IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

FREEDOM PATH, INC. Plaintiff, v. LOIS LERNER, *et al.* Defendants.	)	Civil Action No. 3:14-CV-1537-D

FREEDOM PATH'S REPLY BRIEF IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT FOR COUNTS VI AND VIII

Dated: November 16, 2016

Respectfully submitted,

By: /s/ Chris K. Gober

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INTRODUCTION

The Government argues that the jeopardy for any group facing the "facts and circumstances" test is neither (1) being subjected to an unconstitutionally vague process nor (2) a chilling of its constitutionally-protected speech. *See* Gov't Response Br. at pp. 1-2 (ECF No. 88, Page ID 2003-04). But the Government is incorrect in both respects, and even a cursory analysis of the "facts and circumstances" test reveals a regulatory test that is unconstitutional under the First and Fifth Amendments to the United States Constitution.

Over the years, the Internal Revenue Service has made clear that social-welfare organizations, which are organized under § 501(c)(4) of the Internal Revenue Code, may make political communications so long as those communications are not "the primary purpose" of the organization. *See* 26 U.S.C. § 527(f)(1); Rev. Rul. 81-95, 1981-1 C.B. 332 (1981), *available at* 1981 WL 166125. Those political communications are speech, and the ability to engage in it is an enormous benefit to social welfare organizations. Yet it is the IRS, which employs an unconstitutional test to analyze these organizations' activities, that plays gatekeeper for such speech. And because the "facts and circumstances" test of Revenue Ruling 2004-6 is so vague and overly broad, it allows the IRS—whether purposeful or not—to provide the benefit of speech for groups whose political persuasions the IRS prefers and to deny it to groups whose political persuasions the IRS dislikes.

A group that falls on the wrong side of the "facts and circumstances" test is not just subject to a tax as the Government infers. Gov't Response Br. at 8 (ECF No. 88, Page ID 2006). While the imposition of a tax could potentially constitute harm, this is not the proper way to analyze the most harmful jeopardy lurking in the "facts and circumstances" test here. Rather, to individuals operating a social-welfare organization, the consequences of making

communications that fall on the wrong side of the "facts and circumstances" test are three-fold: (1) the possible annihilation of the social-welfare organization itself, caused by a loss of its tax-exempt status; (2) the lesser, but no less unconstitutional jeopardy, of being deprived of the funds necessary to make such communications; and/or (3) the possibility of being subject to criminal or civil fines for filing false or improper tax returns if the IRS concludes that certain speech should have been reported as political. These consequences threaten the social-welfare organization for undisputed reasons, which the Government grudgingly admits and cannot deny.

The first reason, stated in the Government's words, is: "[T]he factors identified in Revenue Ruling 2004-6 . . . play a part in helping to determine whether an organization *has engaged in too much* political campaign intervention activity *to be entitled to tax-exempt status under section 501(c)(4)*." Gov't Response Br. at 6 (ECF No. 88, Page ID 2006) (emphasis added). In other words, results from the "facts and circumstances" test can allow the IRS to deny an organization its 501(c)(4) status. The set of facts that comprise the second reason are: section 501(c)(6) trade associations, 501(c)(5) labor unions, and other (c)(4)s choose whether to contribute to the speech of a 501(c)(4), like Freedom Path, based on whether the group's tax-exempt status is in good standing. For example, firms in the finance industry and many of the employees who work for them are strictly prohibited or severely limited in their ability to donate to political campaigns, including to a group the IRS may soon determine has a "primary purpose" of political activity. *See* 17 C.F.R. § 275 (Securities and Exchange Commission Rules against political contributions by investment advisors); MSRB rule G-37(b); SEC Regulatory Notice 16-40. Therefore, if the process for obtaining and maintaining 501(c)(4) status is vague, an agency may, through the enforcement of that vague standard,

deprive an organization of needed funds. If the process is overbroad, rights to speech and association are necessarily chilled irrespective of any tax assessment or tax-status determination that may also result at a later date. This is the central issue in this case, but the Government makes other arguments to obfuscate the most relevant harms asserted.

The Government spends a lot of time in its Response Brief arguing that the "facts and circumstances" test is a civil regulation, (ECF No. 88, Page ID 2011), that is sufficiently objective (*id.* at Page ID 2010), that it applies to business activity (*id.* at Page ID 2012), and that it does not chill constitutionally protected speech (*id.* at Page ID 2023). To the contrary, Freedom Path has demonstrated that the "facts and circumstances" test is not objective, that social-welfare organizations are more devoted to advocacy than to business activities, and that advocacy is a form of constitutionally protected speech. *See* Plaintiff's Memo in Support of Partial MSJ (ECF No. 84). Any regulation of that advocacy utilizing a vague and overly broad test is necessarily capricious under the Fifth Amendment to the United States Constitution and necessarily chills speech protected by the First Amendment.

The Government also argues that, if an organization has any concerns about losing its tax-exempt status or incurring a tax, then it can simply use a separate segregated fund (i.e., a political action committee or "PAC" organized under § 527 of the Internal Revenue Code). Gov't Response Br. at 15 (ECF No. 88, Page ID 2017). But such an argument skirts the entire issue in this case: *What is the proper, constitutional process owed to a group organized under § 501(c)(4)?* The argument also obfuscates the fact that a separate segregated fund is a separate legal entity, distinct from the corporation itself. The Supreme Court has long held that a PAC and its sponsoring organization are not the same entity. *Austin v. Michigan Chamber of Commerce,* 494 U.S. 652 (1990) (Kennedy, J, dissenting); *overruled on other*

grounds in *Citizens United v. FEC*, 558 U.S. 310 (2010). A separate segregated fund must first be formed under § 527, maintain a separate bank account, file a separate tax return, and is generally regulated by the Federal Election Commission and/or other state election commissions (and thus subjected to contribution limits, source restrictions, and enhanced reporting obligations not applicable to 501(c)(4)s). *See* 52 U.S.C. § 30101(4). In short, establishing a separate segregated fund imposes administrative and financial burdens on 501(c)(4)s simply to exercise rights of free speech that the Constitution permits them to exercise in their own right.

Finally, the Government notes that Freedom Path, or any other social-welfare organization or tax-exempt applicant, may appeal any adverse determination the IRS may make in the future. Gov't Response Br. at 10 (ECF No. 88, Page ID 2012). But an appeal that adjudicates *results* created by an unconstitutional process—especially without the opportunity to first challenge the *process* itself, *see Catholic Answers, Inc. v. United States*, 438 F. App'x 640 (9th Cir. 2011) (unpublished opinion) *cert. denied* 132 S. Ct. 1143 (2012); *Christian Coal. of Fla., Inc. v. United States*, 662 F.3d 1182, 1196 n.13 (11th Cir. 2011)—is, in fact, no remedy at all. *See Z Street v. Koskinen*, 791 F.3d 24, 31-32 (D.C. Cir. 2015).

ARGUMENT

A. The "Facts And Circumstances" Test Reaches And Chills Constitutionally Protected Speech

First, the Government argues that "[s]ection 527(f) [merely] creates parity between section 501(c) organizations and section 527 political organizations by taxing section 501(c) organizations 'to the extent they actually operate as political organizations.'" Gov't Response Br. at 4-5 (ECF No. 88, Page ID 2006-07), quoting S. Rep. No. 93-1357 (1974), *available at*

1974 WL 11700. Second, the Government wants this Court to know "what Revenue Ruling 2004-6 does *not* do. It does not ban, restrain, or even regulate speech." Gov't Response Br. at 7 (ECF No. 88, Page ID 2009). The first argument misses the point of this case; the second is incorrect.

While the terms of the "facts and circumstances" test do not expressly prohibit speech, it is well-settled that a group whose primary purpose is or becomes "exempt function activity" (i.e., "political campaign intervention") cannot attain nor maintain status as a 501(c)(4) organization. *See* 26 U.S.C. § 527(f)(1); Rev. Rul. 81-95, 1981-1 C.B. 332 (1981), *available at* 1981 WL 166125 (holding that an organization that is *primarily* engaged in activities that support social welfare may be subject to tax under § 527(f) if it engages in political campaign intervention activities). As the Government admits, the "facts and circumstances" test "describes discrete instances of political campaign intervention activity, which would be considered among all the group's activities that do not promote social welfare . . . in determining whether the group is operated primarily for social welfare purposes." Gov't Response Br. at 11, n. 8 (ECF No. 88, Page ID 2013). In short, a group weighing whether to air or publish a communication risks its very existence as a social-welfare organization unless the communication meets the threshold laid out by the IRS. Any test regulating speech in that context must be objective: the "facts and circumstances" test is not.

Furthermore, groups such as trade associations, labor unions, and other 501(c)(4)s—as well as firms and individuals in the financial industry—are either prohibited or far less likely to contribute funds to an organization whose communications appear to place it on the wrong side of 501(c)(4) status. *See* Plaintiff's Memo in Support of Partial MSJ, at 19-20 (ECF

No. 84, Page ID 1933-34). Because potential donors may refrain from contributing to a 501(c)(4) based on its status, which is determined by the communications it makes, any test policing those communications must be objective. Otherwise, speech is chilled.

B. The "Facts And Circumstances" Test Is Unconstitutionally Vague

The Government asserts that Revenue Ruling 2004-6 has not been applied to Freedom Path. Gov't Response Br. at 7 (ECF No. 88, Page ID 2009). The Government makes this argument to cabin Freedom Path's claim as a facial challenge, not a challenge as-applied. *Id.* Fair enough: the parties to this case did agree to stay the IRS's use of the "facts and circumstances" test to Freedom Path's application for tax-exempt status during the pendency of this case. *See* Order Granting Plaintiff's Motion for Preliminary Injunction (ECF No. 79, Page ID 1811). Nonetheless, Freedom Path did have the "facts and circumstances" test applied to two of its communications and the result demonstrates why the "facts and circumstances" test is "no standard at all, and makes the tax status of charitable organizations and their donors a matter of the whim of the IRS." *United Cancer Council, Inc. v. Commissioner of Internal Revenue,* 165 F.3d 1173, 1179 (7th Cir. 1999).

The IRS's September 2013 letter to Freedom Path included a summary of the "facts and circumstances" in the "LAW" section of their letter, which was then followed by an "ANALYSIS" section that applied the "facts and circumstances" test to two television ads, "Repeal It" and "Three Men," that Freedom Path had aimed at the general public. 2d Am. Compl. ¶ 65 (ECF No. 49-1, Page ID 1170); Appendix to Gov't Br. in Support of Mot. to Dismiss Plaintiff's Second Am. Compl. ("MTD Appendix") at 45-54 (ECF No. 57, Page ID1549-58). While Freedom Path contends that both ads clearly meet the standard for issue advocacy under the Supreme Court's opinion in *FEC v. Wisconsin Right to Life*, 551 U.S. 449 (2007)

("*WRTL II*"), the IRS's September 2013 letter alleges that the two ads are not issue advocacy under § 501(c)(4) but are, instead, "exempt function activity" under § 527(e)(2) (i.e., political campaign intervention) and thus, subject to tax. 2d Am. Compl. ¶¶ 107-122 (ECF No. 49-1, Page ID 1186-92); MTD Appendix at p. 52 (ECF No. 57, Page ID 1556) ("Accordingly, based on all of the facts and circumstances, we conclude that the two television advertisements and three mailers that express approval for Candidate2 also constituted campaign intervention.").

The Government asserts that "the void-for-vagueness doctrine protects two essential values of the due process clause: fair notice and fair enforcement." Gov't Response Br. at 8. (ECF No. 88, Page ID 2010). The first case it cites, however, undermines its argument: "[B]ecause we assume that man is free to steer between lawful and unlawful conduct, we *insist* that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." *Grayned v. City of Rockford*, 408 U.S. 104, 108-09 (1972). The "facts and circumstances" test fails this standard. Revenue Ruling 2004-6 presents six factors "tend[ing] to show" that a given communication is campaign intervention activity and five factors "tend[ing] to show" that a given communication is not campaign intervention activity, and no single factor is determinative or predominates. Rev. Rul. 2004-6. The eleven factors are not weighted against each other, and the ruling acknowledges that other unspecified facts and circumstances may be equally relevant but varying on a case-by-case basis. *Id.* In addition, the ruling presents six hypothetical "situations." Each situation lays out an isolated set of facts and states a result in those circumstances, and there is little reasoning provided for the result beyond a restatement of the applicable factors. *Id.* In practice, the guidance is of limited use to Freedom Path and other

501(c)(4) organizations who seek to operate in compliance with applicable rules and regulations, and especially for those who want to do so with confidence. Indeed, the IRS has not even specified the amount of campaign intervention activities allowed or clarified the way the IRS measures the quantity of an organization's campaign intervention activities. *See* Martha B. Lackritz, *Comments on Proposed Regulations Show Exempt Organization's Concerns*, Taxation of Exempts, at 12, Sept./Oct. 2014, citing McPherson, EO Training Materials Suggest 51 Percent Threshold, p. 122 (Pl's Apx. in Support of Mot. To File Mots. For PSJ and for PI, Ex. D, Apx. at 17 (ECF No. 75-1, Page ID 1750-62)).

C. The "Facts And Circumstances" Test Is Unconstitutionally Overbroad

The Government argues that the "facts and circumstances" test is not unconstitutionally overbroad. Gov't Response Br. at 21 (ECF No. 88, Page ID 2023). To better understand why this argument is incorrect, it is worth noting two constitutional tests available to IRS that the IRS is *not* deploying. The IRS is not deploying an easy-to-understand test ratified by the Supreme Court in multiple speech cases: that a group may spend up to 49% of its resources "expressly advoca[ting] the election or defeat" of a clearly identified candidate to public office in a calendar year and still maintain its status as a social-welfare organization, *see Buckley v. Valeo,* 424 U.S 1 (1976), or a test ratified as objective by the Supreme Court in *WRTL II*: that a 501(c)(4) organization may spend up to 49% of its resources in calendar year on speech that is the "functional equivalent of express advocacy." *WRTL II*, 551 U.S. at 469-70.

The "facts and circumstances" test is unconstitutionally overbroad because it sweeps into "exempt function activity" speech that is clearly "genuine issue advocacy." *WRTL II*, 551 U.S. at 469-70. The means through which the test sweeps genuine issue advocacy into the

category of exempt function activity is its multi-factor format that includes, but is not limited to, eleven separate factors weighted as the trier of fact wishes them to be weighed. *See* Plaintiff's Memo in Support of Partial MSJ, at 9-17 (ECF No. 84, Page ID 1923-31).

Specific factors identified in the "facts and circumstances" tests are also of questionable validity. First, the Supreme Court has specifically held that the fact that a communication that coincides with an electoral campaign or is delivered close in time to the election is irrelevant to determining whether the communication is or is not genuine issue advocacy. *WRTL II*, 551 U.S. at 472. Second, the question of whether a communication is part of an ongoing series of substantially similar communications appears to favor established, single-issue interest groups, whereas the *exact same* communication made by either a new organization or a broad-based advocacy organization is more likely to be treated as "political campaign intervention." The Supreme Court recently warned that "the Government may commit a constitutional wrong when by law it identifies certain preferred speakers." *Citizens United*, 558 U.S. at 340. Third, Revenue Ruling 2004-6 asks whether a "communication is targeted at voters in a particular election." It is difficult to draw any conclusions about how this factor is relevant based on the IRS's treatment of it. In all six examples, the expenditures described are "targeted to voters"; however, in Scenarios 1, 2, and 5, the expenditure *is not* deemed to be for an exempt function, while in Scenarios 3, 4, and 6 the expenditure *is* deemed to be for an exempt function. These examples, even when taken together, fail to indicate how the "targeted to voters" factor matters one way or another in the analysis.

To the extent that the factors used by the IRS focus on contextual or external considerations, as opposed to objectively examining the communication within its own "four corners," those factors are constitutionally suspect. "[C]ontextual factors . . . should seldom

play a significant role in the inquiry. Courts need not ignore basic background information that may be necessary to put an ad in context . . . but the need to consider such background should not become an excuse for discovery or broader inquiry of the sort we have just noted raises First Amendment concerns." *WRTL II*, 551 U.S. at 473.

By using such illusory factors and applying them in such an amorphous way, the rule sweeps into "exempt function activity" speech that is clearly "genuine issue advocacy," thus causing the "facts and circumstances" test be unconstitutionally overbroad.

D. Penalties Need Not Be Criminal to Chill Speech

The Government asserts that the penalties, here, are not criminal. Gov't Response Br. at 2 (ECF No. 88, Page ID 2004). But penalties need not be criminal to chill speech. *281 Care Committee v. Arneson*, 638 F.3d 621, 630 (8th Cir. 2011) ("Although no complaints against the plaintiffs ever reached the criminal stage and no criminal prosecution was ever threatened, non-criminal consequences contemplated by a challenged statute can also contribute to the objective reasonableness of alleged chill.") (citing *Babbitt v. United Farm Workers Nat'l. Union,* 442 U.S. 289, 302 n.13 (1979)); *Vermont Right to Life Committee v. Sorrell,* 221 F.3d 376, 382 (2d. Cir. 2000) (noting that fear of civil penalties can be as inhibiting of speech as criminal prosecution). Regardless, criminal prosecutions for filing false or fraudulent tax returns are possible if the IRS were to determine that an organization intentionally misreported its political activity numbers on its tax return. 26 U.S.C. § 7206-7607.

CONCLUSION

For the foregoing reasons, the Court should grant Freedom Path's Motion for Partial Summary Judgment and declare the "facts and circumstances" test unconstitutional.

CERTIFICATE OF SERVICE

I hereby certify that on the 16th day of November 2016, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system which will send notification of such filing to the following counsel for the Government: Caroline D. Ciraolo, Joseph A. Sergi, Laura C. Beckerman, Laura M. Conner, Joseph R. Ganahl, Jeremy N. Hendon, and Gerald A. Role.

/s/ Chris K. Gober
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