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UIL -0501.03-30;4955.01-01;4955.01-02

T:EO:RA:T3

JUL 24 2000

INTERNAL REVENUE SERVICE
TECHNICAL ADVICE MEMORANDUM

District Director

Taxpayer's Name:

Taxpayer's Address:

Taxpayer Identification:

Number:
Tax Years:
Date of Conference:

LEGEND:

A =
B =
C =
D =
E =
F =
G =
H =
J =
K =
L =
M =
O =
T =
X =
Z =

2/3

ISSUES

1. Did certain letters sent in cooperation between the exempt organization, "X", and an active candidate for political office, "A", during A's campaign constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Internal Revenue Code (hereafter "code") and section 1.501(c)(3)-1(c)(3)(iii) of the Treasury Regulations (hereafter "Regulations")?

2. Did X, by providing the candidate for public office, A, with the names and addresses of those who respond to the mailing of letters in question constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(c)(3)(iii) of the Regulations?

3. Do the acts involved in issues 1 and 2 above, constitute private benefit to the candidate, A, or to the political party, "T", with which he is affiliated, within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(c)(2) of the Regulations?

4. Do the sanctions provided under section 4955 of the Code apply to X under the facts involved in issues 1 and 2, above?

5. Do the sanctions provided under section 4955 of the Code apply to managers of X who knowingly participated in the acts involved in issues 1 and 2, above?

6. To what extent should X or its managers be granted relief by virtue of the application of section 7805(b) of the Code to the extent of any adverse conclusion under section 501(c)(3) or 4955 of the Code? Reference is specifically made to the technical advice memorandum of 1979 and/or the ruling letter of December 10, 1991, issued to X?

FACTS

A. Issues 1 through 4:

X is a non-profit corporation organized and existing under the law of C. It was incorporated on February 11, 1973. X is exempt from federal income tax under section 501(c)(3) of the Code by virtue of a determination letter from the Service dated November 27, 1973. X was granted exemption on the basis of an educational purpose to conduct and sponsor research on the social and economic forces in the country and the governmental interaction with these forces.

Z, an advertising agency specializing in direct mail fund raising, contacted X in April, 1995, to determine if X would be interested in a fund raising package signed by A. A announced his candidacy for the T nomination for the office of K on April 9, 1995, the same month as Z's initial contact with X.

X and A agreed to the fund raising arrangement proposed by Z. The initial fund raising package is discussed in greater detail hereafter. Z managed the conduct of the direct mail campaign including the design of the fund raising package.

The initial package was sent by X as a prospect mailing, i.e., a mailing sent to potential donors who had not previously contributed to X. The prospect mailing lists were obtained in some instances by X paying rental fees for lists owned by others, and in other instances by X exchanging its list with other list owners. A third version of the package was a "housefile" version of the prospect mail package. The housefile version was mailed to persons who had previously contributed to X.

The housefile mailing dated June 30, 1995, reached 293,628 addresses. The prospect mailings were made in batches. The batches sent out on June 7, 1995; June 12, 1995; April 6, 1995; March 29, 1995; and April 29, 1996, were sent to a total of 370,071 addresses. The prospect mailings sent out on May 15, 1995; January 17, 1996; January 19, 1996; and June 10, 1996,

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were sent to a total of 824,573 addresses. The batches sent out on August 14, 1995; August 31, 1995; October 26, 1995; and November 2, 1995, were sent to a total of 415,867 addresses. The second prospect package was mailed July 31, 1996; August 14, 1996; September 2, 1996; September 16, 1996; September 19, 1996; and October 4, 1996, to a total of 829,026 addresses. Taken together, all of the prospect and housefile mailings reached a grand total of 2,733,165 addresses. (There is no information on how many of these packages were mailed to the same address.)

The June 30, 1995, housefile mailing cost $111,024 to X and produced gross income of $266,609, resulting in net income of $155,585 from charitable donations. The net income from prospect mailings was $32,994 based on direct costs of $486,254 and gross income of $519,198. The net income does not include indirect costs such as overhead. The first prospect mailing resulted in the addition of over 28,000 donor names to the housefile, and the second prospect package added 9,435 donor names to the housefile list.

The initial fund raising package consisted of several elements. The package was mailed in an envelope which showed both "[Title] A" and "X" as the return addressee, although each was listed on a separate line. Each was of equal prominence. The address used on the return envelope was that of the X. The primary letter inside the package was a four page letter printed on the letterhead of "[Title] A" and was signed by A. The package also contained a four page brochure titled B by A and X. The package also contained a survey questionnaire to be mailed back by the recipient, indicating the recipient's view of various political issues and whether the recipient would describe him/herself as "Liberal", "Conservative", "Libertarian", or "Other."

Substantially all of the revenues of X are raised from contributions from the public. In 1996, X received contributions and grants of $5 million from private foundations, $2 million from business corporations, $9.1 million as major gifts from individuals (excluding direct mail) and $5.8 million from direct mail support on the housefile. As is apparent, direct mail solicitation is an important component of X's total

revenues of $28.6 million for 1996. The prospect mailings are used to develop the housefile list. Most revenue from direct mail solicitations is generated by the housefile mailings. The prospect mailings are engaged in for the purpose of developing the housefile, rather than as a moneymaker alone. In 1995, X mailed 6,315,320 letters to prospects. In 1996, X mailed 4,775,435 letters to prospects.

X has had a working relationship with A for a number of years prior to the mailings in question here. X used A's signature on fund raising letters mailed in 1987 and 1988. A was a candidate for K in 1987 and 1988. The possibility of using A's signature in 1994 was discussed.

X states that A's signature was considered a good one for X to use for several reasons. X's prior experience with the use of A's signature had been positive. Further, A had high name recognition in 1995 with potential donors.

Both A and X reviewed and approved all direct mail packages drafted by X's agents before they were mailed by X. Although the packages stated that the survey responses would be tabulated and provided to A and others, this was never done.

Although the direct mail campaign began in June, 1995, the agreement between A and X was not reduced to writing until a "Memo of Understanding" dated July, 1996, was executed on behalf of A and X. Prior thereto, the agreement between X and A was only a verbal agreement. The July, 1996, agreement provides that in exchange for the use of A's signature, X will provide A with a one time use of the names and addresses of all donors and non-donors respondents to any mail sent over A's signature under the A/X fund raising letter. The Agreement also provided that the use of A's signature is not a X endorsement of A nor is it a A endorsement of X. A reserved the right to pull the A signature with 30 day written notice.

Pursuant to the July, 1996, agreement, A had received, by early August, 1996, approximately 43,800 names of donors generated by the A/X direct mail campaign. However, A did not limit his use of the names he received from X to a one-time use

as provided by the terms of the agreement. Rather, A's campaign added the names permanently to A's campaign mailing list, and used them more than once. Accordingly, a new agreement between the parties provided that X was to be compensated for the multiple use of donor names by A's campaign. This was to be accomplished by the transfer of 35,000 names of donors to A's campaign for one time use in X's direct mail prospect program.

The multiple use by A's campaign of the X donors names resulted because X had not employed a technique called "seeding" to monitor multiple use of names. Seeding is a technique used by organizations conducting direct mail fund raisers to monitor use of names that have been rented to or exchanged with another organization. Seeding is a standard industry practice of placing dummy names in the rented or exchanged list. The transferor organization will detect multiple use of its rented or exchanged names when the "seeded" or dummy names receive multiple mailings. X had not previously used seeding when lists were transferred to political figures in consideration for their endorsements on X's direct mail fund raising campaign. As a result of the problems associated with A's campaign's multiple use of X's donor names, X now employs seeding as a standard technique with political figures who endorse X's direct mail fund raising campaigns.

The A/X prospect mailing gained X 29,004 new donors and 53,532 non-donor responses, as of July, 1996. The A/X housefile mailing produced 15,135 responses with donations. Names of donor respondents to the mailing were given to A's campaign in accordance with the agreement. At some point A's campaign informed X that A did not care to receive the names of non-donor respondents.

X's policy of providing a one-time use of a response generated mailing list, as compensation for the use of such persons signature on the direct mail campaign, has been X's standard compensation arrangement for a number of years. This policy has been uniformly applied, without exception, since 1990.

X considers the use of signatures of certain elected officials to be important to its direct mail fund raising effort. For competitive reasons, X feels compelled to adequately compensate these elected officials for their signatures.

From 1995 to mid-1997, X has used the signatures of a number of elected officials and public figures in its fund raising letters in addition to that of A, for both house file and prospect mailings. Such names included: D, E, F, G, H, and J. X states that these individuals were chosen primarily because their views on important topical issues coincide with the views X believes are held by prospective donors contained on X's donor lists. Each year X has used the signature of one or more elected officials.

X has submitted information suggesting that the X/A fund raising campaign was conducted in an ordinary and customary manner typical of its other fund raising efforts. It was Z's idea to propose the test mailing using A's signature to X based on Z's understanding that other groups were having good financial results with A signed prospect packages. The contract was not initiated at A's request. All matters relating to the A prospect mailings were handled in the same fashion as other prospect mailings using high profile signers for the X prospect mailings handled by Z. The placement of A's name on the carrier envelope, the heading of the solicitation letter and other places in the prospecting package is consistent with the placement of high name recognition signature on other prospect mailings. Z's representative also stated that multiple use, or even co-ownership, of the results of a prospect mailing is the consideration frequently necessary to secure the cooperation of a high profile signer.

Information from the A campaign direct mail fund raising professional also has some bearing on this matter. He stated that A had the most powerful signature in the T market and those of allied interests in 1995 and 1996. Many direct mail vendors were aware that A's signature was "hot" and were interested in obtaining it for their own client for fund raising purposes.

B. Issue 5:

The principal officers of the X are L, its President, M, its Vice President and Treasurer, and O, its Executive Vice President and Chief Operating Officer. The direct mail campaign is managed by these officers. A prospect package that is mailed out on a test basis is evaluated by M. M recommended the use of the A/X letter in a direct mail campaign. The one time use of names as compensation to the signer of the letter is a policy adopted by senior management: L, M, and O. M's nearly 35 years experience in the direct mail business led him to understand the value of certain signatures. The text of the A/X letter was written by the vendor and then approved by L, M, and O, and others at X.

The affidavit of M describes his general responsibility at X for the direct mail campaign but does not describe his specific involvement with the A/X direct mail fund raising campaign.

The above named officers of X were aware that some tax ramifications were associated with the A/X fund raising letters. However, they were not specifically aware that the A/X letter would result in IRS "challenge". Accordingly, they held no internal discussions or meetings regarding tax ramifications of that direct mail effort. All the officers were acquainted with the previously issued X technical advice memorandum and favorable ruling received by X.

LAW AND ANALYSIS

Section 501(c)(3) of the Internal Revenue Code provides for recognition of exemption of organizations organized and operated exclusively for charitable, religious, educational, and other stated purposes; no part of the net earnings of which inures to the benefit of any private shareholder or individual; no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation; and which does not participate in, or intervene in (including the publishing or distribution of statements), any political

campaign on behalf of, or in opposition to, any candidate for public office.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(3)(i) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if it is an "action" organization.

Section 1.501(c)(3)-1(c)(3)(iii) of the regulations provides that an organization is an "action" organization if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. The term candidate for public office means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such candidate.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a pubic rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or person controlled, directly or indirectly by such private interests.

Section 4955(a)(1) of the Code imposes on each political expenditure by a section 501(c)(3) organization a tax equal to 10 percent of the amount thereof. This tax shall be paid by the organization. In 1987, Public Law 100-203 added Code section 4955 effective for tax years beginning after December 22, 1987.

Section 4955(a)(2) of the Code imposes on the agreement of any organization manager to the making of any expenditure, knowing that it is a "political expenditure," a tax equal to 2 1/2 percent of the amount thereof, unless such agreement is not willful and is due to reasonable cause. This tax shall be paid by any organization manager who agreed to the making of the expenditure.

Section 4955(d)(1) of the Code provides, in general, that the term political expenditure, means any amount paid or incurred by a section 501(c)(3) organization 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 political office.

Section 53.4955-1(b)(1) of the Foundation and similar excise taxes Regulations (the Regulations) provide that the excise tax under section 4955(a)(2) on the agreement of any organization manager to the making of a political expenditure by a section 501(c)(3) organization is imposed only in cases where-

(i) A tax is imposed by section 4955(a)(1);

(ii) The organization manager knows that the expenditure to which the manager agrees is a political expenditure; and

(iii) The agreement is willful and not due to reasonable cause.

Section 53.4955-1(b)(4) of the Regulations provides in part that an organization manager is considered to have agreed to an expenditure knowing that it is a political expenditure only if-

(A) The manager has actual knowledge of sufficient facts so that, based solely on these facts, the expenditure would be a political expenditure;

(B) The manager is aware that such an expenditure under these circumstances may violate the provisions of federal tax law governing political expenditures; and

(C) The manager negligently fails to make reasonable attempts to ascertain whether the expenditure is a political expenditure, or the manager is aware that it is a political expenditure.

Section 53.4955-1(b)(5) of the Regulations provides that an organization manager's agreement to a political expenditure is willful if it is voluntary, conscious, and intentional. No motive to avoid the restrictions of the law or an incurrence of any tax is necessary to make an agreement willful. However, an organization manager's agreement to a political expenditure is not willful if the manager does not know that it is a political expenditure.

Section 53.4955-1(b)(6) of the Regulations provides that an organization manager's actions are due to reasonable cause if the manager has exercised his or her responsibility on behalf of the organization with ordinary business care and prudence.

Section 53.4955-1(b)(7) of the Regulations provides in part that an organization manager's agreement to an expenditure is ordinarily not considered knowing or willful and is ordinarily considered due to reasonable cause if the manager, after full disclosure of the factual situation to legal counsel, relies on the advice of counsel expressed in a reasoned written legal opinion that an expenditure is not a political expenditure under section 4955. However, the absence of advice of counsel with respect to an expenditure does not, by itself, give rise to any inference that an organization manager agreed to the making of the expenditure knowingly, willfully, or without reasonable cause.

Rev. Rul. 78-76, 1978-1 C.B. 377, holds that a foundation manager (a trustee) of a private foundation (a trust) who, representing both himself and the trust, willfully and without reasonable cause, sells property he owns to the trust knowing that the sale is an act of self-dealing under the Internal Revenue Code, is liable for both the tax imposed on the participation of foundation managers by section 4941(a)(2) as well as the section 4941(a)(1) tax.

Under situation 3 and 4 of Rev. 78-248, 1978-1 C.B. 154, the exempt organization is held to be engaged in the participation or intervention in a political campaign because the organization's questionnaire or voters guide shows bias in favor of one candidate or another.

Rev. Rul. 80-282, 1980-2 C.B. 178, holds that the publication of the organization's newsletter concerning a broad range of political issues did not constitute the participation or intervention in a political campaign under the specific facts of that ruling.

Analysis:

Issue 1:

A announced his candidacy for public office on April 9, 1995. Section 1.501(c)(3)-1(c)(3)(iii) of the Regulations defines the term "candidate for public office" as an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state, or local. The same definition is also found in section 53.4945-3(a)(2) of the Foundations and similar excise tax Regulations. Thus, A was clearly a candidate for public office at the time that the fund raising letters were produced and mailed by X.

An organization may be found to have participated or intervened in a political campaign even though it is the organization's intention, in conducting such activities, to further its exempt purpose. In Rev. Rul. 67-71, 1967-1 C.B. 125, the Service held that the organization's activity in

evaluating the qualifications of all potential candidates, and then selecting and supporting a particular slate of candidates, constitutes participation in a political campaign. The Service reached this conclusion notwithstanding that the selection process may have been completely objective and unbiased and was intended primarily to educate and inform the public about the candidates. Similarly, the Second Circuit in The Association of the Bar of the City of New York v. Commissioner, 858 F2d 876 (2d Cir, 1988), cert. denied, 490 U.S. 1030 (1989), held that the organization's activity in rating candidates for judicial office, even though nonpartisan and in the public interest, constituted participation or intervention in a political campaign.

Rev. Rul. 76-456, 1976-2 C.B. 151, describes an organization having an educational purpose of elevating the standards of ethics and morality that prevail in the conduct of campaigns for election to office. However, if the organization solicits the signing or endorsement of its code of fair campaign practices by candidates, it will fail to qualify for exemption because of such activity (and subsequent publication thereof), which constitutes the participation or intervention in a political campaign which may not be excused or avoided merely because that the organization regarded its activity as furthering its exempt purpose.

Assuming that X did not intend to further A's political campaign X may still be deemed to have participated or intervened in a political campaign even if its purpose for the A/X direct mail fund raiser was both further its exempt educational purpose and generate revenues. Based on the authority cited in the preceding paragraphs, an organization is not excused from acts of political campaign intervention because the organization had a "good" purpose. Political campaign intervention is not overcome by a "good" purpose.

For example, in both Rev. Rul. 67-71 and Bar of the City of New York, supra, it was clear that the intervention had some value to the public and was not necessarily motivated by purely partisan intentions. In Rev. Rul. 67-71, it was clearly stated that the information regarding which candidate was best

qualified "was intended primarily to educate and inform the public about the candidates." In Bar of the City of New York, supra, it was clear that the Second Circuit considered the ratings of judicial candidates based on their legal background to be of value when, at page 881-82, it stated:

> The members of this panel . . . empathize with efforts of such Association to improve the administration of justice. We recognize, however, that it is not within our province to grant Bar Associations a tax exemption that Congress has not seen fit to grant.

A public statement disseminated by a charity may serve more than one purpose (e.g., a so-called "dual-purpose communication"). Even though one such purpose is proper and furthers the organization's exempt purpose, the public statement may nonetheless constitute prohibited campaign intervention. For example, a written or broadcast message may be both educational and constitute intervention in a political campaign. As another example more closely on point, a communication may serve legitimate fund raising purposes of the organization, yet may also constitute prohibited campaign intervention. For example, jargon and catch phrases contained in an organization's fund raising letters may demonstrate evidence of bias and constitute improper political campaign intervention, even if, as the organization contended, contributions received in response to the letters were used only to finance nonpartisan, educational activities. Thus, the fact that the statements made in the letters in question here were coupled with a request for donations to X and a survey (and the fact that the fund raising campaign was successful) cannot insulate the letters from inquiry as to whether they also constitute prohibited campaign intervention.

As to whether any particular letter constitutes campaign intervention, it has long been held that the determination of whether a public communication made by, or on behalf of, an organization constitutes intervention in a political campaign for purposes of section 501(c)(3) of the Code is made on the basis of all the surrounding facts and circumstances. See Rev. Rul. 78-248, cited above. This determination for purposes of

section 501(c)(3) does not hinge on whether the communication constitutes "express advocacy" for Federal election law purposes. Rather for purposes of section 501(c)(3), one looks to the effect of the communication as a whole, including whether support for, or opposition to, a candidate for public office is express or implied.

A number of published rulings have found there to be participation or intervention in a political campaign despite lack of express advocacy on behalf of or opposition to the election of a specific candidate. In Rev. Rul. 76-456, described above, the mere publication of the names of candidates for election who endorse or sign the organization's code of ethics is deemed to be participation or intervention in a political campaign in the nature of an attempt to influence voter opinion in favor of those who signed the code and in opposition to those who did not sign. In situation 3 and 4 of Rev. Rul. 78-248, 1978-1 C.B. 154, the exempt organization is held to be engaged in the participation or intervention in a political campaign merely because a candidate questionnaire or a "voters guide" shows some bias in favor of one candidate or another. Similarly, in Rev. Rul. 86-95, 1986-2 C.B. 73, the Service held that the conduct of public forums involving statements by qualified congressional candidates could be conducted in such a manner as to show bias or preference for or against a particular candidate. In such a case, the public forum would constitute political campaign intervention or participation in spite of the failure to explicitly propose the election or defeat of any candidate.

In Rev. Rul. 80-282, the Service held that the publication of the organization's newsletter concerning a broad range of political issues did not constitute the participation or intervention in a political campaign. One issue of the newsletter is devoted to the listing of the voting records of all incumbent members of Congress on selected legislative issues together with an expression of the organization's position on such issues. The publication also indicates whether the congressional member voted in accordance with the organization's position on the issue. The newsletter is nonpartisan and will not refer to elections, campaigns or candidates. The Service

contrasted the holding in this ruling to that of situation 3 and 4 of Rev. Rul. 78-248. The distinguishing features of Rev. Rul. 80-282 are that the newsletter is distributed to relatively few persons, no attempt is made to target the publication of the newsletter toward particular areas where elections are being held, it doesn't name incumbents for re-election, includes all office holders, and makes no comparison with other candidates.

Rev. Rul. 80-282 is distinguishable from the facts of this case. The newsletter in the ruling is distributed only to a few thousand people. In the subject case, X mailed 2,733,165 letters. The newsletter in the Revenue Ruling is not published to coincide with an election campaign. In this case, X's fund raising letters do, in fact, coincide with the A's election campaign. There are other important differences discussed in following paragraphs.

The issue of campaign intervention often focuses on whether the content, slant, and context of the comments of a fund raising letter constitute intervention in a political campaign. Other organizations, much like X, have argued that the catchwords and commentary contained in the fund raising letters were necessary to attract the financial support of the targeted audience. Factors of importance to these issues include consideration of whether statements of the organization were contemporaneous with election periods and were biased against certain candidates or in favor of other candidates.

A's authorship of the letter (and the language chosen by A) is the most determinative aspect of the letter in terms of whether it involves political campaign intervention. This letter is not just about positive attributes or characteristics associated with A or negative attributes associated with A's opponent, but, additionally, it represents an affirmative statement by candidate A himself during A's campaign. It is a forum for A. This is a letter on A's letterhead and with A's signature at the bottom of the letter. The letter is most likely read by the recipient as fully representative of A's opinion and expression. In the letter, A takes a position on various issues that sound very much like his campaign

statements. The prospect version of the A/X letter contains the following:

> **"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."**
>
> **"Families, not bureaucrats, should control what their children are taught."**
>
> **"Lets reform the structure of the federal government by sticking to the basics of defense, foreign affairs and fighting crime."**

Thus, X assisted A by distributing statements that are very much like his campaign statements, positions, and rhetoric. At the time the letters were mailed, A was more than a politician, he was a candidate for elected office. As such he was highly visible to the public and closely connected in the public mind with his campaign effort. Recipients of the A/X letter would naturally associate the statements of the letter as indistinguishable from A's election effort. As stated earlier, the letter does not directly urge the election or the defeat of either candidate. Nevertheless, by featuring the A signature and using the first person with a text in the letter sounding very much like campaign rhetoric, the fund raising letter is inextricably tied to the election of the signatory of the letter.

Further, the association of the statements by A in the letter with the 1996 campaign is made all the more likely by reference to negative associations with A's opponent. A's opponent is mentioned by name in a negative light three times in the letter and once in the attached "B." There is a "him or me" quality to this letter, a contest, likely to evoke an

association with the election campaign in the mind of the recipient. By directly naming the principals to the election (in the text or by virtue of the signature), the association of the message of the letter to the election is greatly strengthened. As mentioned above, the wording of the political message by A has the flavor of campaign rhetoric which also adds to the picture of a campaign contest.

The A/X letters include the following language which could be interpreted as opposition to A's opponent (the incumbent holder of K):

> "I want to change how Washington taxes, spends and regulates.
>
> "But with [A's opponent] in the White House, true reform will not come easily. It requires all who want it to work together."

Even though there is no explicit call for the defeat of A's opponent, the language cited above suggests action by the recipient to oppose A's opponent.

The fact that the letters were sent out under the joint letterhead of A and X, but were signed only by A does not change the analysis made above. This position is based on either of two principles. First, A essentially was X's agent for fund raising purposes such that it is appropriate to attribute the statements made by A in the letters to X. Secondly, the statements made by A in the letter may not be directly attributable to X, but X still engaged in prohibited campaign intervention by distributing A's statements that constituted political campaign activities on behalf of A and in opposition to his opponent. X's use of A as a fund raising spokesman under the facts at issue is analogous to the issues that arise when a candidate is invited to speak at an organization event, supposedly not in his capacity as a candidate but as a public office holder or expert in public policy. In such case, the organization must ensure that the candidate speaks only in his/her individual capacity at the event and that no campaign activity occurs in connection with the event. In contrast, with

the A/X letters, there is no doubt that A is engaged in campaign activities for the reasons discussed in the preceding paragraphs.

The Service has had a concern with the use of words like "conservative", "liberal", "leftist", "far right", "pro-life", or "pro-choice" as a means of supporting, in a disguised manner, a particular political candidate. The use of conservative or liberal labels may be used to attack a candidate and support another candidate. In addition to including affirmative statements by A during A's campaign regarding election issues and negative statements about A's opponent, X's fund raising letter uses politically loaded language and words. The original prospect letter had two references to persons of one political persuasion, both in close proximity to A's opponent in the text of the letter. On page 3 of the letter, the first line, A's opponent is described as follows:

> "[A's opponent], **who campaigned as a reformer has become the spokesman for the status quo."**

Two lines later persons of one political persuasion are described as follows:

> **"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."**

Thus, the text puts persons of one political persuasion in a bad light and indirectly connects them to A's opponent by indirectly challenging the assertion that he is new or different, and it links him as the spokesman for the status quo. The link becomes even closer spatially on the page entitled B, where it is stated that:

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

There are other statements contained in the house prospect mailing letter that have political meaning. The following statement puts A's opponent in a negative light by associating him with special interests:

> **"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 too many of them rich and powerful."**

At other points in the letter, A, as author of the letter, makes declarative statements concerning the issues he supports. He supports actions affecting government by elimination of certain existing conditions. He adopts the belief of X in a specific type of government, enunciated values, and a position on relations with other governmental bodies. Moreover, A is linked in this letter to his friend who is a former leader of the same political party as A.

In summary, the content and the timing of the letters in question constitute prohibited political campaign intervention. Statements made in the letters supported A's political agenda and criticized the opposing candidate. The letters were sent during the period of A's primary election as well as the general election up to October 4, 1996. There were also mailings in July and August of 1996 and 3 mailings in September, 1996. The total of all letters were sent to 2.7 million addresses, many of recipients of such statements could be assumed to be eligible voters in the up-coming election in that the election was a national election as opposed to a district or state-wide election. As stated earlier, A's signature of the letter is the most determinative factor as to political campaign intervention. It represents a forum for A to present positive aspects of his candidacy and negative aspects of his opponent.

Accordingly, we hold as follows:

The A/X direct mail fund raising letters constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Internal Revenue Code.

Issue 2:

A's campaign received from X the mailing list containing approximately 43,800 names by August, 1996. A's campaign used these names in its fund raising efforts. A's campaign was limited to a one time use of the names according to the contract between the parties. A's campaign exceeded this use and we may assume that for purposes of this memorandum that A's campaign exercised more or less unrestricted use of the names during the campaign period. Near the end of July, 1996, X was compensated for the excessive use of the donor names by means of the transfer of 35,000 names of donors to A's campaign to X for a one time use of such names for a fund raising effort on behalf of X in its prospect program.

The question of political campaign intervention relates to whether (1) the transfer to and use by A's campaign of X's donor names was a legitimate business transaction and (2) the use of X's donor names in exchange for A's signature and the one time use of 35,000 campaign donor names of A by X is a fair market value exchange.

X has customarily exchanged its donor name list with political figures who have signed the fund raising letters. If its prior history in this regard is deemed reasonable, then, most likely, the actions with respect to this case would be deemed reasonable. It is a question of fact whether the use of the donor list, in essence a "renting" of the list, is an appropriate business transaction. We can make two observations in regard to this question. First, X has used the names of political figures in the past as a means of promoting its direct mail fund raising campaign. Second, we know that the sale or exchange of lists between exempt organizations for fund raising purposes is not an uncommon practice.

In summary, as to the subject case, we do not see why, in general, the transfer of the use of the organizations' donors list generated by virtue of the A/X fund raising mailing would not be considered an appropriate and legitimate business transaction.

Care should be taken however to distinguish the situation where a candidate is given an unfair advantage. One example is where mailing lists have been made available on an exclusive basis which would deny their access to other potential candidates.

There is the issue of whether X favored A's campaign by not using ordinary and prudent business practices in the direct mail fund raising industry to limit the overuse of the donor list. By utilizing the seeding technique, X could have protected itself against the overuse of its donor list and thus maintain its proprietary interest. In any case, X was able to discover the violation and it received compensation therefor.

The District raises the argument that the transfer of X's list of donors to A's campaign in accordance with the agreement between the parties saved A's campaign, in essence, the financing costs and other costs of generating its own donor list. It was said that A got his A friendly list basically "for free" because X paid all the out of pocket prospecting costs. Further, the cost of prospecting for X was less than that for A's campaign because a nonprofit postal rate was available to X for the mailings which is not available to the A's Campaign.

All of this may be true, but the fact remains that A's campaign received the donor list in consideration for A's signature. It did not receive the list as a gift but as bargained for consideration for the use of A's name and signature. If X had paid A cash consideration for his signature on the prospect mailings and the house file mailings, A's campaign could have used the cash to pay costs of developing a list of supporters. X's list transferred to A's campaign for use was originally for a limited one time use. Additional consideration was paid by A's campaign for the excessive use of the lists in violation of the contract between the parties. If

the various exchanges were all at fair market value, A's campaign has gained no advantage by virtue of its transaction with X. In addition, it is clear that the letters signed by A were a successful fund raising vehicle for X in terms of actual donations generated and housefile lists developed.

Our office is provided no information regarding the values related to the exchange of X's list of donors accumulated from the A/X fund raising effort. X has provided information suggesting that its practice of allowing only a one time use of the donor's list is more restrictive than the standard practice in the industry, where multiple use of the donor list would be deemed necessary to acquire the signature of a prominent elected official like A. Lacking the required valuation necessary to this determination, we are unable to say that X's actions in allowing a one time use by A of the developed mailing list from the A/X letters constituted an inappropriate or disproportionate financial benefit to A's campaign by X. As a result, we are unable to establish campaign intervention or campaign participation with respect to this issue.

Accordingly, we hold as follows:

We lack sufficient valuation information on to the various exchanges to establish that the providing of the donor's list from the A/X direct mail fund raising effort to A constituted campaign intervention or campaign participation within the meaning of section 501(c)(3) of the Code.

Issue 3: Private Benefit

Another issue raised in this matter is whether providing a list of donor names from the A/X fund raising effort to A for use in his campaign is private benefit under section 1.501(c)(3)-1(d)(1)(ii) of the Regulations.

The resolution of such issue is unnecessary in light of our determination under issue 1 that the A/X fund raising letters constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Code.

Issue 4: Section 4955

Does the section 4955 tax on political expenditures apply to the organization for the facts involved in issues 1 and 2, above?

We find campaign intervention or campaign participation under section 4955 for the same reason as discussed under issue 1, above.

Section 4955(a) of the Code imposes a tax on each political expenditure. Section 4955(d)(1) defines the term "political expenditure" to include any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or disbursement of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Accordingly, we hold as follows:

The A/X direct mail fund raising letters constitute intervention or participation in a political campaign within the meaning of section 4955(a)(1) of the Code.

Issue 5: Section 4955(a)(2) tax on organization managers

Section 4955(a)(2) of the Code imposes a tax of 2 1/2 percent on the agreement of any organization manager to the making of any expenditure, knowing that it is a political expenditure, unless such agreement is not willful and due to reasonable cause. The language of this provision is very similar to the language of the provisions imposing taxes on a foundation manager under section 4941(a)(2) for self-dealing, under section 4944(a)(2) for jeopardizing investments, and under section 4945 for taxable expenditures. The language of each of these provisions contains a "knowing" clause; the tax is imposed only if the manager knows that the expenditure is a prohibited

expenditure (e.g., a political expenditure, a taxable expenditure, etc.). Each of these provisions contains a savings clause under which the tax will not be imposed where the action or agreement of the manager/foundation manager "is not willful and is due to reasonable cause."

Similarly, section 53.4955-1(b) of the Foundation and Similar Excise Tax Regulations has provisions concerning the tax imposed under 4955(a)(2) that closely mimic the language of the Regulations under 4941, 4944, and 4945 with respect to the tax imposed on the foundation manager under those provisions.

Section 53.4955-1(b)(4) of the Regulations addresses the "knowing" clause. Under this provision, the manager must have actual knowledge that the expenditure is a political expenditure. Evidence tending to show that the manager has reason to know that a particular expenditure may constitute a political expenditure is relevant in determining whether the manager has actual knowledge. Section 53.4955-1(b)(5) defines a manager's agreement as "willful" if it is voluntary, conscious, and intentional. A political expenditure is not willful if the manager does not know that it is a political expenditure. Section 53.4955-1(b)(6) provides that a manager's actions are due to reasonable cause if the manager has exercised his or her responsibility on behalf of the organization with ordinary business care and prudence.

Section 53.4955-1(b)(7) provides a safe harbor if the manager relies on the advice of counsel, expressed in a reasoned written legal opinion, that an expenditure is not a political expenditure.

By virtue of section 53.4955-1(b)(8), the burden of proof regarding the issue of whether an organization manager has knowingly agreed to the making of a political expenditure is placed on the Secretary under section 7454(b) of the Code.

Rev. Rul. 78-76, 1978-1 C.B. 377, provides an example of the imposition of the tax under 4941(a)(2) on the participation of a foundation manager in an act of self-dealing defined in section 4941. The trustee of a trust that is a private

foundation, representing both himself and the private foundation, willfully and without reasonable cause sells property he owns to the private foundation knowing that the sale is an act of self-dealing under section 4941.

The tax under 4941(a)(2) of the Code was imposed on foundation managers in Madden v. Commissioner, T.C. Memo 1997-395. In that case the Court held that payments made to a janitorial and maintenance company which was a disqualified person with respect to the private foundation were self-dealing under 4941. Further, the Court imposed the tax under section 4941(a)(2) on the foundation managers. The Court concluded that the foundation managers possessed actual knowledge of sufficient facts concerning the transactions to establish that the arrangements with the disqualified person (maintenance company) were self-dealing transactions. The Court also noted that the foundation managers failed to obtain the advice of counsel with respect to the payments.

The tax under section 4945(a)(2) was imposed on the foundation manager in the case of Thorne v. Commissioner, 99 T.C. 67 (1992). The Court found that the manager knowingly made a taxable expenditure when he failed to exercise expenditure responsibility with respect to certain grant recipients. The Court reached this conclusion in spite of the manager's claim of reliance on the advice of counsel. The foundation manager received no written opinion of counsel and the Court also indicated that the record did not support a finding that the foundation manager received an oral opinion of counsel. As to a second grantee organization involving a taxable expenditure, the organization was not even formally organized at the time of the purported investigation of it. Further, because the foundation manager was himself a lawyer, the court concluded that he was aware that grants had to conform to certain requirements.

The Request for Technical Advice Memorandum raises as issue 5 the following question:

> Does the section 4955 tax on political expenditures apply to managers who knowingly participated in the acts involved in issues 1 and 2, above?

The information submitted by X shows that the officers of the organization relied on the advice of tax counsel as to the tax consequences relating to X's participation in the A/X direct mail fund raising campaign. As a matter of routine, X's counsel reviewed all of the direct mail fund raising materials, line by line, to determine if there was any violation of section 501(c)(3) of the Code. The officers felt it was unnecessary to examine in any depth the tax implication of the A/X mailing since that letter was reviewed and approved by X's tax counsel.

The response of X's tax counsel was even more detailed in its description of the tax advice offered by him on the A/X letter. He stated that he examined and rendered a counsel opinion on all fund raising texts. Because of the volume of work, almost all opinions were rendered verbally. He also states that because of the lack of any authority on the subject, there was no need to express his opinion in writing. He also stated that "I okayed the A letter texts and the use of his signature." Further, he stated that "The A opinion, like others, approved the format, text, and related materials for his fund raising letter and was entirely verbal." Included in the counsel's correspondence with the organization was a letter dated May 25, 1995, regarding the A/X fund raising letter. A's tax counsel states that X's management made no "knowing" political expenditure because they had been consistently counseled by him that the direct mail fund raising letters did not constitute campaign intervention. He found no authority by the Internal Revenue Service that would, in his opinion, in the context stated in his letter, suggest a violation of section 501(c)(3) of the Code.

As discussed above, section 53.4955-1(b)(7) of the Regulations generally provides a safe harbor for the reliance of the organization manager on the advice of counsel. It states, in part, as follows:

> An organization manager's agreement to an expenditure is ordinarily not considered knowing or willful and is ordinarily considered to be due to reasonable cause if the manager, after full disclosure of the factual situation to

legal counsel (including house counsel), relies on the advice of counsel expressed in a reasoned written legal opinion that an expenditure is not a political expenditure under section 4955 (or that expenditures conforming to certain guidelines are not political expenditures).

One could make the argument that the Memo dated May 25, 1995, addressed to M as Vice President & Treasurer of the X is just such a reasoned written legal opinion of counsel. The Memo addresses two separate and distinct tax issues. The second is clearly identified in the subject heading of the memo as "A as Signatory." Beginning at the bottom of page 2 of the letter and following to the end on page 4, X's tax counsel discusses the issue of whether there is a section 501(c)(3) problem.

The May 25, 1995, memo is relatively brief and does not discuss all the tax issues related to the A/X letters in terms of campaign intervention or participation. Nevertheless, it could be argued that the memo does qualify as a written legal opinion described in section 53.4955-1(b)(7) of the Regulations. It is reasoned. It discusses various aspects of using the signature of a politician including one who is an active candidate for political office in terms of whether the release of the mailing list to the A's campaign is appropriate as quid pro quo. It discusses the chances of success of an IRS challenge to the list transfer. It discusses the value to the organization of list names and mentions the United Cancer Council case pending in the Tax Court as supporting the proposition that the mailing list has value to the organization.

In the end it makes little difference whether one would treat the May 25, 1995, memo as qualifying as a reasoned written legal opinion described in the Regulation cited above. That same Regulation also provides that the absence of written advice of counsel meeting the precise definition of the Regulations does not, by itself, give rise to any inference that an organization manager agreed to the making of the expenditure knowingly, willingly, or without reasonable cause.

The facts disclosed in this case indicate that this organization has received significant ongoing and intensive

legal advice from qualified legal counsel knowledgeable in tax matters. It is the statement of the organization's legal counsel that he rendered his legal opinion on this matter verbally. He indicated that he reviewed the A letter line by line. He reviewed the A letter text and the use of A's signature. His verbal approval of the A letter included review of the format, text, and related materials. In light of the verbal legal opinion expressed by X's tax counsel taken in conjunction with the Memo of dated May 25, 1995, it is very difficult to say that X's managers either (1) knew that the expenditure to which the managers agree is a political expenditure or (2) that the agreement is willful and not due to reasonable cause. The test applied under section 53.4955-1(b)(4) in determining whether an organization manager is considered to have agreed to an expenditure knowing that it is a political expenditure, is as follows;

(A) The manager has actual knowledge of sufficient facts so that, based solely upon these facts, the expenditure would be a political expenditure;

(B) The manager is aware that such an expenditure under these circumstances may violate the provisions of federal tax law governing political expenditures; and

(C) The manager negligently fails to make reasonable attempts to ascertain whether the expenditure is a political expenditure, or the manager is aware that it is a political expenditure.

In this regard, the actions of X's managers may be contrasted with the foundation manager in Rev. Rul. 78-76 and the Madden case, supra, where the foundation manager(s) (1) had knowledge of the elements making up a self-dealing transaction, (2) were aware of the specific payments being made (which were later determined to constitute self-dealing, and, (3) failed to consult qualified legal counsel (consulting only a non-lawyer in Madden). Thus, the actions of such foundation Manager(s) were determined to constitute participation in self-dealing acts.

In summary, even if one were to reach the conclusion that the exception provided by section 53.4955-1(b)(7) was not available for X's benefit in this case, there is a lack of support to suggest that X's managers agreed to an expenditure "knowingly" or that such agreement is "willful and is not due to

reasonable cause." To the contrary, the information that does exist in the file on this matter suggests that X's managers agreed to the expenditure in question without knowing it was a taxable expenditure and that it was not willful because they did not know that it was a political expenditure.

Accordingly, we hold as follows:

The tax imposed under section 4955(a)(2) on the management does not apply to the managers of X in that the participation of such managers in the acts described above, as a political expenditure, was not knowing, and it is excused as not willful and is due to reasonable cause, for the reasons stated above.

Issue 6: Section 7805(b) Treatment:

To what extent should any adverse conclusion of law under section 501(c)(3) or section 4955 be made prospective or retroactive, in recognition of the technical advice of 1979, the ruling letter of December 10, 1991, the examination of prior years returns, or for any other reason by virtue of the application of section 7805(b) of the Code?

The Commissioner, Tax Exempt and Government Entities Division (T) declines to grant relief in this case pursuant to section 7805(b) of the Code.

CONCLUSION

1. The A/X direct mail fund raising letters constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Internal Revenue Code (whether or not the letters were sent in cooperation with the candidate).

2. We lack sufficient information regarding the values of the exchanges to X versus the value of A's signature to X to establish that the providing of the donor's list from the A/X

direct mail fund raising effort to A constituted campaign intervention within the meaning of section 501(c)(3) of the Code.

3. Resolution of the private benefit issue is unnecessary in light of our determination under issue 1 that the A/X fund raising letters constitute intervention in a political campaign within the meaning of section 501(c)(3) of the Code.

4. The A/X direct mail fund raising letters constitute intervention in a political campaign within the meaning of section 4955(a)(1) of the Code.

5. The tax imposed under section 4955(a)(2) on the management does not apply to the managers of X in that the participation of such managers in the acts described above, as a political expenditure, was not knowing, or if knowing, it is excused as not willful and is due to reasonable cause for the reasons stated above.

6. The Commissioner, Tax Exempt and Government Entities Division (T) has denied the requested relief under section 7805(b).

A copy of this technical advice memorandum is to be given to the organization. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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