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AN UNHEALTHY NATION: WHY LOBBYING RESTRICTIONS FOR VOLUNTARY HEALTH CARE ORGANIZATIONS DON'T MAKE SENSE

INTRODUCTION

Recently, Jack Abramoff, a now infamous lobbyist in the federal government, was charged with exploiting the charitable tax exemptions in an attempt to illegally influence Congressmen by giving them seemingly permissible “charitable gifts.”¹ Abramoff’s abuse of charitable organizations was well documented and publicized in the news.² Ignited by the Abramoff scandal, discussions of greater oversight into lobbying activities of nonprofits have increased.³ However, contrary to these views that more oversight is necessary, the idea that certain charitable organizations should have more freedom to lobby because of the important social function they serve has been around for many years.⁴

“[T]ax exemption is a privilege that is accorded only to organizations that meet the requirements of the Code and the Treasury regulations, including the requirement that their activities be in the public interest.”⁵ The privileges granted to 501(c)(3) tax exempt organizations include freedom from federal income tax and the allowance of personal income tax deductibility by contributions of donors.⁶ With these privileges come many costs to exempt organizations, especially those whose mission includes advocacy.⁷

1. Frances R. Hill, *Congress’s Charity Cases*, N.Y. TIMES, Oct. 17, 2006, at A21.

2. See generally Philip Shenon, *Panel Reports Fraud by Some Nonprofits*, N.Y. TIMES, Oct. 13, 2006, at A21; Editorial, *The Whirl of the Political Casino*, N.Y. TIMES, June 29, 2006, at A24.

3. See Stephanie Strom, *New Equation for Charities: More Money, Less Oversight*, N.Y. TIMES, Nov. 17, 2003, at F1. Strom reports that the Internal Revenue Service has 800 employees monitoring the activities of close to 1 million charities. Further, many state governments do not adequately monitor small charities located within the state. *Id.*

4. See generally Laura B. Chisolm, *Exempt Organization Advocacy: Matching the Rules to the Rationales*, 63 IND. L.J. 201, 204 (1987).

5. Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code’s Treatment of Legislative Activities*, 71 TEX. L. REV. 1269, 1323 (1993).

6. I.R.C. § 170(a)(1) (2006); I.R.C. § 501(c)(3) (2006).

7. See Mortimer M. Caplin & Richard E. Timbie, *Legislative Activities of Public Charities*, 39 LAW & CONTEMP. PROBS. 183, 185 (1975).

Some commentators suggest that it appears illogical to prevent charitable organizations from promoting a mission of advocacy through lobbying activities.⁸ Many exempt organizations accomplish their missions through legislative advocacy, such as promoting legislation to ban smoking.⁹ Other exempt organizations promote numerous social and economic issues that are the direct subject of many legislative proceedings.¹⁰

Many of the services that large charities provide to the government are within the area of health and voluntary health services.¹¹ “Voluntary health care charities,” for purposes of this Note, are categorized as those charities that are primarily organized and operated to serve a health advocacy function.¹² As the nation becomes increasingly unhealthy, health issues have shifted to the forefront of the minds of many Americans.¹³ In 2004, health care spending in America accounted for 15% of the economy, with spending in excess of \$1.55 trillion dollars.¹⁴ Every day, government officials, politicians, and legislators make decisions about numerous health issues that impact the health of the nation.¹⁵ However, under the current Internal Revenue Code regulations, voluntary health care charities are highly restricted in their attempts at advocating for advancement of health-related legislation.¹⁶

8. Galston, *supra* note 5, at 1322.

9. See generally AMERICAN CANCER SOCIETY, CANCER FACTS AND FIGURES 47 (2006), <http://www.cancer.org/downloads/STT/CAFF2006PWSecured.pdf>.

10. See Caplin & Timbie, *supra* note 7, at 184.

11. See generally American Cancer Society, <http://www.cancer.org> (last visited June 14, 2008); American Heart Association, <http://www.americanheart.org> (last visited June 14, 2008); American Diabetes Association, <http://www.diabetes.org> (last visited June 14, 2008); American Lung Association, <http://www.lungusa.org> (last visited June 14, 2008).

12. Examples of these organizations include: American Cancer Society, <http://www.cancer.org> (last visited June 14, 2008); American Heart Association, <http://www.americanheart.org> (last visited June 14, 2008); American Diabetes Association, <http://www.diabetes.org> (last visited June 14, 2008); American Lung Association, <http://www.lungusa.org> (last visited June 14, 2008).

13. See generally Nancy Hellmich, *USA Wallowing in Unhealthy Ways*, USA TODAY, Aug. 22, 2002, available at http://www.usatoday.com/news/health/2002-08-21-james_x.htm.

14. Robert Pear, *Health Spending Rises to 15% of Economy, a Record Level*, N.Y. TIMES, Jan. 9, 2004, at A16.

15. AMERICAN CANCER SOCIETY, *supra* note 9, at 47.

16. See I.R.C. § 501(c)(3)(2006); Treas. Reg. § 1.501(c)(3)-1(c)(2), (d)(1) (as amended in 1990).

The charitable exemption that 501(c)(3) tax exempt organizations receive is only available if the organization is not operated for profit, does not participate directly or indirectly in any political campaign on behalf of or in opposition to any candidate for public office, or if any of the net earnings inure to the benefit of a private person or shareholder.¹⁷ Further, these organizations must be organized and operated for tax exempt purposes and will lose their tax exempt status if more than an insubstantial amount of their activities do not coincide with this tax exempt purpose.¹⁸ Although advocacy by charitable organizations “may not fit comfortably within the narrowest and most traditional sense of ‘charitable’ enterprise, many believe that the roles of advocate and improver of social systems, empowerer of citizens, and critic and monitor of government policies and programs are among the most crucial functions of the nonprofit sector.”¹⁹

Many charitable organizations in the United States have “turned their efforts to raising public awareness, demanding accountability from governmental agencies, and pressing for changes in the law, all in an attempt to serve the collective interests of those whose needs are ill-served by the status quo.”²⁰ For many years, the existence of tax exempt charities has been justified on the grounds that these charities provide services to the government that are beyond the ability of the government to provide.²¹

However, under the current lobbying restrictions, “it is not clear just how much of what kind of activity, addressed to which social issues, will so color the character of an organization that it no longer qualifies for exemption and donor deductibility under *section 501(c)(3) of the Internal Revenue Code*.”²² This Note will scrutinize the inefficiency of current advocacy restrictions as applied to voluntary health organizations and will propose a more efficient

17. I.R.C. § 501(c)(3)(2006); Treas. Reg. § 1.501(c)(3)-1(c)(2), (d)(1)(ii) (as amended in 1990).

18. Treas. Reg. § 1.501(c)(3)-1(a)(1) (as amended in 1990).

19. Chisolm, *supra* note 4, at 205.

20. *Id.* at 204.

21. *Id.*

22. *Id.* at 207.

approach to monitoring exempt organization advocacy. Part I of this Note will give an overview of obtaining tax exempt status as a 501(c)(3), discuss the benefits and limitations that accompany tax exempt status as a 501(c)(3)²³ and will discuss the organizational and operational tests.²⁴ Part II of this Note will address the history of the lobbying restrictions currently affecting 501(c)(3) organizations,²⁵ the substantial part test and the expenditure test.²⁶ Part III of this Note addresses the problems associated with the current lobbying restrictions, including problems with 501(c)(3) organizations funneling their lobbying activities within 501(c)(4) organizations and policy reasons why the restrictions should be lifted for voluntary health care organizations.²⁷

Part IV will discuss the need to reform the current lobbying restrictions as applied to voluntary health care organizations.²⁸ Finally, this Note concludes that the present state of lobbying restrictions is not justified in its application to voluntary health organizations.²⁹

I. OVERVIEW OF OBTAINING 501(c)(3) STATUS

The Internal Revenue Code exempts from taxation many different types of organizations.³⁰ There are roughly twenty-eight types of organizations, including labor unions, trade associations, certain fraternal societies, social welfare organizations, veterans groups, and social clubs that are tax exempt.³¹ Charitable organizations, which are

23. See discussion *infra* Part I.A.

24. See discussion *infra* Part I.B.

25. See discussion *infra* Part II.A.

26. See discussion *infra* Part II.B.

27. See discussion *infra* Part III.

28. See discussion *infra* Part IV.

29. See discussion *infra* Conclusion.

30. See generally I.R.C. § 501 (2006).

31. See generally I.R.C. § 501(c)(1)–(25) (2006) for more in-depth descriptions of these different categories.

organized and operated exclusively for a charitable purpose are categorized as 501(c)(3) organizations under the Code.³²

A. Benefits of Electing 501(c)(3) Status

The Supreme Court in *Bob Jones University v. United States* stated, “[c]haritable exemptions are justified on the basis that the exempt entity confers a public benefit—a benefit that the society or the community may not itself choose or be able to provide, or that supplements and advances the work of public institutions already supported by tax revenues.”³³

Obtaining section 501(c)(3) status is beneficial to organizations, and thus desirable, because contributions made by a donor are tax deductible, while contributions to other tax exempt organizations are not deductible.³⁴ Section 170(c)(2)(D) of the IRC permits taxpayers who contribute donations to 501(c)(3) organizations to deduct the amount of their contributions on their federal income tax returns.³⁵ Commentators have suggested that charitable status is a reflection on donor’s selections of particular philanthropic ideas that are of specific worth to the public.³⁶ Thus, charitable institutions deserve their tax subsidy because of the public’s influence and willingness to donate to a particular cause.³⁷ There are other organizations designated under the Code as tax exempt, such as the 501(c)(4) social welfare organization.³⁸ However, despite receiving tax exempt status,

32. I.R.C. § 501(c)(3) (2006).

33. *Bob Jones Univ. v. United States*, 461 U.S. 574, 591 (1983). Bob Jones University was an educational institution that discriminated on the basis of race. The Supreme Court determined that Congress intended the IRS Code to meet common-law standards of charity. Because the university’s acts of discrimination were “contrary to public policy,” the court refused to grant tax exempt status. *Id.* at 595.

34. See generally I.R.C. § 170(b) (2006).

35. I.R.C. § 170(c)(2)(D) (2006). I.R.C. § 501(c)(1)–(5) provide further contributions that can be deducted.

36. See generally Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1384 (1991).

37. *Id.* at 1385.

38. The 501(c)(4) “social welfare organization” is explained and discussed in Part III.A of this Note.

501(c)(4) organizations may not be as desirable an option because contributions to these organizations are not deductible.³⁹

B. Organizational and Operational Tests

In order to obtain tax exempt status as a 501(c)(3), an organization must be both organized and operated exclusively for one or more tax exempt purposes.⁴⁰ If an organization fails to meet either of these two tests, it will not obtain a tax exempt status.⁴¹ Under the organizational test, the 501(c)(3) exempt organization must be organized exclusively for one or more exempt purpose.⁴² The organization is exempt only if its articles of organization “[l]imit the purposes of [the] organization to one or more exempt purposes.”⁴³ Moreover, the 501(c)(3) exempt organization is expressly denied the power “to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.”⁴⁴ Thus, an organization is not considered organized exclusively for one or more exempt purposes if its articles expressly empower it to carry out, in more than an insubstantial amount, any activities that are not in furtherance of their exempt purposes.⁴⁵

39. I.R.C. § 501(c)(4) (2006).

40. Treas. Reg. § 1.501(c)(3)-1(a) (as amended in 1990). The actual text of the Internal Revenue Code reads:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, 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 (except as otherwise provided in subsection (h)), and 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 candidate for public office.

I.R.C. § 501(c) (2006).

41. Treas. Reg. § 1.501(c)(3)-1(a)(1) (as amended in 1990).

42. Treas. Reg. § 1.501(c)(3)-1(b) (as amended in 1990).

43. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(a) (as amended in 1990).

44. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(b) (as amended in 1990).

45. Treas. Reg. § 1.501(c)(3)-1(a)(2)(iii)1.501(c)(3)-1(a)(2)(b)(iii) (as amended in 1990).

Under the operational test, 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 of such exempt purposes specified in section 501(c)(3)."⁴⁶ An organization is not regarded as operated exclusively for one or more exempt purpose "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."⁴⁷ Further, the presence of a single, significant non-exempt purpose will disqualify the organization under the operational test.⁴⁸ The Code specifies a section for organizations that attempt to influence legislation as a substantial part of their activities.⁴⁹ These types of organizations, deemed "action" organizations, cannot receive tax exempt status under section 501(c)(3) of the Code, but may qualify as a social welfare organization under 501(c)(4).⁵⁰

501(c)(3) organizations are only considered to be organized and operated exclusively for one or more tax exempt purpose if they serve a public, rather than a private, interest.⁵¹ To meet this requirement, the organization must 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 persons controlled, directly or indirectly by such private interests."⁵² Moreover, the net income of the 501(c)(3) cannot inure, in whole or in part, "to the benefit of any private shareholder or

46. Treas. Reg. § 1.501(c)(3)-1(c)(1) (as amended in 1990).

47. *Id.*

48. See *Better Business Bureau of Washington, D.C. v. United States*, 326 U.S. 279, 283 (1945) ("[T]he presence of a single [non-exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes."). See also *Church By Mail, Inc. v. Comm'r of Internal Revenue*, 765 F.2d 1387, 1388 (9th Cir. 1985) (finding that the Church was operated for a substantial non-exempt purpose of providing a market for an advertising service); *Hutchinson Baseball Enterprises, Inc. v. Comm'r of Internal Revenue*, 696 F.2d 757, 763 (10th Cir. 1982) (finding that a non-profit organization promoting recreational and amateur athletics had a substantial non-exempt purpose of promoting an amateur baseball team).

49. Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) (as amended in 1990).

50. See Treas. Reg. § 1.501(c)(3)-1(c)(3)(i), (iii), (iv) (as amended in 1990); I.R.C. § 501(c)(4) (2006); see also discussion *infra* Part III.A.

51. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 1990).

52. *Id.*

individual.”⁵³ Finally, no substantial part of the organization’s activities may be attempts to influence legislation or participate in political candidate campaigns.⁵⁴

II. OVERVIEW OF LOBBYING RESTRICTIONS

A. History of Lobbying Restrictions

Federal tax law limits the amount of legislative and political activities of charitable 501(c)(3) organizations in two ways.⁵⁵ First, charities may lose their tax exempt status if they engage in a substantial amount of legislative lobbying.⁵⁶ Second, charities may not participate in political campaigns on behalf of candidates for office.⁵⁷ Congress passed the first lobbying restrictions applicable to tax exempt organizations in 1934, when it stated that “no substantial part of the activities” of a tax exempt corporation or foundation may consist of “carrying on propaganda, or otherwise attempting, to influence legislation.”⁵⁸

B. Tests of Lobbying Activity

There are two main regimes that apply to the lobbying activities of public charities.⁵⁹ These regimes, considered “tests” of lobbying activities, are the substantial part test and the expenditure test.⁶⁰

53. I.R.C. § 501(c)(3) (2006); *see also* Treas. Reg. § 1.501(a)-1(c) (as amended in 1982) (Private shareholders are defined as a person or “persons having a personal or private interest in the activities of the organization.”); *East Tennessee Artificial Breeders Assoc. v. United States*, 63-2 U.S. Tax Cas. (CCH) P9748 (1963) (defining “inurement” as “use; user; service to the or benefit of a person.”).

54. Treas. Reg. § 1.501(c)(3)-1(b)(3)(ii) (as amended in 1990).

55. I.R.C. § 501(c)(3) (2006).

56. *Id.*

57. *Id.*

58. Revenue Act of 1934, Pub. L. No. 73-216, § 101(6) (1934). Introduced by Senator David Reed of Pennsylvania, this amendment was born from the need to protect charitable donors from inadvertently financing political activities. *See generally* Deborah J. Zimmerman, *Branch Ministries Inc. v. Rossotti: First Amendment Considerations to Loss of Tax Exemption*, 30 N. KY. L. REV. 249, 252 (2003) (discussing 501(c)(3) tax exemptions).

59. *See* Treas. Reg. § 1.501(c)(3)-1(b) (as amended in 1990); Treas. Reg. § 1.501(h)-1(a)(1),(2) (as amended in 1990).

60. *Id.*

1. *Substantial Part Test*

The substantial part test requires that a 501(c)(3) organization not devote more than an “insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise; or directly or indirectly to participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of or in opposition to any candidate for public office”⁶¹ To do any of these things would characterize the 501(c)(3) as an action organization, terminating its tax exempt status.⁶² Currently, there is little guidance for tax exempt organizations to determine what level of activity is allowed before potentially jeopardizing the organization’s status.⁶³

2. *Expenditure Test*

The expenditure test is outlined in Section 501(h) of the Internal Revenue Code.⁶⁴ Section 501(h) and 4911 of the Internal Revenue Code were added as amendments in 1976 and were “seen as an important step in the direction of curing the faults of the pre-1976 substantiality test [the substantial part test].”⁶⁵ As opposed to the substantial part test, if a charitable organization elects the expenditure test as a substitute, a strict limit is imposed on the amount of money the 501(c)(3) can spend in an effort to influence legislation.⁶⁶ Many public charities elect the expenditure test instead of the substantial part test to determine their allowable expenditures to influence legislation.⁶⁷

61. Treas. Reg. § 1.501(c)(3)-1(b)(3)(i)-(iii) (as amended in 1990).

62. Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii) (as amended in 1990).

63. Guidance for exempt organizations on the meaning of “substantial” has been unpredictable. See discussion *infra* Part III.

64. See Treas. Reg. § 1.501(h) (as amended in 1990).

65. Chisolm, *supra* note 4, at 225.

66. Treas. Reg. § 1.501(h)-1(3) (as amended 1990); I.R.C. § 4911(c)(2) (2006) (currently, this limit is \$1,000,000).

67. Treas. Reg. § 1.501(h)-1(a)(2) (as amended 1990).

Under a specific formula, a public charity that elects 501(h) status can make lobbying expenditures within specified dollar limits.⁶⁸ By remaining within these certain limits, “the electing public charity will not owe tax under section 4911 nor will it lose its tax exempt status as a charity.”⁶⁹ These limits are determined on a scale of the fraction of the total expenditures the charity makes within a year in support of its exempt purpose.⁷⁰ “Lobbying expenditures” are amounts spent to influence legislation.⁷¹ “Influencing legislation” is “any attempt to influence any legislation” either “through an attempt to affect the opinions of the general public or any segment thereof,”⁷² or “through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation.”⁷³

The expenditure test also distinguishes between direct lobbying and grassroots lobbying.⁷⁴ As opposed to direct lobbying, which is aimed at legislators, grassroots lobbying is an “attempt[] to urge or encourage the public to contact members of a legislative body for the purpose of proposing, supporting, or opposing legislation.”⁷⁵ Expenses on grassroots lobbying cannot exceed one-fourth of the total lobbying percentage limitation.⁷⁶ An exempt organization will be forced to pay an excess expenditure tax in the event that they have “excess lobbying expenditures,” which occurs when either the amount of lobbying expenditures exceed the lobbying nontaxable

68. Treas. Reg. § 1.501(h)-1(a)(3) (as amended 1990).

69. *Id.*

70. See I.R.C. § 4911(c)(2) (2006). The yearly percentage limits are the lesser of \$1,000,000 or: 20% for the first \$500,000 of exempt purpose expenditures; \$100,000 plus 15% of the second \$500,000 of exempt purpose expenditures; \$175,000 plus 10% of the exempt purpose expenditures; or \$225,000 plus 5% of exempt purpose expenditures exceeding \$1,500,000. *Id.*

71. I.R.C. § 4911(c)(1) (2006).

72. I.R.C. § 4911(d)(1)(A) (2006).

73. I.R.C. § 4911(d)(1)(B) (2006).

74. Treas. Reg. § 56.4911-2(a)(2) (as amended in 1990).

75. Treas. Reg. § 1.162-20(c)(4) (as amended in 1995).

76. I.R.C. § 4911(c)(4) (2006).

amount,⁷⁷ or the amount of grassroots expenditures exceed the grassroots nontaxable amount.⁷⁸

C. *Constitutionality of Lobbying Restrictions*

In 1983, the Supreme Court ruled on the constitutionality of the lobbying restrictions imposed on section 501(c)(3) organizations in the case of *Regan v. Taxation With Representation of Washington*.⁷⁹ Taxation With Representation was an organization which sought to promote its view of “public interest” in the federal taxation arena and was formed to take over two nonprofit organizations.⁸⁰ The first corporation, Taxation With Representation Fund, promoted the public interest through litigation and the publication of a journal, and had tax exempt status as a 501(c)(3) organization.⁸¹ The second organization, Taxation With Representation, was formed primarily for influencing legislation and had tax exempt status as a 501(c)(4) organization.⁸² Taxation With Representation attacked the lobbying restrictions for its 501(c)(3) organization because it sought to use the tax deductible contributions to support the substantial lobbying activities of the 501(c)(4) organization.⁸³ The Internal Revenue Service denied Taxation With Representation tax exempt status because more than a substantial part of its activities included attempts to influence legislation.⁸⁴

After losing its tax exempt status, Taxation With Representation challenged the 501(c)(3) lobbying restrictions and claimed that the prohibition of substantial lobbying was unconstitutional under the First Amendment.⁸⁵ Taxation With Representation sued the

77. I.R.C. § 4911(b)(1) (2006).

78. I.R.C. § 4911(b)(2) (2006).

79. See *Regan v. Taxation With Representation of Washington*, 461 U.S. 540 (1983).

80. *Id.* at 543.

81. *Id.*

82. *Id.* As discussed in Part III.A. of this Note, a 501(c)(4) organization is a “social welfare organization” which is also a tax exempt organization, but unlike a 501(c)(3) organization, any donations to a 501(c)(4) are not tax deductible.

83. *Regan v. Taxation With Representation of Washington*, 461 U.S. at 543–44.

84. *Id.* at 542.

85. *Id.*

Commissioner of the Internal Revenue Service, the Secretary of the Treasury, and the United States seeking a declaratory judgment that their organization should be granted 501(c)(3) tax exempt status.⁸⁶ The Supreme Court affirmed the IRS's denial of tax exempt status because a substantial part of its intended activities would consist of attempts to influence legislation.⁸⁷ The Court focused on two important principles: (1) the First Amendment does not require the government to subsidize lobbying, and (2) "a legislature's decision not to subsidize the exercise of a fundamental right does not infringe that right."⁸⁸

The Court explained that both tax exemptions and tax deductions are essentially a government subsidy of an organization.⁸⁹ In essence, a tax exemption operates as a cash grant from the government to an organization.⁹⁰ Moreover, "[t]he system Congress has enacted provides this kind of subsidy to nonprofit civic welfare organizations generally, and an additional subsidy to those charitable organizations that do not engage in substantial lobbying."⁹¹ Thus, Congress made a conscious decision to not subsidize the political activities of charities as much as charities' other activities.⁹²

The Court held that Taxation With Representation could still obtain tax exemption as a 501(c)(4) organization; however it would have to ensure that the 501(c)(3) organization did not subsidize the 501(c)(4) organization because "otherwise, public funds might be spent on an activity Congress chose not to subsidize."⁹³ The Court indicated that by requiring an exempt organization to conduct all of its lobbying activities through a 501(c)(4), it prevents the public subsidy of lobbying without requiring the parent organization to be

86. *Id.*

87. *Id.* at 550.

88. *Id.* at 549.

89. *Regan v. Taxation With Representation of Washington*, 461 U.S. at 544.

90. *Id.*

91. *Id.*

92. *Id.* at 550.

93. *Id.* at 544.

forced to forego all lobbying or give up the public subsidy of deductibility for its other activities.⁹⁴

Taxation With Representation argued that despite the availability of a 501(c)(4) structural option, the IRS imposed onerous requirements on these organizations, which “effectively make it impossible for a § 501(c)(3) organization to establish a § 501(c)(4) lobbying affiliate.”⁹⁵ However, the Court indicated that the IRS only required the 501(c)(3) organization and the 501(c)(4) “sister” organization to be separately incorporated and maintain clear records indicating that all tax-deductible contributions of the 501(c)(3) were not used for lobbying.⁹⁶ The Court said these requirements were “not unduly burdensome.”⁹⁷

III. PROBLEMS WITH THE PRESENT SYSTEM

A. Creating a “Sister” 501(c)(4) Organization May Not Be The Best Option

As discussed in the previous section, the Supreme Court concluded in *Regan v. Taxation With Representation* that there is no penalty imposed by the lobbying restrictions of 501(c)(3) organizations because a 501(c)(3) organization that wishes to advocate can house all of these activities within a 501(c)(4) sister organization.⁹⁸ By isolating lobbying activities within a 501(c)(4), the exempt organization could continue to receive tax deductions on all of its funds, except for the lobbying activities.⁹⁹ Many charitable organizations form 501(c)(4) entities to promote a particular cause, including proposing legislation and endorsing political candidates who share the views of the organization.¹⁰⁰

94. *Id.* at 553 (Blackmun, J., concurring).

95. *Regan v. Taxation With Representation of Washington*, 461 U.S. at 544 n.6.

96. *Id.*

97. *Id.*

98. *Regan v. Taxation With Representation of Washington*, 461 U.S. at 544.

99. *Id.*

100. Charles E. Hodges II & Edward M. Manigault, *Political Activity and Lobbying By Charities: How Far Can it Go? What are the Risks?* J. TAX’N, Sep. 2000, at 182.

A 501(c)(4) organization is a social welfare organization that is exempt from taxation.¹⁰¹ The main difference between classification as a 501(c)(3) entity and a 501(c)(4) entity is that a 501(c)(3) allows for personal income tax deductibility of contributions by donors under § 170(c)(2), while donors to a 501(c)(4) may not deduct these contributions.¹⁰² However, unlike a 501(c)(3), a 501(c)(4) organization has no restrictions on lobbying and does not have to refrain from attempting to influence legislation.¹⁰³ In fact, the IRS has held that a 501(c)(4) organization may carry on political activities.¹⁰⁴ An organization that is considered an “action” organization may still qualify for tax exempt status under section 501(c)(4) of the Code.¹⁰⁵ Although the Court in *Taxation With Representation* indicated that by funneling lobbying activities into a 501(c)(4) sister organization, the 501(c)(3) does not have to choose between free speech or deductibility for its other activities,¹⁰⁶ this method of lobbying through a 501(c)(4) organization presents two key problems.¹⁰⁷

First, establishing a 501(c)(4) entity requires that certain standards be met.¹⁰⁸ A 501(c)(4) should be separately organized and established under state law, should maintain separate bank accounts, and should keep separate records from the 501(c)(3).¹⁰⁹ In addition, the 501(c)(3) and 501(c)(4) should allocate key employees such as officers and directors, as well as shared goods, services, and facilities so as to not

101. Section 501(c)(4) of the Internal Revenue Code exempts organizations that are “operated exclusively for the promotion of social welfare.” I.R.C. § 501(c)(4)(A) (1982). “Social welfare” is defined to be “the common good and general welfare of the people of a community” and “bringing about civic betterments and social improvements.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (2007).

102. See *supra* Part I.B.

103. Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (2007).

104. See Rev. Rul. 81-95, 1981-1 C.B. 332.

105. See *supra* Part II.

106. *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 553 (1983) (Blackmun, J., concurring) (discussing the majority’s holding).

107. See discussion *infra* Part III.

108. See *Hodges II & Manigault*, *supra* note 100, at 182.

109. Internal Revenue Service, *Fiscal 2000 CPE Text for Exempt Organizations, Chapter S, Affiliations Among Political, Lobbying, and Educational Organizations*, 1999 TNT 169-30, at par. 15 (Sept. 1, 1999).

risk the status of the 501(c)(3).¹¹⁰ If a 501(c)(4) entity affiliated with a 501(c)(3) fails to observe all the formalities of separate organizational status, its activities may be considered those of the 501(c)(3) organization, especially if the 501(c)(3) provides any subsidy.¹¹¹ A 501(c)(3) may jeopardize its own exempt status and be characterized as non-charitable if its affiliation with a 501(c)(4) is used to conceal a primary purpose of advocacy.¹¹²

Second, by forcing exempt organizations to house all of their advocacy within a 501(c)(4), it withholds incentives for donors to contribute deductible donations.¹¹³ Contributors to a 501(c)(4) organization cannot deduct their donations on their individual income tax returns.¹¹⁴ Although a 501(c)(3) organization may be able to house lobbying activity within a 501(c)(4), without the ability to receive deductible contributions, a great portion of the organization's funds may dissipate¹¹⁵ and the 501(c)(4) may not be able to financially maintain its existence.¹¹⁶

B. The Obscure Meaning of "Substantial" and Problems with 501(h) Election

A second problem with the current restrictions on charitable lobbying is that there is no simple rule as to what amount of lobbying activity is considered to be "substantial."¹¹⁷ Exempt organizations operating advocacy activities under the substantial part test may find it extremely difficult to gauge the amount of permissible lobbying activities.¹¹⁸ Further, guidance on an allowable amount of advocacy activity from the judicial opinions has been varied and

110. *Id.*

111. *Id.*

112. Chisolm, *supra* note 4, at 239.

113. See generally Galston, *supra* note 5.

114. See I.R.C. § 170(c)(2) (limiting the types of organizations to which donors can make a charitable contribution).

115. See James H. Fogel, *To the IRS, 'Tis Better to Give than to Lobby*, 61 A.B.A. J. 960, 961 (1975).

116. See Caplin & Timbie, *supra* note 7, at 195.

117. See *id.* at 183-84. See generally Galston, *supra* note 5, at 1279.

118. See discussion *infra* Part III.B.

unpredictable.¹¹⁹ For example, in *Haswell v. United States*, the United States Court of Claims used a percentage test to determine that an organization's lobbying activities were substantial, thus causing the organization to lose its tax exempt status.¹²⁰ In *Haswell*, the court held that the organization engaged in substantial lobbying activity when 16-20% of its expenditures were used for lobbying and the legislative program was an important part of the organization's agenda.¹²¹ Utilizing the same percentage test, the Sixth Circuit in *Seasongood v. Commissioner* held that lobbying by an organization was not substantial when it accounted for less than 5% of its expenditures.¹²²

However, the Tenth Circuit in *Christian Echoes National Ministry, Inc. v. United States* used a much broader test to determine if an organization's lobbying activities were substantial:

The political activities of an organization must be balanced in the context of the objectives and circumstances of the organization to determine whether a *substantial* part of its activities was to influence or attempt to influence legislation. A percentage test to determine whether the activities were substantial obscures the complexity of balancing the organization's activities in relation to its objectives and circumstances.¹²³

Consequently, charities making a good faith attempt to comply with the "substantial part" test are left with vague and uncertain standards.¹²⁴

Under the "substantial part" test, a charity may participate in some lobbying activities; however, because of the lack of coherent

119. Compare *Haswell v. United States*, 500 F.2d 1133, 1142 (Ct. Cl. 1974), with *Seasongood v. Comm'r of Internal Revenue*, 227 F.2d 907, 911-12 (6th Cir. 1955).

120. *Haswell*, 500 F.3d at 1146.

121. *Id.* at 1146-47.

122. *Seasongood*, 227 F.2d at 912.

123. *Christian Echoes Nat'l Ministry, Inc. v. United States*, 470 F.2d 849, 855 (10th Cir. 1972) (citation omitted).

124. See Caplin & Timbie, *supra* note 7, at 195.

standards governing what is “substantial,” there is an undue administrative burden on all concerned.¹²⁵ A charity that wishes to participate in legislative activity must first determine what constitutes legislative activity within the Code and then look to unpredictable standards to determine if these activities are substantial.¹²⁶

To determine if a charity in question is within the allowable limits of lobbying activity, the Internal Revenue Service must investigate the facts and circumstances of each case and make numerous factual and legal judgments.¹²⁷ Given that the Internal Revenue Service currently has 800 employees in charge of monitoring close to one million charities, this does not appear to be an easy feat.¹²⁸ Moreover, because the lines of allowable lobbying activity are so blurred, many charities will simply avoid participation fearing revocation of their status.¹²⁹

Although there is much uncertainty as to the extent of lobbying activity that would jeopardize an organization’s tax exempt status under the “substantial part” test, a principal advantage of electing 501(h) status, allowing lobbying activities measured in accordance with the expenditure test, are the clearer, bright-line rules regarding permissible amounts of lobbying activities.¹³⁰ However, large public charities may find the annual \$1 million limit for total lobbying expenditures highly restraining to the organization’s attempts at advocacy.¹³¹

125. *See id.* at 191.

126. *Id.* at 195.

127. *Id.* at 194.

128. *See* Stephanie Strom, *New Equation for Charities: More Money, Less Oversight*, N.Y. TIMES, Nov. 17, 2003, at F1.

129. *See* Caplin & Timbie, *supra* note 7, at 185.

130. *See* discussion *supra* Part II.B.

131. While \$1 million is not an insubstantial amount of money, for an organization such as the American Cancer Society, with annual revenues close to \$1 billion, electing 501(h) status would limit the organization’s lobbying efforts to 1/1,000 of their annual income. Moreover, if 1/1,000 of the organization’s income was attributed to lobbying efforts, this amount does not seem to be so “substantial” as to jeopardize the organization’s status under the “substantial part” test. *See generally* American Cancer Society, IRS Form 990 Return for National Home Office (2005), http://www.cancer.org/docroot/AA/content/AA_1_7_National_Home_Office_Form_990_2005_PDF.asp; American Cancer Society, IRS Form 990 Group return for Consolidated Divisions (2005), <http://www.cancer.org/downloads/AA/GroupFY05990.pdf>.

C. Public Policy Considerations

One large paradox of the current lobbying restrictions is that to meet the requirements of a tax exempt, charitable organization, the organization must be organized to promote public rather than private interests.¹³² However, because exempt organizations, rather than businesses, are restricted in their lobbying efforts, the Code's restrictions have made it "more onerous for organizations formed to promote the public interest and more generous for entities formed to serve private or commercial interests"¹³³

The issues that public charities promote are varied; however, these issues are generally the subjects of legislative process in both state and national government.¹³⁴ Voluntary health care organizations feel the impact of legislative decisions on matters such as funding for research, health care regulations, and ensuring that all social classes in society have access to some degree of health care.¹³⁵ Some important goals of health care organizations are achieved only through legislation.¹³⁶ For example, many state and local governments have recently enacted smoking bans to prevent smoking in public places.¹³⁷ Smoking cessation is a goal of the American Cancer Society,¹³⁸ a goal achieved in large part with the aid of legislative activity.¹³⁹

132. Treas. Reg. § 1.501(c)(3)-1(d)(ii) (2007).

133. See Galston, *supra* note 5, at 1271-72. Galston argues that the role of legislators is to determine what actions or policies will benefit the community as a whole, to not only to implement, but also to discover, legislative choices. Galston argues generally that charities should have even greater access to lobbying because they can more accurately transmit to legislators "the existence, extent, and intensity of constituent preferences." *Id.* at 1337.

134. See Caplin & Timbie, *supra* note 7, at 197.

135. *Id.* Even non-health related charities, such as educational institutions, are greatly impacted by legislative activities in areas such as improving the quality of public education. *Id.*

136. *Id.*

137. See generally Thomas A. Lambert, *The Case Against Smoking Bans*, 13 MO. ENVTL. L. & POL'Y REV. 94 (2005).

138. American Cancer Society, *Cancer Facts and Figures 46* (2006), <http://www.cancer.org/downloads/STT/CAFF2005f4PWSecured.pdf>.

139. See generally Mark J. Horvick, *Examining the Underlying Purposes of Municipal and Statewide Smoking Bans*, 80 IND. L. J. 923 (2005).

Some commentators suggest that lobbying restrictions “effectively den[y]” charities access to pursue their charitable purpose.¹⁴⁰ Moreover, some commentators advocate the removal of all lobbying restrictions.¹⁴¹ A fundamental aspect of a democratic government is ensuring that legislation benefits society as a whole, accounting for the viewpoints of all members of society.¹⁴² Legislators not only receive input from individual citizens, but also from groups informed about the issues.¹⁴³ In this respect, charities, especially voluntary health care charities, may be in the best position to provide meaningful assistance to legislators when drafting legislation related to social problems.¹⁴⁴ Voluntary health care charities, organized and operated exclusively for their charitable purpose can offer guidance and information for legislators implementing programs to better the health and wellbeing of society.¹⁴⁵

Historically, commentators have put forth several arguments contending that exempt organizations should forego legislative activity because of their exempt status.¹⁴⁶ One major argument against legislative activities by tax exempt organizations is that government should not subsidize participation in politics, giving charitable organizations an upper-hand over their for-profit peers.¹⁴⁷ Without being restricted in their lobbying activities, exempt organizations’ activities may jeopardize government neutrality.¹⁴⁸ Congress made a clear policy choice to avoid subsidizing political activity through tax benefits given to charities.¹⁴⁹ Further, advocates

140. Caplin & Timbie, *supra* note 7, at 197.

141. See Fogel, *supra* note 115, at 961 (espousing that society needs a countervailing view of businesses and added information from charities, acting as unbiased sources, which can aid legislators in arriving at more informed decisions. A percentage limitation of legislative activities is in direct opposition to Congress’s justification for charitable exemptions.)

142. See Caplin & Timbie, *supra* note 7, at 198.

143. *Id.*

144. *Id.*

145. *Id.*

146. Chisolm, *supra* note 4, at 247.

147. *Id.* at 249-50.

148. See Theodore L. Garrett, *Federal Tax Limitations on Political Activities of Public Interest and Educational Organizations*, 59 GEO. L.J. 561, 583 (1971).

149. Laura Brown Chisolm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 GEO. WASH. L. REV. 308, 315 (1990).

of this “neutrality” argument posit that certain charitable organizations would have a much stronger voice in the legislative arena, giving certain organizations an unfair advantage.¹⁵⁰

The current system of lobbying restrictions “is not really neutral at all.”¹⁵¹ Businesses are able to deduct any lobbying expenses that “bear a direct relationship to the [organization].”¹⁵² However, businesses are not able to deduct lobbying expenditures if there is too attenuated a connection between the legislation and the welfare of the business.¹⁵³ Because the lobbying restrictions are much more arduous as applied to charitable organizations, the restrictions create both an easier and cheaper method for businesses to lobby.¹⁵⁴

Although critics suggest that engaging in social activism and advocacy “distorts and demeans the charitable mission,” many in the nonprofit sector appear to support tax exempt, charitable organizations advocating their missions.¹⁵⁵ Under common law, political activities as a means to accomplish a charitable goal do not cause an organization to be considered “non-charitable.”¹⁵⁶ For example, a charity organized and operated to relieve poverty may further their mission by endorsing a political candidate who may support legislation for the homeless.¹⁵⁷ It is hard to see how this lobbying activity is not a charitable activity.¹⁵⁸

Historically, within a modern democracy, it is a challenge for legislators to remain current on all of the varied issues put before them.¹⁵⁹ Given the present health of American citizens, it appears that

150. See Theodore L. Garrett, *Federal Tax Limitations on Political Activities of Public Interest and Educational Organizations*, 59 GEO. L.J. 561, 584–85 (1971).

151. Chisolm, *supra* note 4, at 250.

152. Treas. Reg. § 1.162-15(b) (2007).

153. See Treas. Reg. § 1.162-20(b)(1)(i) (2007). However, no deductions are allowed for political campaign activities or for lobbying in connection with nominations, appointments, or referenda. Treas. Reg. § 1.162-20(c)(4) (2007). *Id.*

154. See Galston, *supra* note 5, at 1271–72.

155. Chisolm, *supra* note 4, at 248.

156. Johnny Rex Buckles, *Not Even a Peep? The Regulation of Political Campaign Activity by Charities Through Federal Tax Law*, 75 U. CIN. L. REV. 1071, 1090 (2007).

157. See *id.* at 1090.

158. See *id.* at 1091.

159. See generally Elias Clark, *The Limitation on Political Activities: A Discordant Note in the Law of Charities*, 46 VA. L. REV. 439 (1960).

legislators may be in need of guidance and support from health care advocates.¹⁶⁰ The United States “spend[s] more per capita on health care than any other developed country.”¹⁶¹ Yet, as evidence of a health care system in need of reform, the United States does not even rank in the top twenty nations for life expectancy measured in healthy years.¹⁶² Charitable voluntary health organizations are in a unique position to provide both social services and advocate for the health and well-being of the nation.¹⁶³ Being organized and operated exclusively for the public good¹⁶⁴ may in fact put voluntary health organizations in a uniquely beneficial position to monitor and advocate for government policies and programs.¹⁶⁵

IV. THE NEED FOR REFORM

As the Supreme Court stated in *Regan v. Taxation With Representation*, “Congress . . . not . . . this Court . . . has the authority to determine whether the advantage the public would receive from additional lobbying by charities is worth the [additional] money the public would pay to subsidize that lobbying, and other disadvantages that might accompany that lobbying.”¹⁶⁶ Congress has broad discretion in the field of taxation, and the presumption of constitutionality of a tax statute cannot be overcome unless there is an explicit demonstration that the classification is “hostile and oppressive discrimination against particular persons and classes.”¹⁶⁷ The Supreme Court clearly stated that it is up to Congress to decide which charities are worthy of subsidized lobbying.¹⁶⁸ Congress

160. See *supra* notes 13–14 and accompanying text.

161. Donald L. Barlett & James B. Steele, Op-Ed, *The Health of Nations*, N.Y. TIMES, Oct. 24, 2004, § 4, available at 2004 WLNR 4785821.

162. *Id.* According to the article, the United States comes in “an embarrassing 29th, sandwiched between Slovenia and Portugal.” *Id.*

163. Chisolm, *supra* note 4, at 205.

164. See generally *infra* Part I.A (describing the organizational and operational tests).

165. See generally Chisolm, *supra* note 4, at 205.

166. *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 550 (1982).

167. *Id.* at 547.

168. *Id.* at 550.

subsidizing lobbying for veteran's organizations are viewed as a legitimate policy because veterans have "been obliged to drop their own affairs to take up the burdens of the nation."¹⁶⁹ Thus, Congress must determine whether voluntary health care organizations are vital and worthy enough to the country to obtain similar lobbying treatment.¹⁷⁰

If voluntary health care charities had the opportunity to increase their lobbying activities in support of a public mission of health they may be able to "fill a void left by the purely political, and depressingly bureaucratic, operations of government."¹⁷¹ With increased abilities to lobby, large voluntary health care organizations, such as the American Cancer Society, would be particularly influential in political health care advocacy because of its financial resources and ability to coordinate health care action on a national level.¹⁷²

Lobbying restrictions promote the integrity of nonprofits by ensuring that they do not cease from operating a public interest mission.¹⁷³ However, the complexity of the current lobbying rules and the cost of compliance may cause some organizations to forgo using their political voice.¹⁷⁴ While increasing the lobbying ability of voluntary health care organizations may help improve the health of the nation, a concern remains that increased lobbying may further "a private interest more than insubstantially . . . [through] exploitation of a charitable entity for private purposes."¹⁷⁵ If Congress passed legislation that allowed voluntary health care charities, or any charities for that matter, to have more flexibility in their lobbying

169. *Id.* at 550 (internal quotation marks omitted).

170. *See id.*

171. Johnny Rex Buckles, *Not Even a Peep? The Regulation of Political Campaign Activity by Charities Through Federal Tax Law*, 75 U. CIN. L. REV. 1071, 1093 (2007). Similar arguments have been made to liberalize advocacy restrictions for religious institutions as churches and other faith-based organizations are voluntary associations that engage in character building and thus, deserve additional privileges of federal tax law. Miriam Galston, *Civic Renewal and the Regulation of Nonprofits*, 13 CORNELL J. L. & PUB. POL'Y 289, 396 (2004).

172. *See id.* at 360.

173. *Id.* at 402.

174. *Id.*

175. Buckles, *supra* note 171, at 1092.

activities, the risk remains that the charity will no longer promote a public interest.¹⁷⁶ If any legislation were to be proposed it would be necessary for Congress to “protect the integrity of the charitable sector without unnecessarily stifling its political voice.”¹⁷⁷

If Congress relaxed the prohibition of political activities for voluntary health care charities, the possibility exists that there could be an increased partnership between the government and the charitable sector in ameliorating the health care crises in the United States.¹⁷⁸ Although Congress treats voluntary health care charities the same as any other organization operated for a charitable purpose, the meaningful contributions certain voluntary health care charities make to benefit society may justify relaxed lobbying restrictions.¹⁷⁹

CONCLUSION

Lobbying restrictions on charitable voluntary health organizations simply do not make sense.¹⁸⁰ Under the Code regulations, charitable voluntary health organizations are severely restricted in their advocacy efforts,¹⁸¹ yet these organizations are in the best position to advocate for the health of Americans.¹⁸²

The United States is an unhealthy nation that spends over one billion dollars each year on health care.¹⁸³ Within the United States, there are many charitable voluntary health organizations dedicated to improving the health of Americans.¹⁸⁴

The two current legislative activity regimes, the substantial part test and the 501(h) election, are both lacking.¹⁸⁵ The substantial part

176. *Id.*

177. *Id.* Whether liberalization of lobbying rules for voluntary health care organizations is constitutional or prohibited is beyond the scope of this Note.

178. See Buckles, *supra* note 171, at 1094–1096.

179. See *supra* notes 169–179 and accompanying text.

180. See discussion *supra* Part III.

181. See discussion *supra* Part II.B.

182. See discussion *supra* Part III.C.

183. See discussion *supra* Introduction.

184. See *id.*

185. See discussion *supra* Part II.B.

test offers an obscure meaning of “substantial” which provides little guidance and makes lobbying by charitable organizations too onerous.¹⁸⁶ The 501(h) election, while providing a clear monetary limit on allowable legislative activity, is limited to a \$1 million dollar annual expenditure, which is much too small to promote the advocacy efforts by organizations, such as the American Cancer Society with annual revenues close to \$1 billion dollars.¹⁸⁷

Although the Supreme Court in *Regan v. Taxation With Representation* affirmed that 501(c)(3) organizations may house their lobbying activities within a 501(c)(4) “social welfare” organization; this may not always be a good option for large charities.¹⁸⁸ Forming a 501(c)(4) organization does not clarify the obscure meaning of how much activity is “substantial.”¹⁸⁹ Moreover, due to the technicalities that exist for proper creation and maintenance of a 501(c)(4), many charities will find this option administratively burdensome and may opt to forego any lobbying activities.¹⁹⁰

Further, the benefits of allowing voluntary health organizations to lobby outweigh the risks.¹⁹¹ Voluntary health organizations are in the best position to inform legislators and advocate for the health of Americans.¹⁹² Although the limitations on political activities by charities are well-rooted in the legislative history of 501(c)(3) organizations, after considering the current health care crisis in the United States, it may be time that the limitations are reconsidered.¹⁹³

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186. See discussion *supra* Part III.A.

187. See discussion *supra* Part III.B.

188. See discussion *supra* Part III.A.

189. See *id.*

190. See discussion *supra* Part III.A.

191. See discussion *supra* Part III.C.

192. See *id.*

193. See discussion *supra* Part IV.