to becoming President of CCP, Mr. Keating was the Executive Director of the Club for Growth. He has played a key role in helping the Club grow its membership and influence in public policy and politics.

For many years, Mr. Keating served as Executive Vice President of the National Taxpayers Union. Mr. Keating also served as the Washington Director of Americans for Fair Taxation, a tax reform group that promotes passage of the FairTax to replace the income tax.

In May 1996, he was appointed to the National Commission on Restructuring the Internal Revenue Service by then-Senator Bob Dole because of his leading role in the development and passage of the Taxpayers' Bill of Rights. The Commission's report was released in June 1997, and served as the basis for legislation approved by Congress in 1998, which included a further expansion of taxpayers' rights as advocated by Mr. Keating during his work on the Commission.

He also played key roles in passage of income tax indexing legislation to prevent inflation from boosting taxpayers into higher tax brackets and passage of a bill to protect innocent spouses from being dunned by the IRS for unfair tax debts.