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Taxing the Unheavenly Chorus: Why Section 501(c)(6) Trade Associations are Undeserving of Tax Exemption

TAXING THE UNHEAVENLY CHORUS: WHY SECTION
501(C)(6) TRADE ASSOCIATIONS ARE UNDESERVING OF
TAX EXEMPTION

PHILIP T. HACKNEY[†]

ABSTRACT

The United States has long nourished a vibrant and extensive non-profit sector. It accomplishes this in part by providing a subsidy through exemptions from tax at the federal, state, and local levels. The subsidy is provided to charitable organizations, social welfare organizations, labor unions, business leagues, and many other nonprofit organizations. I argue that we should end the subsidy for the nonprofit groups that represent business interests. Some argue that we should subsidize nonprofit groups that provide goods or services that would not otherwise be sufficiently supplied by the market (market failure theory). Additionally some argue that we subsidize to promote pluralism and a robust civic sector. Neither theory supports the provision of this subsidy to business interests. There is little evidence of market failure in this sector. Interest group literature has long shown business interests dominate the interest group sector. We can thus expect the subsidy to enhance that bias rather than reduce it. Furthermore, because of significant collective action problems suffered by large latent groups, the policy of subsidizing business interests likely enhances the voice of the politically strong business interests, and devalues the voice of the politically weak. We should end or at the least weaken policies subsidizing business interests.

[†] James E. & Betty M. Phillips Associate Professor of Law, Louisiana State University Law Center. I dedicate this Article to the good people that manage and have managed the exempt organizations sector at the IRS. I was proud to work with all of you and learned much from each of you. I also thank a number of people who have provided feedback on earlier iterations of this Article including Ellen Aprill, Amy Blackwell, Samuel Brunson, Frances R. Hill, Lloyd Hitoshi Mayer, David Miller, Shu Yi Oei, James Puckett, Sussanah Tahk, and Donald Tobin. I thank the members of the 2013 and 2014 Junior Tax Conference and the 2014 Tulane Tax Law Roundtable. Finally, a big thanks to the LSU Law Center for a grant making this work possible. I especially thank my research assistants Amelia Hurt, Joseph Ellison, Randall Thomas, and Jeff Butler for their dedicated work on this Article.

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INTRODUCTION

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

—Adam Smith¹

The flaw in the pluralist heaven is that the heavenly chorus sings with a strong upper-class accent.

—E.E. Schattschneider²

1. ADAM SMITH, THE WEALTH OF NATIONS 232 (Andrew Skinner ed., Penguin Classics 1999) (1776).

Many were recently surprised and outraged when they found out that the National Football League (NFL) is exempt from federal income tax.³ While the NFL has indicated it now plans to switch to taxable status,⁴ it has long avoided paying income tax because it is considered a tax-exempt business league just like a chamber of commerce or the American Bar Association (ABA).⁵ Barbers, or lawyers, or doctors, or football team owners, to name some, can join forces as tax-exempt business leagues, pool their money, invest their money, provide business services, share information, and generally promote and lobby legislators regarding their common business interest, all without owing any income tax.⁶ Many U.S. representatives and senators have recently called for the removal of this tax exemption for all sports leagues including the NFL.⁷ This Article agrees that ending the tax exemption of these sports-related business leagues is a good idea; however, denying exemption to sports business leagues does not go far enough. Business leagues as a category fail to satisfy any theory justifying income tax exemption. Furthermore, providing exemption to these organizations likely even causes some harm. This Article calls for Congress to end tax exemption for these organizations.

In the nonprofit world, business leagues are considered mutual-benefit organizations because they work primarily to benefit the members of the organization, such as the aforementioned barbers, lawyers and doctors. Tax exemption for mutual-benefit organizations such as busi-

2. E.E. SCHATTSCHEIDER, *THE SEMISOVEREIGN PEOPLE* 35 (1960).

3. 26 U.S.C. § 501(c)(6) (2012). Congress added “professional football leagues” to the statute in 1966. Act of Nov. 8, 1966, Pub. L. No. 89–800, § 6(a), 80 Stat. 1508, 1515 (codified as amended at 26 U.S.C. § 501(c)(6) (2012)).

4. See Richard Rubin, *NFL Will End Its Tax-Exempt Status, Goodell Tells Owners*, BLOOMBERG (Apr. 28, 2015 10:50 AM), <http://www.bloomberg.com/politics/articles/2015-04-28/nfl-will-end-its-tax-exempt-status-goodell-tells-team-owners>.

5. 26 U.S.C. § 501(c)(6) exempts from income tax “[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.” § 501(c)(6).

6. *Id.* § 501(a).

7. Senator Coburn has introduced the PRO Sports Act, S. 1524, that excludes all professional sports leagues from qualifying as tax-exempt organizations. PRO Sports Act, S. Res. 1524, 113th Cong. (2013). Representative Dave Camp’s Tax Reform Act of 2014 called for the removal of exemption for sports leagues in § 5301 of that proposal. DAVE CAMP, TAX REFORM ACT OF 2014 DISCUSSION DRAFT § 5301, at 162 (2014), *available at* http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf. Senators Maria Cantwell and Harry Reid introduced a bill that would pull the exemption of the NFL to put pressure on the NFL for maintaining the mascot name of the Washington Redskins. S. 2884, 113th Cong. (2014); Press Release, U.S. Senator Maria Cantwell, Cantwell, Reid, Johnson Introduce Bill that Would Revoke NFL’s Tax-Exempt Status (Sept. 18, 2014), <http://www.cantwell.senate.gov/public/index.cfm/press-releases?ID=0b70fa20-f382-484f-a343-333e39b0ae57>. Senator Cory Booker has also introduced legislation calling for the end of the NFL’s exemption. Securing Assistance for Victims’ Empowerment (SAVE) Act, S. 2816, 113th Cong. (2014). His proposal would send the tax paid to support domestic violence victims. Bernie Becker, *Senators Throw Hail Mary at NFL*, THE HILL (Sept. 21, 2014, 6:00 AM), <http://thehill.com/policy/finance/218398-senators-throw-hail-mary-at-nfl>.

ness leagues is generally accepted to be the provision of a subsidy.⁸ The subsidy for business leagues occurs because three forms of income are not taxed: (1) investment income; (2) commercial income from the sale of goods and services to members and nonmembers; and (3) member income from member dues. Because much of the activities conducted by business leagues would be deductible at some point, the subsidy is mostly a matter of tax deferral rather than full exemption.⁹ The subsidy likely amounts to a relatively small amount compared to the tax system on the whole. Nevertheless, it does establish an opportunity for a significant sector of the business community to save in a tax-free manner to enhance the opportunities of a business league's members. Furthermore, federal tax-exempt status is so often used as a signal for worthiness of other important subsidies and benefits such as state and local property tax exemption that getting tax exemption right at the federal level has many important spillover effects.¹⁰

Some argue we should subsidize nonprofits that provide goods or services that would not otherwise be sufficiently supplied (market failure theory).¹¹ Additionally some argue that we should subsidize nonprofits to promote pluralism and a robust civic sector (pluralism theory).¹² This Article argues that neither theory applies to support exemption for business leagues. It demonstrates that the goods and services supplied by business leagues are generally not undersupplied. This undermines support for the market failure theory. Additionally, business interests suffer relatively little collective action problems as compared to large, latent interests, such as the poor. This undermines the support for the pluralism theory. Interests that can never organize will never be able to access the subsidy of tax exemption. Business interests, on the other hand, as will

8. See Philip T. Hackney, *What We Talk About When We Talk About Tax Exemption*, 33 VA. TAX REV. 115, 151-52 (2013).

9. See Daniel Halperin, *Income Taxation of Mutual Nonprofits*, 59 TAX L. REV. 133, 155-56 (2006).

10. BAZIL FACCHINA, EVAN SHOWELL & JAN E. STONE, TOPICS IN PHILANTHROPY: PRIVILEGES & EXEMPTIONS ENJOYED BY NONPROFIT ORGANIZATIONS: A CATALOG AND SOME THOUGHTS ON NONPROFIT POLICYMAKING 44-46 (1993) (cataloging some of the different rights nonprofit organizations are entitled to beyond federal income tax exemption such as exemption from state sales and property taxes). The state of Louisiana for instance provides exemption from ad valorem taxation to business leagues under article 7, section 21 of its state Constitution. LA. CONST. art. VII, § 21(B)(3). It provides the exemption to "a nonprofit corporation devoted to promoting trade, travel, and commerce, and also property of a trade, business, industry or professional society or association, if that property is owned by a nonprofit corporation or association organized under the laws of this state for such purposes." *Id.*

11. Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 67-68 (1981); see Burton A. Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy*, in THE ECONOMICS OF NONPROFIT INSTITUTIONS 21, 22-24 (Susan Rose-Ackerman ed., 1986).

12. See, e.g., *Bob Jones Univ. v. United States*, 461 U.S. 574, 609-10 (1983) (Powell, J., concurring) (describing the "role played by tax exemptions in encouraging diverse, indeed often sharply conflicting, activities and viewpoints"); see also LESTER M. SALAMON, AMERICA'S NONPROFIT SECTOR: A PRIMER 14 (2d ed. 1999); John W. Gardner, *The Independent Sector*, in AMERICA'S VOLUNTARY SPIRIT, at ix, xiii-xv (Brian O'Connell ed., 1983).

be demonstrated in the Article, seem to have relatively easy access to this subsidy. Thus, instead of promoting pluralism by promoting all diverse interests that wish to organize and lobby government, the subsidy for business interests enhances the voice of the politically strong and devalues the voice of the politically weak. Thus, the subsidy worsens pluralist interests rather than enhancing them.

Although not particularly numerous (approximately 67,000 registered as tax-exempt in 2013),¹³ nor awash in national assets or revenue (\$71 billion in total assets and \$41 billion in total revenue in the sector in 2013),¹⁴ these organizations are often considered some of the most politically influential organizations in the country.¹⁵ Post *Citizens United*,¹⁶ many who closely observe our political system have called for new regulation of business leagues and social welfare organizations through the Code focusing primarily on disclosure rules related to political campaign activity.¹⁷ This Article adds to the tax legal literature on tax-exempt organizations by viewing them through the lens of interest-group literature.

13. Internal Revenue Service, *Data Book, 2013*, IRS PUBLICATION 55B, 56 tbl.25 (2013), available at <http://www.irs.gov/pub/irs-soi/13databk.pdf>.

14. *Number of Non-501(c)(3) Exempt Organizations in the United States, 2013*, NAT'L CTR. FOR CHARITABLE STATISTICS, <http://nccsweb.urban.org/PubApps/profileDrillDown.php?state=US&rpt=CO> (last visited June 23, 2015) (information derived from the IRS Business Master File 10/2013).

15. Business leagues, such as the National Federation of Independent Business, the U.S. Chamber of Commerce, and the American Association for Justice, regularly made up the majority of the organizations listed in *Fortune* magazine's Power 25, a list of the most influential lobbying organizations on the federal level based on a polling of insiders. FRANK R. BAUMGARTNER ET AL., *LOBBYING AND POLICY CHANGE 224* (2009). *Fortune* maintained the list from 1997 to 2001. Although the list is not based on any scientific principles in assessing actual influence, it does correlate with amount of resources placed towards influencing national policy. *Id.* at 223–24. In the first quarter of 2013, *Roll Call* published a list of the twenty-five largest lobbying spending firms—eight of the twenty-five were comprised of business leagues, with the top three being business leagues. Kent Cooper, *Top 25 Organizations Lobbying in First Quarter*, ROLL CALL (Apr. 23, 2013, 7:40 AM), <http://blogs.rollcall.com/moneyline/top-25-organizations-lobbying-in-first-quarter/>. Of the list of the biggest lobbying spenders of 2013, *OpenSecrets.org* indicates that five business leagues were included in the top ten. *Organization Profiles*, OPENSECRETS.ORG, <http://www.opensecrets.org/orgs/> (last visited June 23, 2015) (crediting the Center for Responsive Politics). The other five are business corporations. *Id.*

16. *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

17. The DISCLOSE Act of 2012 sponsored by Senator Sheldon Whitehouse would have amended the Federal Election Campaign Act of 1971 to provide for additional disclosure from corporations, labor unions, and other organizations when they make “independent expenditure[s]” effectively advocating for a candidate. Democracy is Strengthened by Casting Light on Spending in Elections Act of 2012, S. 3369, 112th (2d Sess. 2012); see also Donald B. Tobin, *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, 10 ELECTION L.J. 427, 440 (2011) (calling for disclosure of contributions to certain tax-exempt organizations for political action on a rapid basis); Ciara Torres-Spelliscy, *Hiding Behind the Tax Code, the Dark Election of 2010 and Why Tax-Exempt Entities Should be Subject to Robust Federal Campaign Finance Disclosure Laws*, 16 NEXUS 59, 92–93 (2010–2011) (calling for requiring tax-exempt organizations to disclose substantial donors when such organizations advertise for political causes); Greg Colvin, *A Silver Bullet that Would End Secret Tax-Exempt Money in Elections*, CAMPAIGN FOR AMERICA'S FUTURE (Apr. 11, 2012), http://blog.ourfuture.org/20120411/A_Silver_Bullet_That_Would_End_Secret_Tax-Exempt_Money_in_Elections (proposing a cap on political intervention spending by any organization organized under § 501(c) of the lesser of \$100,000 or 10% of expenditures).

The primary contribution of this Article is to highlight the dominant purpose of these organizations, describe their activities, and demonstrate why they do not fit well into the tax exemption rubric.

There are many interest groups in addition to business leagues including for-profit corporations and other tax-exempt organizations, such as labor unions¹⁸ and social welfare organizations.¹⁹ This Article focuses on business leagues in an attempt to get a greater understanding of the interest group role played by one small facet of the exempt organization sector. There is a dearth of scholarly legal literature on social welfare organizations, labor unions, and business leagues as part of the nonprofit sector or part of the tax-exempt sector. Given the challenges the IRS has lately faced in regulating this sector,²⁰ it seems an opportune time to begin a careful examination of the roles of these important organizations to our society.

Legal scholars who examine the role of interest groups often examine ways to justify the regulation of lobbying²¹ or the limits on campaign finance spending.²² They view these intrusions of money into the political process as harmful to the country because of either corruption or harm to national economic interests because such activities engage in harmful rent-seeking.²³ They see the logic of imposing such regulation to be common sense. They view the First Amendment as the primary reason we might be circumspect in imposing regulation on the political activities of these groups.²⁴ However, instead of focusing on the regulation of lobbying or political campaign activity, this Article focuses on whether we should subsidize organizations whose primary purpose is to lobby and engage in some political campaign activity.

Many scholars of the tax-exempt sector espouse the political science theory of pluralism as a reason to strongly support exemption for a broad range of nonprofit organizations.²⁵ However, political scientists and

18. 26 U.S.C. § 501(c)(5) (2012).

19. *Id.* § 501(c)(4).

20. *See, e.g.*, TREASURY INSPECTOR GEN. FOR TAX ADMIN., INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW, NO. 2013-10-053, at 3–5 (2013), available at <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf> (describing how tax-exempt status is reviewed and determining that the IRS inappropriately reviewed some tax-exempt applications).

21. *See, e.g.*, Richard L. Hasen, *Lobbying, Rent-Seeking, and the Constitution*, 64 STAN. L. REV. 191, 191–92 (2012) (examining current lobbying regulations and proposing and justifying a new national economic welfare rational for lobbying regulation).

22. *See, e.g.*, Richard Briffault, *The Uncertain Future of the Corporate Contribution Ban*, VAL. U. L. REV. (forthcoming 2015), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2475908 (exploring the constitutional status of the corporate campaign contribution ban and effects of recent Supreme Court cases).

23. *See, e.g.*, Briffault, *supra* note 22; Hasen, *supra* note 21, at 226–35.

24. Hasen, *supra* note 21, at 234–40.

25. *See, e.g.*, Bob Jones Univ. v. United States, 461 U.S. 574, 609–10 (1983) (Powell, J., concurring) (describing the “role played by tax exemptions in encouraging diverse, indeed often

economists long ago found that pluralism as a description of the political universe misses significant factors in interest group formation. Mancur Olson demonstrated that there are some groups and interests, such as the poor, that are so large and latent that it is very difficult if not impossible for them to organize even with a subsidy.²⁶ A close study of business leagues shows that they form with relative ease and appear to dominate the interest group sector. Large, latent interests like the poor are rarely able to organize. The subsidy is easily accessed by most business interests but rarely accessed by less powerful organized interests. Thus, instead of tax exemption operating as a neutral, democracy-enhancing law, it likely does just the opposite by protecting and enhancing the status quo of powerful interests.

A possible implication of this finding is that tax exemption may generally harm democracy rather than improve it. If true, we should rethink the exemption of exempt organizations that represent the political voice of various interests, such as social-welfare organizations, labor unions, and business leagues. I do not take a position on this issue in this Article. I plan to look in greater depth at the activities of these organizations in future articles. It might be that there are some interests that are substantially underrepresented in our democracy, such that exemption may be the right policy option. In this Article I simply maintain that the exemption for business leagues is not needed as a market response. Additionally, the subsidy causes harm to our democracy by enhancing the voice of an already powerful group.

Arguably, if we eliminated tax exemption for business leagues many of them might be able to reorganize as social welfare organizations and maintain exempt status. This seems highly likely, and for that reason if there were an elimination of exemption for business leagues there would need to be a similar closing of access to tax exemption under other sections of the Code such as § 501(c)(4). Peak organizations such as the U.S. Chamber of Commerce may still qualify. As will be discussed in the Article in Part III.A, in many cases peak organizations actually do suffer collective-action problems. So perhaps a move from one tax-exempt section to another makes sense. I argue, however, that the business-league sector as a whole should be eliminated because, as will be seen below, business interests are already well represented in our democracy and providing these organizations extra money for greater voice is a bad idea.

Finally, business leagues are powerful. Removing exemption may be politically impossible. As a second-best move, I recommend applying a net-investment income tax on business leagues as is already applied on

sharply conflicting, activities and viewpoints"); see also SALAMON, *supra* note 12, at 14; Gardner, *supra* note 12, at xiii–xv.

26. MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* 57–59 (2d prtg. 1971).

tax-exempt social clubs.²⁷ The Clinton administration unsuccessfully attempted to do just this in 1999.²⁸ While this would not entirely limit the subsidy to business leagues, it would modestly improve the status quo.²⁹ As an important side benefit, eliminating exemption for business leagues would reduce the need for the IRS to make a determination as to whether a business league had engaged in too much political campaign intervention, a notoriously challenging problem for the IRS.³⁰

Part I of this Article considers the scholarly literature regarding collective action as it relates to the formation of interest groups. Part II describes the requirements of qualifying as a tax-exempt business league and the rationales justifying these organizations' exemption. It then evaluates the implications of collective action theory for the exemption rationales. It additionally reviews taxing regimes that might apply to business leagues instead of a policy of tax exemption to provide a suitable comparison. Part III provides a more detailed look at the activities of business leagues by providing case studies regarding the three general types of business leagues: peak organizations, trade associations, and professional associations. Someone unfamiliar with business leagues might choose to start first with Part III. The concrete examples of the formation, maintenance, and activities of these organizations can help in understanding the first two Parts of this Article. Part IV concludes that ending exemption for business leagues is the right policy choice.

I. INTEREST GROUP MOBILIZATION AND THE COLLECTIVE-ACTION PROBLEM

Ever since James Madison's Federalist No. 10, we have been concerned in the United States about the ability of groups to unfairly influence our democracy. Madison referred to this problem as rule by faction. By faction he meant a situation where either a minority or a majority of citizens "are united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the community."³¹ However, Madison recognized

27. 26 U.S.C. § 512(a)(3) (2012). I made this argument regarding applying the net investment income tax to the whole of the mutual-benefit organizations of the tax-exempt sector. See Hackney, *supra* note 8, at 120–24.

28. See J. COMM. ON TAXATION, 106TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2000 BUDGET PROPOSAL 278–82 (Comm. Print 1999), available at <https://www.jct.gov/publications.html?func=startdown&id=2888>; see also Jacob M. Schlesinger, *Clinton Plan to Tax Lobbyists' Investment Gains Hits Home in a Fury of Faxes, Letters, Web Sites*, WALL ST. J., Feb. 17, 1999, at A24 (describing the lobbyist efforts opposing the proposed tax increase).

29. See Halperin, *supra* note 9, at 135–37 (discussing the deferral effect granted if only a net investment tax is applied to such organizations).

30. Cf. Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They the Next "Loop-hole"?*, 6 FIRST AMEND. L. REV. 41, 54–56 (2007) (considering whether the 26 U.S.C. § 527 rules are mandatory for organizations that carry on as a political party but choose to operate as a taxable entity).

31. THE FEDERALIST NO. 10, at 48 (James Madison) (J.R. Pole ed., Hackett Publ'g Co. 2005).

the absolute need for citizens to express their voice. Thus, instead of recommending the elimination of factions, Madison recommended a republican form of government along with the separation of powers.³² These institutions he believed would limit the ability of any one particular group to establish tyranny.³³ To Madison, tyranny meant total control over the government and the people by one group.³⁴ Today, scholars continue to examine the problem of faction through the study of interest groups.

All business leagues are interest groups. An interest group is “a collection of individuals or a group of individuals linked together by professional circumstance, or by common political, economic, or social interests” that satisfies three requirements: (1) the organization is not a political party, i.e., the name of the organization does not appear on a ballot; (2) it uses some of its resources to try to influence legislative, judicial, or executive decisions at any level of government; and (3) it is organized outside of the government it intends to influence.³⁵ Business leagues are not political parties, they use significant resources to influence governmental decisions at all levels, and they are organized outside of government. Finally, although business leagues perform functions in addition to acting as a governmental mouthpiece, “[i]nterest groups’ service organizations quite ironically are by-products of their lobbying organizations, not the other way around.”³⁶

Thus, studies regarding the interest group sector are relevant to a study of business leagues. However, interest group literature is vast and conflicting. For instance, research considering the effectiveness of interest groups in lobbying and electoral efforts is still relatively undeveloped.³⁷ A researcher studying interest groups faces substantial problems of proof given the vast complexity of the sector and its interaction with the government.³⁸ The researcher must often be able to measure actions that are dynamic rather than static.³⁹ Nevertheless, there is an area of interest group research that has achieved great success: questions of col-

32. *See id.* at 51–53.

33. *See id.* at 51.

34. THE FEDERALIST NO. 47, at 261 (James Madison) (J.R. Pole ed., Hackett Publ’g Co. 2005) (“The accumulation of all powers legislative, executive and judiciary in the same hands . . . may justly be pronounced the very definition of tyranny.”).

35. JOHN R. WRIGHT, INTEREST GROUPS AND CONGRESS: LOBBYING, CONTRIBUTIONS, AND INFLUENCE 22–23 (1996) (internal quotation mark omitted).

36. John Mark Hansen, *The Political Economy of Group Membership*, 79 AM. POL. SCI. REV. 79, 94 (1985).

37. For a review of the state of the literature from a number of years ago, see FRANK R. BAUMGARTNER & BETH L. LEECH, BASIC INTERESTS: THE IMPORTANCE OF GROUPS IN POLITICS AND IN POLITICAL SCIENCE 13–17, 128–29 (1998).

38. *See id.* at 18.

39. *See* BAUMGARTNER ET AL., *supra* note 15, at 169–70. The authors conducted a longitudinal study providing new knowledge on the effectiveness of lobbying over a period of time and across a wide range of organizations and interests. *Id.* at 1–2.

lective action.⁴⁰ This happens to be fortunate for this inquiry because the question of collective action is the question of how well certain interest group services fare in the marketplace. When are people and organizations able to organize in order to provide the interest group services they desire?

Part I demonstrates that of all the interest group sectors, business interests face the least collective-action problem. In other words, business interests as compared to labor, environmentalists, the poor, etc., face the smallest amount of market failure in organizing to represent their interests before government. Instead of the business league subsidy working to ensure our society has the right level of needed goods and services, it may lead to an oversupply of business-league services. In turn, this could lead to a democracy that is over reflective of business interests.

A. Pluralism Problems

When the study of interest groups and their impact on politics began in earnest in the early to mid part of the twentieth century, there was a belief that individuals who had an interest could and would express that interest through a group if they had the desire.⁴¹ In the 1940s and 1950s pluralism reigned as the prevailing theory of group politics.⁴² Pluralism holds that groups express the interests of the people to their government.⁴³ Furthermore, interest groups provide the ideal vehicle to ensure that our democracy most closely represents the interests of its people.⁴⁴ To some theorists, “[t]here is no group without its interest. An interest . . . is the equivalent of a group.”⁴⁵ In this purist conception of pluralism, no obstacles stand in the way of individuals who want to form an interest group.⁴⁶ Based on these principles, the pluralist asserted that in order to know what a government is going to do, all you need do is study interest group interaction and negotiation with each other and the government.⁴⁷

There are two main strains of pluralism. In one version, the government acts as referee ensuring that a reasonable bargain is negotiated among the interest groups of society.⁴⁸ This is pluralism in a descriptive

40. See BAUMGARTNER & LEECH, *supra* note 37, at 8.

41. See, e.g., KAY LEHMAN SCHLOZMAN & JOHN T. TIERNEY, ORGANIZED INTERESTS AND AMERICAN DEMOCRACY, at ix-x (1986).

42. SCOTT H. AINSWORTH, ANALYZING INTEREST GROUPS 5 (2002).

43. *Id.*; BAUMGARTNER & LEECH, *supra* note 37, at 48.

44. *Id.*

45. ARTHUR F. BENTLEY, THE PROCESS OF GOVERNMENT: A STUDY OF SOCIAL PRESSURES 211 (The Principia Press of Ill., Inc. 1949) (1908); see also Charles B. Hagan, *The Group in a Political Science*, in APPROACHES TO THE STUDY OF POLITICS 38, 40 (Roland Young ed., 1958) (discussing the “group concept”).

46. See, e.g., Kay Lehman Schlozman, *What Accent the Heavenly Chorus? Political Equality and the American Pressure System*, 46 J. POL. 1006, 1007 & n.1 (1984) (discussing the pluralist history).

47. AINSWORTH, *supra* note 42, at 5.

48. DAVID B. TRUMAN, THE GOVERNMENTAL PROCESS: POLITICAL INTERESTS AND PUBLIC OPINION 104-06 (1951).

sense. Another version of pluralism, however, argues for the values of pluralism in a prescriptive sense.⁴⁹ The prescriptive pluralist believed we should encourage the formation of groups to enhance our representational democracies' closer reflection of the interest of its people.⁵⁰ Some tax-exempt scholars argue in favor of tax exemption from this prescriptive approach. For example, some argue that providing exemption to nonprofit organizations is a part of the solution to ensuring a more representative democracy.⁵¹ By providing a subsidy for the formation of groups, we encourage everyone to form groups to represent their interests to the government and the government will thereby be more reflective of all the people's interests.

In what is known as the disturbance theory of interest group formation, David Truman, a pluralist, said that interest groups form in waves.⁵² For Truman, a political interest group is made up of individuals with shared interests and claims upon others that the group attempts to satisfy through the governmental process.⁵³ When individuals determine they have a need that can only be delivered by government, i.e., a need where "rights are not well established and negotiation costs are high,"⁵⁴ those individuals will organize a group to ask the government to fulfill that need. This simple act of organization disturbs the status quo.⁵⁵ That disturbance sends waves through the political system because another set of individuals will organize in reaction to offset the demands of the first group.⁵⁶ In Truman's theory, groups form in greatest numbers during times of change, such as technological, social, economic, or political.⁵⁷

E. E. Schattschneider criticized the pluralist claim famously stating that "[t]he flaw in the pluralist heaven is that the heavenly chorus sings with a strong upper-class accent."⁵⁸ Although there are plenty of interest groups that form, he said, the groups that form overwhelmingly represent the interests of the wealthy rather than the average citizen.⁵⁹ For Schattschneider, there are those groups that work for public interest and

49. AINSWORTH, *supra* note 42, at 6; JEFFREY M. BERRY & CLYDE WILCOX, *THE INTEREST GROUP SOCIETY* 11 (5th ed. 2009).

50. AINSWORTH, *supra* note 42, at 6; BERRY & WILCOX, *supra* note 49, at 11.

51. *See, e.g.*, *Bob Jones Univ. v. United States*, 461 U.S. 574, 609 (1983) (Powell, J., concurring) (describing the "role played by tax exemptions in encouraging diverse, indeed often sharply conflicting, activities and viewpoints"); *see also* SALAMON, *supra* note 12, at 15–17 (explaining that nonprofit organizations are essential to the sense of community which is required to uphold a democratic polity); Gardner, *supra* note 12, at xiii–xv (stating that nonprofit organizations foster creativity and nurture our "national life").

52. TRUMAN, *supra* note 48, at 59.

53. *Id.* at 33.

54. AINSWORTH, *supra* note 41, at 13.

55. TRUMAN, *supra* note 48, at 59–62.

56. *Id.*

57. *Id.* at 57; *see also* AINSWORTH, *supra* note 42, at 13.

58. SCHATTSCHNEIDER, *supra* note 2, at 35.

59. *Id.* at 31–34.

those that work for private, or special, interests.⁶⁰ The distinction between the two groups is the exclusive character of one over the other.⁶¹ Thus, a group that works for world peace or child welfare is not exclusive, but the National Association of Manufacturers is exclusive—only manufacturers can belong.⁶² These exclusive organizations are “special interests.”⁶³ Additionally, there are those that are organized and those that are not organized. Only the organized can impact the rights of the community and the political process.⁶⁴ To Schattschneider, to understand politics you should study small groups.⁶⁵ As Schattschneider said, “It has been assumed that only legal barriers inhibited the disfranchised. We know better now. The exclusion of people by extralegal processes, by social processes, by the way the political system is organized and structured may be far more effective than the law.”⁶⁶

In 1965, Mancur Olson offered a theoretical basis for why the interest-group system is biased in favor of the “upperclass” and business interests as Schattschneider contended.⁶⁷ This theory also supported the claim that not all groups with an interest can or will organize. He demonstrated through his economic model that small homogenous groups can form with relative ease while large latent groups form with great challenge, if at all.⁶⁸ The difference between a small homogenous group and a large latent group is at once self-explanatory, but also a matter of basic economic principles. Groups form to provide collective goods that cannot be provided through individual action.⁶⁹ However, interest groups face significant free-rider problems because of the collective nature of the goods interest groups necessarily primarily provide.⁷⁰ With the free-rider problem, public goods that cost less than the return one person will receive in return will be provided; public goods that cost more than the return to one person will be provided at inefficient levels, or will not be provided at all. And, this is the economic defining characteristic of a large latent group: “in a large group in which no single individual’s contribution makes a perceptible difference to the group as a whole . . . it is certain that a collective good will *not* be provided unless there is coercion or some outside inducements.”⁷¹

Olson evaluated whether his theory explained specific group contexts that he could observe. He noted that within the trade association

60. *Id.* at 22.

61. *Id.* at 23–24.

62. *Id.* at 25–26.

63. *Id.* at 29.

64. *Id.*

65. *Id.* at 35.

66. *Id.* at 111.

67. OLSON, *supra* note 26, at 142–45.

68. *Id.* at 48–58.

69. *Id.* at 15–16.

70. *Id.*

71. *Id.* at 44.

context, the collective-action problem will typically hinder the formation of all except small groups of narrow interests.⁷² Larger groups will be forced to either use outside inducements by selling what Olson referred to as “selective incentives,” such as insurance or information, or obtain coercion from a source like the state.⁷³ Olson defined selective incentives as private goods, such as insurance, or administrative operations, or discounts on other goods, and services that are sold by a group to induce members to join.⁷⁴ Groups provide selective incentives because the public good is by its own terms available whether the individual joins or not.

With respect to trade associations, Olson provided anecdotal evidence as to the size of the trade association pressure community.⁷⁵ A lobbying index from the late 1940s provided evidence that trade associations made up about two-thirds of the interest group community.⁷⁶ That type of representation dwarfed any other type of interest at that time.⁷⁷ Olson asserts that business dominance of the interest group sector “must be due in large part to the fact that the business community is divided into a series of (generally oligopolistic) ‘industries,’ each of which contains only a fairly small number of firms.”⁷⁸ Olson suggests that in most instances the trade associations involved in the pressure community have a relatively small number of members.⁷⁹ At the time of his writing, the median number of members of a trade association was somewhere between 24 and 50.⁸⁰ Today, membership of trade associations still tends to be small—the median number of memberships of American business associations in 2002–2003 was 353.⁸¹

In spite of the numerical superiority, there are latent interests in the business community that face collective action problems.⁸² For instance, the business community as an interest in its own right is represented by peak organizations like the U.S. Chamber of Commerce. This broad business interest is not made up of small homogenous interests and thus faces problems with organizing consistent with other large latent inter-

72. Russell Hardin provides a useful definition here suggesting that the idea of a small group may include hundreds of organizations, each of whom would benefit, or lose, so significantly from a change that it is worthwhile for each one of the organizations to spend on the collective benefit. RUSSELL HARDIN, *COLLECTIVE ACTION* 12 (1982). Hardin suggests that the oil industry, for instance, has hundreds of organizations involved, but would still be a small group under this definition. *Id.*

73. OLSON, *supra* note 26, at 133–35.

74. *Id.*

75. *Id.* at 141.

76. *Id.* (citing to Lobby Index 1946–1949, H.R. REP. NO. 3197 (1950)).

77. *Id.*

78. *Id.* at 143 (emphasis omitted).

79. *Id.* at 144–45.

80. *Id.* at 144.

81. LYN SPILLMAN, *SOLIDARITY IN STRATEGY* 83 (2012). In 2002–2003, the median membership of American business associations was 353, and 45% of American business associations are made up of memberships between 100 and 1000. *Id.* Only 7% have more than 10,000 members. *Id.* at 84.

82. OLSON, *supra* note 26, at 143–45.

ests. Professional associations, too, represent a large group of people whose interests are not entirely homogenous; such groups face collective-action problems too. While professionals often manage to form into groups, the individuals with such professional interests need to find means other than the collective good, consisting of promoting and lobbying for the particular professional interest, to entice people to join the group. Thus, organizations like the medical societies and the American Medical Association (AMA), discussed in more detail in Part III below, and the bar associations and the American Bar Association (ABA), primarily overcome the collective-action problem by obtaining government-related coercion.⁸³ These associations establish licensing systems at the state level and require significant educational requirements to force membership via coercion.⁸⁴ Thus, professional associations manage to operate "closed shop[s]," so desired by labor unions.⁸⁵

Professional associations do not rely on coercive efforts alone to solve the collective action problem; they also use selective incentives that often have a strong compulsory nature.⁸⁶ For instance, legal malpractice insurance is often hard to find outside of the bar association. They sell publications too that strongly connect the professional community and provide opportunities to network.⁸⁷ Of course, as we will see in Part III below in the case of the AMA, and in part in the case of the Cotton Trade Institute, these associations may also control a code that industry players must purchase from the association in order to operate in the industry. These codes can provide the business group substantial monetary support, particularly where it has the imprimatur of the state.⁸⁸

B. Research on the Collective-Action Problem

Although many criticize Olson's theory, the central instinct that small, economic special-interest groups possess a significant advantage over other groups in organizing has not been contradicted by later research. The critiques of Olson's theory focus on the fact that under his theory there should be few to no broad-based public interest groups.⁸⁹ Thus, consumer and environmental groups should not form with any great regularity.⁹⁰ However, after Olson wrote, these two types of interests proliferated. Modelers of Olson's theory predict that less than 5% of a latent population should mobilize, but in many instances some strongly

83. *Id.* at 137.

84. *Id.* at 138.

85. *Id.*

86. OLSON, *supra* note 26, at 137-39.

87. *Id.* at 140.

88. JACK L. WALKER, JR., MOBILIZING INTEREST GROUPS IN AMERICA 76 (1991).

89. *See, e.g., id.* at 45-48 (discussing the irony of a focus on the problems of collective action at the time when there were so many social movements managing to overcome this very problem); Grant Jordan & William A. Maloney, *How Bumble-bees Fly: Accounting for Public Interest Participation*, 44 POL. STUD. 668, 668-70 (1996).

90. *See, e.g., WALKER, supra* note 90, at 45-48.

public-oriented interests have obtained population slices that are much greater than that.⁹¹ Some research thus takes a look at why and how these interests are able to overcome the collective-action problem.⁹² This research considers how selective incentives work in solving the collective-action problem and whether other incentives may play a role.⁹³

Nevertheless, the evidence discussed in the next three sections below shows business interests maintain an overwhelming advantage in interest group formation.⁹⁴ Not surprisingly, individuals and entities with the resources to organize—i.e., money, facilities, and skilled professional individuals—organize to represent their interests with greater ease than other individuals and entities. Finally, research demonstrates that interest groups (1) obtain a large share of their resources from a few large well-financed members, and (2) the organizations tend to follow the lead of those members.⁹⁵

1. Bias in the Interest Group System Leans Heavily Towards Business Interests

Empirical evidence confirms that there is a bias in the interest group system towards business interests.⁹⁶ In a simple review of interest groups that lobbied in Washington in 1981, Schlozman found that business leagues comprised 24.8% of the total interests.⁹⁷ Corporations themselves comprised 45.7% of that interest group community engaged in federal lobbying.⁹⁸ Foreign commerce and corporations made up another 6.5% of those represented.⁹⁹ All other identified groups amounted to only 13% of the total Washington D.C. interest group community.¹⁰⁰ This small portion was composed of labor unions, public interest groups, civil rights groups and minority organizations, social welfare and the poor, the elderly, gays, women, handicapped, and governmental units.¹⁰¹ Schlozman showed that compared to the interests of the U.S. population as a

91. Scott Sigmund Gartner & Gary M. Segura, *Appearances Can Be Deceptive: Self-Selection, Social Group Identification, and Political Mobilization*, 9 RATIONALITY & SOC'Y 131, 134 (1997).

92. See, e.g., WALKER, *supra* note 90, at 60–61; Robert H. Salisbury, *An Exchange Theory of Interest Groups*, 13 MIDWEST J. POL. SCI. 1, 21–22 (1969).

93. See *infra* Part I.D.

94. See, e.g., SCHATTSCHEIDER, *supra* note 2, at 31; SCHLOZMAN & TIERNEY, *supra* note 41, at 49–50; WALKER, *supra* note 90, at 58–59; Robert H. Salisbury, *Interest Representation: The Dominance of Institutions*, 78 AM. POL. SCI. REV. 64, 70 (1984).

95. See BAUMGARTNER & LEECH, *supra* note 37, at 74–75.

96. SCHATTSCHEIDER, *supra* note 2, at 31–33; SCHLOZMAN & TIERNEY, *supra* note 41, at 49–50; WALKER, *supra* note 90, at 61; Salisbury, *supra* note 94, at 70.

97. See Schlozman, *supra* note 46, at 1012 tbl.1.

98. *Id.*

99. *Id.*

100. See *id.*

101. *Id.*

whole, this interest group system is skewed away from the actual interests of all the people of the country.¹⁰²

Schlozman, Verba, and Brady updated this same work in a recent book *The Unheavenly Chorus*.¹⁰³ In their review the authors emphasize a point that cannot be understated: business has a significant organizational advantage in that it already has the skills, power, and resources to organize.¹⁰⁴ We should thus not find it surprising that business interests would be so adept at organizing. In a strict counting of groups within the entire interest group system in 2001, the authors find that business interests continue to dominate.¹⁰⁵ Business leagues, including trade associations and professional associations, altogether make up a full 20% of represented interests.¹⁰⁶ Individual corporations still are the predominant lobbyist group at approximately 35%.¹⁰⁷ The next closest in representation are state and local governments with 10.4%.¹⁰⁸ Labor unions are only 1% of the interest group population, education 4.2%, health 3.5%, and social welfare and poor make up 0.8%.¹⁰⁹ Public interest consists of 4.6% while identity groups 3.8%.¹¹⁰

How do these numbers compare to the 1981 numbers?¹¹¹ Intriguingly, while the nominal business interests have grown they have not kept pace with the growth of some other sectors. The sectors that have grown significantly are health (883%), education (612%) and state and local governments (382%).¹¹² Realistically though this growth is likely directly related to business interests associated with healthcare and education, as health and education have both boomed as industries in this period. While this reflects real growth, part of the sizable growth is because there were almost no groups lobbying in these fields in 1981. For instance, there were eleven public educational institutions and nineteen private educational institutions lobbying in 1981.¹¹³ Thus, while business interests may have grown, their relative growth turns out to make them a smaller set of the interest community. Corporations decreased relatively almost a full 10%, while trade associations decreased by almost 5%.¹¹⁴ This does not mean that business interests as a total amount are less than in 1981. Business interests did increase, but business interest growth did

102. *Id.* at 1011–13.

103. KAY LEHMAN SCHLOZMAN, SIDNEY VERBA & HENRY E. BRADY, *THE UNHEAVENLY CHORUS* 312 (2012).

104. *Id.* at 316.

105. *Id.* at 321 tbl.11.3.

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* at 352–53.

112. *Id.* at 353 tbl.12.1.

113. *Id.* at 359.

114. *Id.* at 356 tbl.12.2.

not keep pace with some other significant interests. However, as noted, it could be that some of that significant growth in the health and education sector should be associated with the business interests that we are considering here.

Schlozman et. al. primarily approach the question of interest group representation from the question of political voice inequality. They find that “[c]onsistent with Schattschneider’s analysis . . . the economically disadvantaged are underrepresented in pressure politics.”¹¹⁵ Notably in the case of unions, the authors observe that because labor unions are so small comparatively, they are forced to spread their limited capacity across a wide spectrum of issues.¹¹⁶ Not inconsistent with the point above that business interests have the skills, power and resources to organize, as demonstrated by the numbers reported above, professional associations alone outnumber unions by a far shot.¹¹⁷

Lowery and Gray criticize these interest group studies that rely on a simple count of the number of interest groups that lobby because the studies, they say, fail to use a baseline upon which to judge bias in the interest system.¹¹⁸ They claim that the authors have no method of judging what an interest group ecosystem should be expected to look like.¹¹⁹ Despite the critique, Lowery and Gray in a recent book with co-author Benz consider the question of the count of organizations at the state level and find that the representation bias at the state level is even more severe.¹²⁰ For instance, business interests made up 73.8% of the lobbying community in 1997 as compared to 62% at the federal level one year prior in 1996.¹²¹ In other work, Gray and Lowery along with other authors provide strong support for the Olson claim that the smaller the set of persons to organize within an interest the greater likelihood that group will organize.¹²² They show there is a direct correlation between a larger number of business firms in a state and a lower number of such firms independently lobbying.¹²³ Despite the baseline critique, Lowery and Gray recognize that none of their objections disproves the high degree of like-

115. *Id.* at 321.

116. *Id.* at 326.

117. *Id.* at 327 tbl.11.4.

118. David Lowery & Virginia Gray, *Bias in the Heavenly Chorus: Interests in Society and Before Government*, 16 J. THEORETICAL POL. 5, 9 (2004).

119. *Id.* at 6.

120. VIRGINIA GRAY, DAVID LOWERY & JENNIFER K. BENZ, *INTEREST GROUPS AND HEALTH CARE REFORM ACROSS THE UNITED STATES* 23–25 (2013).

121. *Id.* at 23.

122. David Lowery et al., *Collective Action and the Mobilization of Institutions*, 66 J. POL. 684, 685 (2004).

123. *Id.* at 686; see also Sally Conway Kilbane & John H. Beck, *Professional Associations and the Free Rider Problem: The Case of Optometry*, 65 PUB. CHOICE 181, 185 (1990) (finding similar results regarding the organizing efforts of optometrists being more challenged in larger states with a larger population).

lihood that business interests are relatively over represented in our political system.¹²⁴

Gray and Lowery have also added to interest group organizational knowledge by providing evidence that only a finite number of groups can exist in an interest group system.¹²⁵ Their model demonstrates that the number of interest groups in any interest group system is not infinite, as the pluralists seemed to suggest, and as tax-exemption literature often seems to accept.¹²⁶ Under their approach, a certain population density supports a limited number of groups as a result of population resources and ability of the government to interact with a certain number of groups.¹²⁷ Once that saturation level is reached, it is much harder for more interests to form. Tax exemption of business leagues may very well help to crowd out other interests that never organize because they are crowded out. This is consistent with the findings that the status quo is incredibly powerful in the interest group system.¹²⁸

2. Use of Selective and Purposive Incentives to Organize

After Olson's seminal collective action work, many interest group scholars focused on how latent organizations, such as environmental interests, form despite the significant collective action challenge such groups should face. The research has focused on the sale of selective incentives and purposive incentives. This area of research still needs significant work, but the quest to determine the level of difficulty some groups may experience in organizing has had some success.

Olson did not initially consider the possibility of selling membership to interest groups through purposive incentives; purposive incentives refer to the sale of the promotion of ideas that people strongly support from a moral or emotional basis.¹²⁹ Olson had argued that the primary way of solving the collective-action problem would be to sell selective incentives such as insurance and magazines.¹³⁰ However, contrary to Olson's suggestion, research demonstrates that many organizations are able to sell membership on a cause-related basis. For instance, people will pay for membership in the Sierra Club to be associated with the cause of environmentalism. Cause-related incentives are typically referred to in the literature as "purposive incentives."¹³¹ Still, citizen

124. Lowery & Gray, *supra* note 120, at 23.

125. David Lowery & Virginia Gray, *The Population Ecology of Gucci Gulch, or the Natural Regulation of Interest Group Numbers in the American States*, 39 AM. J. POL. SCI. 1, 25 (1995).

126. *Id.*

127. *Id.*

128. BAUMGARTNER ET AL., *supra* note 15, at 233, 244.

129. Salisbury, *supra* note 96, at 16.

130. HARDIN, *supra* note 72, at 31.

131. *See, e.g.*, Salisbury, *supra* note 96, at 15-16.

groups and other interests also sell selective incentives to overcome the collective-action problem identified by Olson.¹³²

Robert Salisbury introduced a model to explain group formation that he called the exchange theory of formation.¹³³ His model provides support for a conclusion that business groups should be in a much better position to form than cause-related groups. Consistent with Olson's assumption that people join groups for selfish reasons, he viewed group formation as taking place within the context of a marketplace.¹³⁴ Under the exchange theory, entrepreneurs form groups to sell material, solidary, or expressive benefits to members for a price.¹³⁵ In other words, rather than these nonprofits being "voluntary" associations, they sell goods and services in the market just like for-profit firms. An entrepreneur will not form a group nor maintain it unless he is able to make the profit that he desires.

Salisbury focuses two major factors of interest group formation: (1) groups tend to form when the economy is on the upswing, and (2) groups most commonly rely upon material benefits to form.¹³⁶ Because material benefits are likely less elastic than purposive benefits we should expect that groups that rely on purposive benefits, such as the American Civil Liberties Union, will experience greater difficulty forming and maintaining status than those that rely on material benefits.¹³⁷ In other words, in the case of purposive-based groups, member contributions will be a function of member income; if member income goes down, membership for an organization that sells purposive incentives should fall at a greater rate than for an organization that offers material incentives.¹³⁸

James Q. Wilson studied the ways certain groups overcome the collective-action problem by offering purposive incentives.¹³⁹ Contrary to the claim that individuals are purely rational economic actors, Wilson found that some people have a stronger sense of duty than others and join groups to support a particular cause.¹⁴⁰ Typically joining these groups is low cost and low involvement,¹⁴¹ and these cause-related groups have developed effective means of persuading individuals to join; they emphasize the threat of loss rather than gain because psychologically, the

132. Peter B. Clark & James Q. Wilson, *Incentive Systems: A Theory of Organizations*, 6 ADMIN. SCI. Q. 129, 130-31 (1961); Hansen, *supra* note 36, at 79-82; Lowery & Gray, *supra* note 120, at 15.

133. Salisbury, *supra* note 96, at 2.

134. *Id.* at 17.

135. *Id.* at 17-19.

136. *Id.* at 8, 17-18.

137. *Id.* at 19-20.

138. *Id.*

139. JAMES Q. WILSON, *POLITICAL ORGANIZATIONS*, at viii-xii (Princeton Univ. Press 1995) (1974).

140. *Id.* at viii-ix. *But cf.* WALKER, *supra* note 90, at 47 (criticizing arguments about the rationality of purposive benefits).

141. *See* WILSON, *supra* note 141, at ix.

threat of loss appears to remain a stronger force in our minds.¹⁴² Finally, cause-related groups often rely on a wealthy sponsor; their contributions make the cost of membership much lower.¹⁴³ This last detail is discussed in more detail in Section 3 below.

Terry M. Moe demonstrates that there are individuals who systematically overestimate their importance to the accomplishment of a cause. These individuals join to support an effort that they cannot really aid to the extent they believe.¹⁴⁴ In other words, members join out of self-interest, but they make a mistake in believing that their contributions "make a difference."¹⁴⁵ Moe concludes from this that the collective-action problem is solved more often than Olson's theory would have predicted because individuals make mistakes about the return they will receive from the investment of time or money they make in a large organization.¹⁴⁶ However, it does not mean that such groups form with greater ease than those with the proper resources and material incentives to sell.

John Hansen's work provides further support for the claim that while larger, latent interests can form by selling purposive incentives, once formed, these groups often need to sell selective incentives in order to maintain status. Furthermore, business groups are in a far better position to generate incentives to sell. Hansen found that a group forms first in response to a threat as suggested by the pluralist disturbance theories.¹⁴⁷ The newly formed group generates political benefits by responding to the threat in a political sense. However, in order to maintain or increase its membership, the group often must sell selective incentives such as insurance.¹⁴⁸ This work supports the claim that small groups have little trouble forming without selective incentives. For instance, industry groups dominated in the early twentieth century because of their small size and easy access to resources to organize.¹⁴⁹

The importance of all this work is that cause-related groups can form, but they face much greater challenge than do business groups. Even though cause-related groups might be able to find selective incentives to sell, the business community naturally tends to possess the right material incentives to sell, and the right human and capital resources to organize.

142. *Id.* at x.

143. *Id.* at xii.

144. TERRY M. MOE, *THE ORGANIZATION OF INTERESTS: INCENTIVES AND THE INTERNAL DYNAMICS OF POLITICAL INTEREST GROUPS* 205-07 (1980).

145. *Id.* at 205-06.

146. *Id.* at 222.

147. Hansen, *supra* note 36, at 81.

148. *Id.* at 93-94.

149. *Id.* at 94.

Business groups, though, appear to have an additional advantage. They tend to be able to coopt the government to support their efforts.¹⁵⁰ During war time, Hansen points out, industry groups are boosted dramatically by government efforts to co-opt producers into the war efforts. These periods tend to be highly profitable, and long lasting for building and maintaining organizational structure, for industry groups.¹⁵¹

The work on incentives demonstrates that some latent interests can overcome the collective-action problem. However, none of this work suggests that latent interests are able to overcome the natural ability of business interests to organize. Furthermore, as will be discussed in more detail in the next section, even where the collective-action problem is solved, evidence shows that group managers often do not reflect the majority interest of the members. Different interest distortions occur in different types of groups. The general finding is that wealthy donors often set the agenda of an interest group. This finding holds even in the case of business interests. This next section looks at this important matter.

3. Wealthy Interests Tend to Aid in the Formation of Many Groups

Many interest groups solve the collective-action problem through the contributions of wealthy individuals or entities. These high-wealth individuals or entities provide significantly larger sums than the average member.¹⁵² Although this solution to the collective-action problem is more prevalent among citizen groups, business interests often solve the collective-action problem through wealthy interests as well.¹⁵³ These wealthy contributors tend to substantially influence the direction of the group. Fundraisers often live by a rule that 80% to 90% of support of an organization will come from 10% to 20% of the contributors.¹⁵⁴ This appears true for business leagues as well. These organizations tend to rely on a few loyalists for their support.¹⁵⁵ In the trade association context, for instance, member dues are often paid on a sliding-scale basis such that large corporations pay the predominant portion of member dues.¹⁵⁶

Jack Walker found that that sale of selective incentives simply could not explain the explosion of citizen interest groups in the 1970s.¹⁵⁷ While some of that growth could be explained by the selective-incentives

150. Hansen, *supra* note 36, at 93–94.

151. *Id.*; see also AINSWORTH, *supra* note 42, at 27 (stating that government involvement with trade associations in the early twentieth century was often associated with getting a more technocratic result instead of following the politics of spoils).

152. See BAUMGARTNER & LEECH, *supra* note 37, at 32.

153. See Michael L. Barnett, *One Voice, But Whose Voice? Exploring What Drives Trade Association Activity*, 52 BUS. & SOC'Y 213, 219 (2012).

154. L. PETER EDLES, FUNDRAISING: HANDS-ON TACTICS FOR NONPROFIT GROUPS 11 (1993).

155. BAUMGARTNER & LEECH, *supra* note 37, at 32.

156. WALKER, *supra* note 90, at 83–84.

157. Jack L. Walker, *The Origins and Maintenance of Interest Groups in America*, 77 AM. POL. SCI. REV. 390, 396 (1983).

theory of Olson,¹⁵⁸ Walker found that many groups located important new sources of funds outside their membership.¹⁵⁹ In fact, 89% of the citizen groups received outside sources of funds, while only 34% of business associations did.¹⁶⁰ Walker found that the citizen groups overwhelmingly received their funds from wealthy patrons.¹⁶¹ However, his data showed that they are an important source for all of the interest group sectors including business interests.¹⁶² Additionally, the citizen group beliefs overwhelmingly tracked the political beliefs of the wealthy patrons.¹⁶³ Others have found highly similar results with respect to trade associations as well.¹⁶⁴

Recent research has confirmed the large influence of wealth also on our country's policy choices. While no one has been able to conclusively prove that interest groups controlled by wealthy interests have caused this state of affairs, several authors marshal evidence demonstrating the dominating role that business elites play in shaping public policy and the agendas of our two major political parties.¹⁶⁵ Other authors claim that the process works to make the rich richer.¹⁶⁶ Martin Gilens recently demonstrated that our government policy choices are "strongly tilted toward the most affluent citizens."¹⁶⁷ While in his recent book he did not attribute the cause of that tilt to any substantial interest group role,¹⁶⁸ a more recent article seems to support the biased pluralism model described above.¹⁶⁹ We should not be surprised at this. Recent research shows that wealthier individuals are much more likely to vote, contribute to campaigns, and engage in the political process than all other less-wealthy cohorts.¹⁷⁰ Nevertheless, it is a cause for concern regarding the health of our democracy.

This Section challenged the pluralist argument that subsidizing any and all groups is a good thing. Not all groups face the same challenges in organizing and maintaining status. Some groups find the challenge to organize much harder than others. The evidence shows that business interests have had the least difficulty in organizing. Furthermore, evi-

158. For instance, the AARP succeeds in part by selling a lot of insurance. *Id.*

159. *Id.* at 398.

160. *Id.*

161. *Id.*

162. WALKER, *supra* note 90, at 79.

163. Walker, *supra* note 159, at 401–02.

164. Barnett, *supra* note 155, at 219.

165. See, e.g., G. WILLIAM DOMHOFF, WHO RULES AMERICA? CHALLENGES TO CORPORATE AND CLASS DOMINANCE 153 (6th ed. 2010); Fred Block, *Understanding the Diverging Trajectories of the United States and Western Europe: A Neo-Polanyian Analysis*, 35 POL. & SOC'Y 3, 18–19 (2007).

166. JACOB S. HACKER & PAUL PIERSON, WINNER-TAKE-ALL POLITICS 19 (2010).

167. MARTIN GILENS, AFFLUENCE & INFLUENCE 1 (2012).

168. *Id.* at 161.

169. Martin Gilens & Benjamin I. Page, *Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens*, 12 PERSP. ON POL. 564, 573–74 (2014).

170. See SCHLOZMAN, VERBA & BRADY, *supra* note 105, at 21–22.

dence that organizations form at a greater rate than Olson predicted does not undermine the central instinct that many latent public interests face much greater challenges to organize than do business interests. Finally, even when organized, we can expect that the views expressed by the group will not mimic the majority interests of members, but will instead mimic the interests of the wealthy few.

C. Importance of Groups

None of this is to say that the joining of groups is a bad thing. Nor does this Article make the claim that business leagues serve no useful or important purpose. Comparative studies have shown that a significant sector of publically available organizations is essential to a healthy democracy.¹⁷¹ Voluntary organizations have been shown to be a great educator of Americans in how the democratic process works.¹⁷² Voluntary organizations tend to promote a greater participation in that process.¹⁷³ Additionally, these organizations, including those supporting business interests bring important information to legislators and agency officials. For instance, as Schlozman, Verba, and Brady note, “Organizations are particularly likely to be in a position to provide expert information that is useful in the formulation of policy.”¹⁷⁴ In the 1920s and 30s for instance, before our country had built a substantial bureaucracy, the U.S. looked to trade associations and professional associations over governmental agents for technocratic expertise.¹⁷⁵ Many thought more highly of the technical expertise of the trade associations than the often highly partisan government officials.¹⁷⁶

These last ideas are consistent with the “informational theory” of interest groups, which suggests that you typically find interest groups on both sides of an issue.¹⁷⁷ Additionally, interest groups are more effective when they provide useful reliable information to legislators.¹⁷⁸ Under the informational theory, interest groups that provide bad information will not succeed.¹⁷⁹ Thus, under the informational theory, we should expect most interest groups to provide useful information to legislators without imposing any particular restrictions on their actions. This work supports a claim that interest groups play a real and useful role in government.

171. See GABRIEL A. ALMOND & SIDNEY VERBA, *THE CIVIC CULTURE* 300–01 (1963).

172. See THEDA SKOCPOL, *DIMINISHED DEMOCRACY* 98–107 (2003); Cass R. Sunstein, *Beyond the Republican Revival*, 97 *YALE L.J.* 1539, 1572–73 (1988).

173. Jan Leighley, *Group Membership and the Mobilization of Political Participation*, 58 *J. POL.* 447, 447 (1996).

174. SCHLOZMAN, VERBA & BRADY, *supra* note 105, at 4.

175. See, e.g., MARC ALLEN EISNER, *REGULATORY POLITICS IN TRANSITION* 5 (1993).

176. See *id.*

177. WRIGHT, *supra* note 35, at 174.

178. *Id.* at 174–75.

179. See *id.*

This Article does not question the informational theory of interest groups. It accepts that interest groups, including business leagues, fulfill this important informational role. This Article contends instead that because of the significant bias in favor of business interests in the interest group sector, a subsidy should not be provided to the business interest group sector.

D. Conclusion

As Schattschneider said, the interest group system appears to sing with a distinctly “upper-class bias.”¹⁸⁰ The evidence to date demonstrates that business interest groups overwhelmingly dominate the voices that are heard on Capital Hill. Tax exemption provides a subsidy to these business interests through § 501(c)(6). Based on the evidence of such a significant bias towards business, a subsidy is entirely unjustified.

II. QUALIFYING AS A TAX-EXEMPT BUSINESS LEAGUE AND THE RATIONALES FOR SUCH EXEMPTION

Although there is no legislative history, the exemption for business leagues appears in the Income Tax Act of 1913.¹⁸¹ It seems to originate from a Chamber of Commerce request to exempt “civic and commercial” organizations.¹⁸² “Commercial” organizations, the Chamber told Congress, are not “selfish,” perform “civic functions,” and work to improve commerce in the interest of all citizens.¹⁸³ To tax these organizations would be to limit their public usefulness. The Chamber argued that civic and commercial organizations should not be taxed for the same “common sense” reason many argue charities should not be taxed—they provide a public benefit in return for the subsidy of exemption.¹⁸⁴ Contemporaneous documents suggest that the government was very open to the idea that these trade organizations played an important public role at the time.¹⁸⁵

180. SCHATTSCHNEIDER, *supra* note 2, at 31.

181. Revenue Act of 1913, ch. 16, § II(G)(a), 38 Stat. 114, 172.

182. See *Hearings on Tariff Schedules of the Revenue Act of 1913 Before the Subcomm. of the Comm. on Finance, 63d Cong. 2001 (1913)* [hereinafter *Hearings*] (statement of U.S. Chamber of Commerce); see also *Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 478 (1979) (discussing the Chamber of Commerce written testimony and finding it persuasive as to the legislative intent of Congress).

183. *Hearings*, *supra* note 184, at 2002.

184. *Id.*

185. E.A. BRAND, BUREAU OF MANUFACTURES, DEP'T OF COMMERCE AND LABOR, SPECIAL AGENTS SERIES—NO. 60, COMMERCIAL ORGANIZATIONS: RESULTS OF AN INVESTIGATION OF THE PROMOTIVE ACTIVITIES OF SEVENTY ASSOCIATIONS IN THE UNITED STATES 7–8 (1912). Issued by the U.S. Department of Commerce, the report suggests that while these trade organizations had existed for some time, it was only after the turn of the century that these organizations came to fruition; chambers of commerce, the report notes, were just beginning to wield significant influence within communities. *Id.* at 7. The monograph discusses the ways chambers of commerce, boards of trade, commercial associations, manufacturers associations, etc. engage in the development of foreign trade, wholesale trade and retail trade, the promotion of transportation and industrial expansion,

A. *Qualifying for Exemption as a Business League*

The statute exempts from federal income tax “[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues.”¹⁸⁶ To qualify as a business league, the Treasury regulations provide that an organization must be formed to promote a common business interest and must direct its activities towards the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual persons.¹⁸⁷ For instance, a business league cannot promote one product among a lot of products that are operating in one line of business, such as a particular brand of auto-part.¹⁸⁸ To maintain tax exemption, a business league may neither perform specific services for its members as a primary activity¹⁸⁹ nor “engage in a regular business of a kind ordinarily carried on for profit.”¹⁹⁰ Consistent with the rest of the tax-exempt sector, the Code explicitly prohibits business leagues from organizing for profit and from allowing earnings to inure to the benefit of any private shareholder or individual.¹⁹¹

Unlike a charitable organization, whose political campaign activity is absolutely prohibited and lobbying limited,¹⁹² a business league may lobby as a primary purpose and may advocate for a candidate as long as it is not the organization’s primary purpose.¹⁹³ In fact, lobbying and influencing politics is generally a primary function of a business league. Under the law of tax-exempt organizations, to intervene in a campaign means to advocate for or against a candidate for public office directly or indirectly.¹⁹⁴ Lobbying, on the other hand, refers to either directly con-

the establishment of conventions, and efforts to bring about civic improvements. *Id.* at 3–4. The publication evinces a sense that these organizations provide huge benefits to the country.

186. 26 U.S.C. § 501(c)(6) (2012). Congress added “professional football leagues” to the statute in 1966. Act of Nov. 8, 1966, Pub. L. No. 89-800, sec. 6(a), § 501(c)(6), 80 Stat. 1508, 1515 (codified as amended at 26 U.S.C. § 501(c)(6) (2012)) (ensuring the National Football League is a tax exempt organization). Senator Coburn recently made efforts to end exemption for sports leagues such as the NFL. PRO Sports Act, S. 1524, 113th Cong. (2013).

187. Treas. Reg. § 1.501(c)(6)-1 (1960).

188. *See id.*

189. *See, e.g.*, Rev. Rul. 56-65, 1956-1 C.B. 199, *clarified by* Rev. Rul. 65-164, 1965-1 C.B. 238 *and* Rev. Rul. 72-211, 1972-1 C.B. 150 (providing information solely to members of the industry is a specific service for members and does not qualify as the exempt purpose of operating a business league).

190. Treas. Reg. § 1.501(c)(6)-1; *see also* Credit Bureau of Greater N.Y., Inc. v. Comm’r, 162 F.2d 7, 7-9 (2d Cir. 1947) (selling credit information and collection services is not a business league exempt purpose); Underwriters’ Labs., Inc. v. Comm’r, 135 F.2d 371, 372-74 (7th Cir. 1943) (testing electronic equipment for safety does not qualify as a business league exempt purpose).

191. Treas. Reg. § 1.501(c)(6)-1.

192. 26 U.S.C. § 501(c)(3) (2012).

193. Rev. Rul. 61-177, 1961-2 C.B. 117; Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 ELECTION L.J. 363 *passim* (2011) (discussing the constitutionality of limiting the speech of nonprofits by limiting their ability to intervene in a political campaign).

194. John Francis Reilly and Barbara A. Braig Allen, *Political Campaign and Lobbying Activity of IRC 501(c)(4), (c)(5), and (c)(6) Organizations*, in EXEMPT ORGANIZATIONS CONTINUING

tacting, or encouraging people to contact, legislators to vote for or against certain legislation.¹⁹⁵

Courts interpret the term “business” in § 501(c)(6) broadly. For instance, the Tax Court has stated that the term business “embraces everything about which a person can be employed.”¹⁹⁶ Thus, industry, manufacturing, and retail are included within the term business, as is any profession, such as the medical profession.¹⁹⁷ Although non-professional workers could have been included within the term business as well, as could have farm-related business interests, these groups have a separate section dedicated to them under the Code.¹⁹⁸ The IRS has accepted that even students of a particular profession can form an organization devoted to promoting business.¹⁹⁹ A hobby, however, rather than a strict business does not qualify.²⁰⁰

The IRS and courts also interpret “promote” in § 501(c)(6) liberally. For instance, hosting lunch meetings to discuss business-related issues qualifies,²⁰¹ although simply providing facilities for members for lunch does not.²⁰² Networking to exchange business prospect information does not promote common business interests either.²⁰³ Publishing a newspaper related to the interests of fisherman,²⁰⁴ establishing a trust for the purpose of collecting, administering and disbursing funds to business leagues,²⁰⁵ and holding semi-annual meetings to discuss technical problems with information data sharing²⁰⁶ all qualify as valid activities to promote a common business interest. A business league that issues a “seal of acceptance” highlighting that the league approves of member products qualifies.²⁰⁷ Similarly, an organization that creates a model building and construction code, and tests products, is considered to be conducting a suitable activity.²⁰⁸ Negotiating with labor on behalf of industry is a valid

PROGRAM EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 2003, at L-4 (2002), available at <http://www.irs.gov/pub/irs-tege/eotopick03.pdf>.

195. *Id.*

196. *Associated Indus. of Cleveland v. Comm’r*, 7 T.C. 1449, 1465 (1946), *acq.* 1947-1 C.B. 1.

197. Rev. Rul. 73-567, 1973-2 C.B. 178.

198. See 26 U.S.C. § 501(c)(5).

199. Rev. Rul. 77-112, 1977-1 C.B. 149.

200. See *Am. Kennel Club, Inc. v. Hoey*, 148 F.2d 920, 922 (2d Cir. 1945).

201. Rev. Rul. 67-295, 1967-2 C.B. 197.

202. Rev. Rul. 70-244, 1970-1 C.B. 132.

203. Rev. Rul. 59-391, 1959-2 C.B. 151.

204. Rev. Rul. 75-287, 1975-2 C.B. 211.

205. Rev. Rul. 82-138, 1982-2 C.B. 106.

206. Rev. Rul. 74-147, 1974-1 C.B. 136.

207. Rev. Rul. 70-187, 1970-1 C.B. 131 (internal quotation marks omitted).

208. I.R.S. Tech. Adv. Mem. 81-17-004 (Jan. 1, 1981); *cf.* *Am. Plywood Ass’n v. United States*, 267 F. Supp. 830, 831-33, 836 (W.D. Wash. 1967) (holding that plywood association that only sold a trademark to its members qualified because over 90% of the industry belonged to the association and, even if it was a service for members alone, the trademark issue would not be more than an incidental amount of activity of the association leaving the organization operating primarily for its exempt purpose).

activity to promote a common business interest.²⁰⁹ Finally, “working for the enactment of legislation designed to improve their competitive standing in the various lines of business, industry, etc., in which they are engaged” is a perfectly fine activity for a business league.²¹⁰

There are limitations placed on a business league’s ability to sell selective services to its members. As mentioned above, a business league may not provide goods and services exclusively to members. For instance, the American Automobile Association, an association of individual car owners, failed to qualify as a business league because its activity was to provide services solely to members.²¹¹ However, there are some seemingly contradictory rulings in this area. In the seal of acceptance ruling above, the IRS ruled that this service to members was a legitimate business-league activity because the vast majority of the industry (over 90%) participated in the particular business league at issue.²¹² That said, there seems to be an ambiguous requirement that member income be at a “meaningful level.”²¹³ This is probably to ensure that the organization is broadly acting on behalf of the particular business or industry rather than running a for-profit business. In a General Counsel Memorandum (GCM) the Office of the Chief Counsel of the IRS (Chief Counsel) opined that an organization that received a significant source of its income from the sale of insurance could not qualify as a business league because it lacked enough member support.²¹⁴ An organization that provides rebates to members but not non-members also fails to qualify as a business league.²¹⁵

Operating for private businesses alone is prohibited. The Supreme Court has found that Treasury regulations establishing a line of business requirement are valid.²¹⁶ This means a business league cannot be established for a particular brand name product or service. The business league must be formed to support the general product or the service. The seminal case is *National Muffler Dealers Association v. United States*.²¹⁷ There, a business league established to support the Midas brand of muffler failed to satisfy the line-of-business requirement as established by long-held Treasury regulations because it supported one brand rather than the line of business involved.²¹⁸ The Court relied substantially on

209. *Associated Indus. of Cleveland v. Comm’r*, 7 T.C. 1449, 1465 (1946), *acq.* 1947-1 C.B. 1.

210. Rev. Rul. 61-177, 1961-2 C.B. 117.

211. *Am. Auto. Ass’n v. Comm’r*, 19 T.C. 1146, 1157-61 (1953).

212. *See* Rev. Rul. 70-187, 1970-1 C.B. 131.

213. John Francis Reilly et al., *IRC 501(c)(6) Organizations*, in EXEMPT ORGANIZATIONS CONTINUING PROGRAM EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 2003, at K-12 (2002), available at <http://www.irs.gov/pub/irs-tege/cotopick03.pdf>.

214. I.R.S. Gen. Couns. Mem. 39,723 (Apr. 8, 1988).

215. *Mich. Mobile Home & Recreational Vehicle Inst. v. Comm’r*, 66 T.C. 770, 777-78 (1976).

216. *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472, 477, 483-84, 488-89 (1979).

217. 440 U.S. 472 (1979).

218. *Id.* at 473, 483-84, 488-89.

the submitted testimony of the U.S. Chamber regarding why business leagues should be considered exempt from taxation on the enactment of the original exemption for business leagues in 1913.²¹⁹ A line of business in most cases according to the Court involves “either an entire industry or all components of an industry within a geographic area.”²²⁰ The IRS recently won a case against Bluetooth Sig, Inc., the maker of a remote technology, because it was formed to support the Bluetooth product rather than the product in general.²²¹ The *Bluetooth* court found that the difference between the trademark involved in American Plywood and the trademark involved in *Bluetooth* was that Bluetooth expressly created this new business opportunity rather than coming upon a business that was actively engaged by numerous organizations already.²²²

Finally, and seemingly redundantly, a business league can go astray by engaging in a business for profit or performing particular services for its members. While these two requirements seem to collapse into the other factors already discussed, they are independent requirements identified by courts and the regulations. For instance, advertising on behalf of members will generally be considered to be the performance of a particular service for members and not support that the organization is organized for exempt purposes.²²³ However, where an organization advertises broadly on behalf of the industry, there is no particular service being provided to a member. A commodity and stock exchange created for members²²⁴ and the creation of a laundry business for members are both examples of prohibited particular services as well as the operation of a business for profit.²²⁵ The IRS has stated that the legal question is whether the activity or service “relieves the member of the necessity of securing the service commercially (or performing the service on an individual basis) in order to properly conduct the member’s business, resulting in a convenience or economy to the member.”²²⁶

B. Difference Between Tax Exemption/Taxable for Business Leagues?

A business league is generally an incorporated entity.²²⁷ Therefore an exemption from income tax means that it does not have to pay the corporate income tax.²²⁸ The amount of any subsidy provided is equal to

219. *Id.* at 478, 488.

220. *Id.* at 482–83 (citations omitted).

221. *Bluetooth Sig, Inc. v. United States*, No. C05–1778–JCC, 2008 WL 312712, at *7–9 (W.D. Wash. Feb. 1, 2008), *aff’d*, 611 F.3d 617 (9th Cir. 2010).

222. *Id.* at *5.

223. *See Auto. Elec. Ass’n v. Comm’r*, 168 F.2d 366, 367–68 (6th Cir. 1948); Rev. Rul. 65-14, 1965-1 C.B. 236; Rev. Rul. 64-315, 1964-2 C.B. 147.

224. Treas. Reg. § 1.501(c)(6)-1 (1960).

225. *A-1 Cleaners & Dyers Co. v. Comm’r*, 14 B.T.A. 1314, 1314, 1316 (1929).

226. I.R.S. Gen. Couns. Mem. 39,411 (Sept. 18, 1985).

227. *See, e.g., Hackney, supra* note 8, at 115 n.2.

228. Business leagues could simply pay tax as a corporation as Major League Baseball appears to have done when it gave up its tax-exempt status. *See Duff Wilson, N.F.L. Executives Hope to Keep Salaries Secret*, N.Y. TIMES (Aug. 12, 2008),

the tax the corporation would have owed. An exempt organization is broadly responsible for the unrelated business income tax under §§ 511–514, but it only owes that tax if it incurs unrelated business income.²²⁹ The corporate tax is a tax on an organization's income, i.e., generally revenue less ordinary and necessary business expenses. In the absence of tax exemption, there are three primary types of income upon which a business league might pay tax: (1) net investment income (portfolio income), (2) income from member dues, and (3) income from the sale of goods and services to members and nonmembers. In each case, to determine income, expenses are offset against the revenue from these activities.

The first type of income and the tax owed is fairly straightforward. A business league does not pay tax on income from gains from stocks and bonds, rental income, royalties and other passive investments that are excluded from Unrelated Business Income Tax (UBIT).²³⁰ Tax exemption for investment income works just like an individual's pension plan. Earnings from capital held by the exempt organization are exempt from tax.²³¹ Such income would generally be taxed at the corporate rate.²³² If, after deductions, a business league earned \$1,000 in investment income, assuming a 36% rate, it would owe \$360. Because, unlike most other corporations, a business league is absolved from this tax, the government can be seen to provide a subsidy to a business league equal to the tax rate multiplied by investment income. Here that amount would be \$360. The benefits most likely accrue to the members who control the organization. The research in Part I(B)(3) would suggest this means that the benefits flow most to the highest paying members of the organization whose interests the organization most typically follows.

The second type of income, membership income, lacks the clarity found in net investment income. Many argue, as discussed in the paragraph below, that member dues do not represent income at all, but only the pooling of resources. Defining membership income requires us to determine what it means to be a member of a nonprofit organization. A

<http://www.nytimes.com/2008/08/12/sports/football/12nfltax.html> (“Major League Baseball changed its status last year to a for-profit corporation.”). It could reorganize as a pass-through entity, such as a partnership or limited liability company, and be taxed under the subchapter K pass-through regime. Or, a business league could be seen as a cooperative that should be taxed under subchapter T of the Code. See CHARLES T. AUTRY & ROLAND F. HALL, *THE LAW OF COOPERATIVES* 91 (2009). A cooperative is an organization that is (1) owned and controlled by the persons who buy or sell its services or goods, (2) engaged primarily in selling to or buying from those who own it, (3) is democratically controlled by its members, and (4) works to maximize benefit to its owners rather than to maximize profits. *Id.* at 1–2. Cooperatives offer a hybrid taxing regime where the organization is in effect taxed both as an entity and treated as a conduit such that the members pay tax on the earnings of the entity. See *id.* at 90–91, 101.

229. 26 U.S.C. §§ 511–514 (2012).

230. *Id.* § 512(b).

231. See *id.* § 501(a), (c)(6).

232. Generally, business leagues are organized as corporate entities. A corporation is taxed under 26 U.S.C. § 11.

member pays business league dues because the business league provides some good or service that the member values at least as much as he paid in dues. From this perspective, a member is a customer of an entity in which the member has some part interest. And, if the business league is a corporate entity separate from its members, which presumably it is, and the membership dues are not the purchase of shares of stock but the acquisition of goods or services, then any retained earnings from dues payments at the end of a taxable year represent income from membership dues. The dues represent the prepayment for goods or services to be received throughout the year. If this is our perspective of a member, the taxation is not very difficult for our income tax system. The subsidy here would be the tax rate times the income exempted from tax.

Some conceive of membership dues as simply the pooling of capital to do something the member could have done without the organization.²³³ For example, a member might pool capital with other members to cooperatively advertise their common interest. Thus, some argue that there is no taxable activity involved in the membership dues situation.²³⁴ This view ignores the entity and views the relationship as nothing more than a conduit. This is a plausible frame through which to view the relationship between member and organization. First, in almost all cases a member of a business league is engaged in a trade or business and would be able to deduct the amount of money that the business league ultimately expends.²³⁵ Thus, although paying the business league allows the member an immediate deduction, this is the correct result for the vast majority of membership dues payments. For those portions that it is the incorrect result, i.e., the member gets a deduction associated with an amount that would not have been deductible until some later year, this aberration results in a tax deferral only rather than complete exemption.²³⁶ Likewise, the business league itself would also be able to deduct most expenditures of the organization at the end of the day. Nevertheless, this view takes an odd view of the normal view regarding an entity individual relationship. The two are normally treated as separate persons.²³⁷ And, even in the case of cooperatives or partnerships, where the entity at times is ignored, the business league exemption choice ignores both the entity and the individual level of tax responsibility.

Finally, the third source of income, payments received from conducting a trade or business, may be currently taxed under the Unrelated Business Income Tax (UBIT) regime or may be exempt as a substantially related trade or business.²³⁸ For instance, if an organization sells a seal of

233. For a discussion of this idea, see Halperin, *supra* note 9, at 134.

234. *E.g., id.* at 139, 155-56.

235. *See, e.g., id.* at 135.

236. *Id.*

237. *Moline Props. v. Comm'r*, 319 U.S. 436 (1943).

238. 26 U.S.C. § 513.

approval to members and nonmembers and the IRS determines the sale of that seal is substantially related to the organization's exempt purpose, the business league will not owe UBIT on the income from that service. However, where the business league sells advertising to particular members, the business league will owe the UBIT on this income for that tax year.

Payments to a tax-exempt business league are not deductible as a charitable contribution, as are donations to a charitable organization,²³⁹ however, most payments to a business league are deductible as a trade or business expense.²⁴⁰ Membership dues are generally deductible, except to the extent any amount is used to lobby or intervene in a political campaign.²⁴¹ From a casual perusal of business league Form 990s it appears that business leagues do not indicate a large percentage of their expenses go to either advocating for or against a candidate or for lobbying.²⁴² This seems odd given the research above suggesting that a primary driver for the creation of business leagues is in order to lobby. Further research into this matter might be fruitful.

To see the impact of taxing a business league, consider what would happen if a business league, call it the American Barbell Association (ABC), gives up its exemption from tax and chooses to be taxed as a corporation.²⁴³ ABC speaks for the benefit of the barbell industry. It engages in the following transactions. It receives \$1,000,000 in dues annually from 1,000 members. It also earns \$100,000 in revenue from the sale of a seal of approval for well-made barbells. Finally, it holds a \$500,000 endowment of stocks and bonds upon which it earns a 10% return or \$50,000. Thus, it receives a total of \$1,150,000 in revenue. Its deductions amount to \$900,000 for speaking for the industry for the year, \$50,000 of

239. *Id.* § 170(a)(1).

240. *Id.* § 162(a).

241. *Id.* § 162(e)(1)(A)–(D).

242. For instance, the US Chamber of Commerce indicates on its 2012 Form 990 that of its \$207 million of expenses, only \$13 million was dedicated to lobbying. Chamber of Commerce 2012 Tax Form, I.R.S. Income Tax Form 990, pt. I, l. 18, pt. IX, l. 11(d), [hereinafter 2012 Chamber of Commerce Form 990], available at <http://www.guidestar.org/FinDocuments/2012/530/045/2012-530045720-09d301b9-90.pdf> (last visited Oct. 30, 2014). The American Medical Association reports \$0 of lobbying expenses in 2012 when reporting \$224 million in total expenses. American Medical Association 2012 Tax Form, I.R.S. Income Tax Form 990, pt. I, l. 18, pt. IX, l. 11(d), [hereinafter 2012 AMA Form 990], available at <http://www.guidestar.org/FinDocuments/2012/360/727/2012-360727175-09d9349b-90.pdf> (last visited June 23, 2015).

243. In many instances, a business league could choose to be organized as a pass-through entity or a cooperative and be taxed as such. Major League Baseball for instance chose to become an LLC and taxed as a partnership when it gave up tax exemption recently. Under partnership taxation, an organization is treated as an entity by the IRS mostly for accounting purposes but not for tax purposes. Instead of taxing the entity, the Code imposes a tax on the partners under the Subchapter K regime. A cooperative provides a hybrid regime. It is incorporated and owes a corporate tax. However, it is allowed to deduct patronage dividends such that any earnings that are distributed to members are not taxed at the corporate level. Subchapter T of the Code would likely apply to most business leagues that chose to be taxed as a cooperative. See *supra* note 230 and accompanying text.

which it reports as lobbying. It spends \$90,000 in administering its seal of approval program. Finally, it incurs \$10,000 in deductible expenses in managing its portfolio. Thus it incurs \$1,000,000 in total expenses.

ABC earned \$40,000 in our first type of identified income, investment income. If it were tax exempt, it would not owe tax on this money. ABC's member income would equal \$100,000.²⁴⁴ If it were tax-exempt, the Association would not owe tax on that amount. Finally, with respect to our third type of income, ABC earned \$10,000 from the sale of the seal of approval. Assuming an even corporate tax rate of 30%, ABC would owe \$12,000 on its investment income, \$30,000 in taxes on member income, and \$3,000 in taxes on its trade or business income. It is possible that even as a tax-exempt entity the Association might owe tax on trade or business amount. It would depend on how the Association structured the seal of approval.²⁴⁵ Thus, as a taxable entity, ABC would pay \$45,000 in taxes on \$150,000 of income, while as tax exempt it would pay nothing or \$3,000 on that same income.

As a taxable entity, ABC could choose to spend all of its member dues on expenses and keep its total tax burden to the \$15,000 owed on investment income and sales of services. It could also possibly treat the excess \$100,000 in member dues as a rebate. In other words, ABC could determine that it charged its members too much and return that money. It would still pay tax on the remaining \$50,000 of investment income and trade or business income.

The incentive effect therefore of granting tax-exempt status, is to encourage the tax-exempt organization to not spend its earnings currently; this is because it gets an advantage over others by having retained earnings that do not face a tax. If the organization is taxable it will be encouraged to either return money to its members or spend it all currently. Thus, if we have reason to believe that it would be better for business leagues to spend its income currently we might choose instead to make them taxable rather than tax exempt.

C. Propriety of Tax Exemption for Business Leagues

Few argue business leagues deserve tax exemption. Those who have opined from a scholarly perspective describe exemption for these organizations as "rickety."²⁴⁶ Even though considered rickety, Boris Bittker and George Rahdert state that it might be self-defeating to tax business

244. I assume the IRS will treat a for-profit business league as if it is in the trade or business of providing lobbying. Thus, the \$50,000 of lobbying expense, while not deductible at the member level because of 26 U.S.C. § 162(e)(1), would be deductible to the business league under 26 U.S.C. § 162(e)(5).

245. See *supra* Part II.A.

246. Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 357 (1976). See also, David S. Miller, *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX LAW. 451, 474 (2014).

leagues.²⁴⁷ They point out that a business league could either be operated at a break-even point, incurring no taxable obligation, or could pass along the extra tax charge to its members who would deduct this charge and substantially lower their total tax obligation.²⁴⁸ Halperin concludes that tax exemption for business leagues is a subsidy but believes there is little harm in the subsidy to the extent it is associated with member services.²⁴⁹ Its primary benefit is deferral.²⁵⁰

Thus, the primary arguments for exempting business leagues from income tax seem to be that taxing them would be a waste of time and an administrative burden. This Section investigates whether there might be positive arguments for tax exemption for business leagues. It finds that there are positive arguments, but ones that are not ultimately satisfactory. It also concludes that the suggestion that taxing business leagues would be a waste of time and an administrative burden are incorrect today.

I have argued that mutual-benefit organizations, such as business leagues, should generally be subject to taxation.²⁵¹ I argued that under the shareholder theory of corporate taxation, mutual-benefit organizations should pay a tax to represent the private gain provided through the operation of the organization. Under corporate tax theories, the most accepted theory of taxation is that we tax corporate entities to tax the shareholders.²⁵² Because the members of mutual-benefit organizations closely resemble the shareholders of a for-profit corporation—they control the organization through voting and are the primary beneficiaries of the actions of the organization—a corporate tax should apply to business leagues and other mutual benefits unless a strong positive case can be made for their exemption. Public benefit corporations, on the other hand, such as charitable organizations are structured to have no members who resemble shareholders. Thus, it is more difficult to make a positive case for taxation of charitable organizations under the shareholder theory of corporate taxation.

Consistent with economic theory for government subsidies, and with the market failure theory, it arguably makes sense to provide exemption to an organization that fulfills an important public purpose.²⁵³ The most common argument made for providing an organization exemption from tax is that the organization provides some public benefit that is at least equal to the amount of tax the organization would have paid (the “quid pro quo theory”).²⁵⁴ The dominant argument within the quid pro

247. Bittker & Rahdert, *supra* note 246, at 357.

248. *Id.*

249. Halperin, *supra* note 9, at 135–36.

250. *Id.* at 135.

251. Hackney, *supra* note 8, at 118.

252. *Id.*

253. *See id.* at 125–26, 155.

254. *See, e.g., id.* at 125.

quo theory holds that we provide a subsidy to nonprofit organizations that solve a market failure.²⁵⁵ Typically, the type of market failure involved is either (1) a good or service that has positive externalities or (2) a public good. No one has explicitly argued that a business league solves a market failure. Nevertheless, there are three market failures, or perhaps government failures, that subsidizing business leagues might solve: (1) it might foster a pluralist society, (2) it might ensure that needed, useful, truthful information is delivered to the government, and (3) it might provide a private regulatory authority (think bar association).

Some make a positive argument for tax exemption.²⁵⁶ They argue tax exemption fosters a pluralist society. By subsidizing the formation of groups that will advocate for societal interests we enhance our democracy. Encouraging the formation of groups can help to ensure all interests of our nation are represented before our government, and can bring us closer to an ideal representative democracy.

This pluralism theory must be based on the assumption that there is a market failure associated with the collective good of governmental interest representation. As discussed in Part I above, this is the collective action problem; although there are many needs of individuals and organizations that could be fulfilled by government, the cost involved in seeking the fulfillment of that need by government is more costly than the return to any one individual. While it would be in the collective interest to organize to spread the cost of speaking to the government, the cost of such organization is often so great compared to the return that some individuals and groups might never organize. Other collective interests might organize, but might never get the optimal amount of this service because many individuals and organizations will free ride on the efforts of others. Thus the basis for this positive case: the subsidy of tax exemption can encourage the development of organizations that represent diverse important views before the government.²⁵⁷ This can enhance the democratic nature of government. We might further enhance the power of this claim by noting that this subsidy is best suited to nonprofit organizations. The absence of owners who might act opportunistically in a nonprofit means nonprofits are more trustworthy than a for-profit organization and thus worthy of the government subsidy.²⁵⁸

255. See, e.g., *id.* at 126.

256. See, e.g., SALAMON, *supra* note 12, at 14; Gardner, *supra* note 12, at xiii–xv.

257. See, e.g., *Bob Jones Univ. v. United States*, 461 U.S. 574, 609 (1983) (Powell, J., concurring) (describing the “role played by tax exemptions in encouraging diverse, indeed often sharply conflicting, activities and viewpoints”); see also SALAMON, *supra* note 12, at 14; Gardner, *supra* note 12, at xiii–xv.

258. Cf. Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2066–67 (2007) (who argued that we had no reason to believe that nonprofit charitable organizations were more deserving of a subsidy for carrying out charitable works than any other organizations).

This represents a prescriptive pluralism. It recommends that the government give aid to organizations that will represent group interests before the government. The positive externality presumably from such activity is that the government will be more democratic because it is more inclusive of the diverse opinions of society.

A related positive case, which I refer to as the information theory, is also based on the problem of collective action. Under this theory the subsidy encourages the collective action of organizations to provide the government with important, necessary information.²⁵⁹ Neither legislators nor government employees can know all the information they need to manage the complex regulatory world. In the early 1900s, in fact, there was a sense that our government should seek out substantial help from these associational groups to scientifically govern commerce.²⁶⁰ Furthermore, interest groups possess valuable electoral information for those running for election.²⁶¹ It is theoretically possible that interest groups could help align a politician's position more closely with the electorate. Thus, business leagues deserve exemption because they fill this important public role of bringing important, necessary information to the government. Again, the case for this claim could be augmented if it could be shown that nonprofits provide better and more truthful information.

Finally, in some cases, some business leagues may serve an important regulatory function. This might be particularly helpful in a circumstance where that function is one that the state might have otherwise operated. These organizations might provide a lower cost, less intrusive means of regulating and ensuring the smooth operation of important professional and industry functions. For instance, bar associations regulate lawyers and many industry associations may regulate the quality of products provided by a particular industry. As will be seen in the case studies below, the Cotton Trade Institute tried to serve as the arbiter of quality products by helping to implement a federal code governing these products. Also, the AMA has served a regulatory role at times by overseeing the quality of drugs, and is today involved in regulating payment structures associated with medical procedures.²⁶²

In assessing these three related positive cases, the first step is to assess whether there is a market failure that business leagues are solving. Arguably, the current set of requirements for business leagues that pro-

259. WRIGHT, *supra* note 35, at 174; *see also* RAYMOND A. BAUER, ITHIEL DE SOLA POOL & LEWIS ANTHONY DEXTER, *AMERICAN BUSINESS & PUBLIC POLICY* 324–25 (1963) (establishing a case from the time that the main way that many business interest groups worked in pressuring Congress was really an informational sharing role). A couple authors in fact make an argument that is consistent with the informational theory; they claim lobbying is a subsidy to the government. Richard L. Hall & Alan V. Deardorff, *Lobbying as Legislative Subsidy*, 100 *AM. POL. SCI. REV.* 69 (2006).

260. EISNER, *supra* note 177, at 5.

261. WRIGHT, *supra* note 35, at 199.

262. *See infra* Part III.F.

hibit an exempt business league from operating for a particular business aids the case that business leagues provide a collective good that might be subject to market failure. Instead of helping just Midas Mufflers, any business league formed around mufflers must help all organizations in that line of business. However, as developed above in Part I, much of the business-league community is made up of small homogenous interests that appear to have little difficulty organizing.²⁶³ Thus, even though they provide a collective good, the type of collective good they provide does not appear to have the substantial market failure that is imagined in the theory supporting exemption from income tax.

Nevertheless, collective action theory and the empirical evidence demonstrates that some business leagues face real collective-action problems. Professional associations and peak associations arguably face some real challenges. Mancur Olson notes the challenges that professional associations face in organizing because they typically represent a large latent interest.²⁶⁴ For instance, a review of the history of the American Medical Association seems to demonstrate that the AMA experienced substantial challenges in organizing prior to the turn of the twentieth century.²⁶⁵ Peak associations too, such as the Chamber of Commerce, face greater challenges in organizing than the small trade associations. Peak associations and professional associations perceive that they must sell selective incentives such as insurance and discounts and offer opportunities to network to attract members.²⁶⁶ Thus, certain sectors of business leagues face market failure. Could this mean that there might be a partial positive case to be made on this market failure?

Maybe, but we might question the extent of that market failure. Many professional associations, for instance, work with their states to establish closed shops that all but eliminate any collective-action problem.²⁶⁷ In order to practice law, for example, you must be a member of your state bar.²⁶⁸ If individuals are forced to join the organization by state compulsion, the collective-action problem is solved. This solves the collective-action problem for many of the most powerful professional associations. Thus, despite the objective challenges that professional associations face, the closed shop generally solves the market failure problem and there is no need for an additional subsidy to solve that problem. Additionally, while peak associations may experience collective action challenges, those challenges are arguably not as intense as some other non-business public interests. Business organizations typically have members with the skills and resources to organize. And, as demonstrated in Part I

263. See *supra* Part I.A.

264. See OLSON, *supra* note 26, at 144 (1965).

265. See *infra* Part III.F.

266. See, e.g., OLSON, *supra* note 26, at 133–35.

267. See *supra* Part I.A.

268. See *supra* Part I.A.

above, business interests are well represented before our government already; under this analysis, the market failure case for these organizations that face a collective action problem becomes suspect as well.

This assessment of the relative level of market failure faced by different types of business leagues suggests that examining the exemption worthiness of organizational types is not a hard and fast science. Different organizational interests experience market failure over a continuum. On the side of extreme market failure we might place large and latent organizational interests, such as the poor, that experience a high degree of market failure. On the other end where organizational interests face almost no market failure, we might place trade associations representing an industry with few members. This continuum suggests that within the business-league organizational sector, some organizational types might be identified that are more deserving than others. For example, peak associations appear to face a greater level of market failure than industry trade associations and may thus be more worthy of exemption.

If we conclude some organizational types within the business-league sector are more deserving of exemption than others, then we need to know what baseline to use in measuring whether a class of organizations on the whole should be entitled to exemption from tax. Should all the organizations that fit within the class suffer significant, severe market failure? Should you compare organizations within a class, or is the relevant question the degree of severity of market failure as compared to all other tax-exempt organizations including charitable organizations? Under the current exemption structure for business leagues there are many trade associations that represent small interests that objectively do not appear to face any market failure.²⁶⁹ Furthermore when business interests are compared to the interests of the poor, the collective-action challenge difference is profound.

It is hard to make an exact judgment, but if we looked at a continuum of nonprofit organizations that face market failure and it went from only a little failure to a lot of failure, we could expect that the vast majority of business leagues fall on the little failure side. The overwhelming empirical evidence discussed above that business interests dominate the interest group field supports this conclusion.²⁷⁰

We could stop the analysis there. If we can conclude that the vast majority of business leagues do not face market failure in a relative sense it becomes hard to suggest they need a subsidy to provide the goods or services we think are helpful. However, to complete the analysis we should assess whether, if properly targeted to the organizations within the business league class that does experience market failure, such as

269. See *supra* Part I.A & B.

270. See *supra* Part I.A & B.

peak organizations, one of the positive cases for business leagues suggested above could carry the day for exemption. In the following paragraphs I consider the positive cases as they might apply to the organizations in the business league class that are on the more severe side of market failure.

The first case is an argument that the subsidy fosters a more pluralistic society. Could the subsidy for peak business associations be supported on the premise that offering peak associations a subsidy will increase the diversity of opinion brought to our government actors? Given the overwhelming evidence that business interests dominate the interest group field, such a claim seems far-fetched. As a result of the existing substantial bias towards business interests, providing a subsidy to business interests likely distorts the democratic community more towards these powerful business interests. Thus, even if exemption were provided solely to peak associations, the objective of pluralism is probably harmed rather than enhanced. Taking into consideration the evidence that there are only so many interest groups that can make up an interest group sector,²⁷¹ we should be doubly concerned about filling the field with interests that already dominate.

The second case, the informational theory, is usually offered as a reason to not impose restrictions on lobbying generally.²⁷² Interest groups bring forth important information to legislators and agency decision makers and we should be inclined to support those activities. Information from the regulated is an important good in and of itself. However, this rationale to be used to support exemption depends on finding market failure. If most business interests organize anyway, it is hard to understand why we need increase the amount of information provided by this community. Pushing the informational theory to support subsidization of lobbying seems a push one step too far.

The third positive case to support business-league exemption presents perhaps the best case because it focuses on a very public function. Under this case, we subsidize the business leagues that perform a public regulatory function by enacting and enforcing rules to govern a profession or industry's relationship with the public and with one another. Professional associations like bar associations enforce professional standards; likewise, some trade associations enforce building codes that may ensure better products for the public. The activity of regulating an important professional or industrial field fulfills a traditional governmental role, and we as a society generally accept that we should not tax the government itself. In a sense this could fit the lessening the burdens of charitable organizations. Thus, this exemption need not rely on market failure.

271. See Lowery & Gray, *supra* note 127.

272. See, e.g., WRIGHT, *supra* note 35, at 174.

One could justify this case on the basis of the organization fulfilling a governmental role alone.

The third case does not broadly support business-league exemption. A small set of business leagues fulfills this public regulatory role. The strongest objection to this case is the evidence that this type of activity is really a byproduct of the primary activity of acting as an interest group on behalf of the industry.²⁷³ Thus, these private associations will continue to pressure government actors to provide a better environment for their industry as a whole. The fact that these organizations get the state's imprimatur to regulate the industry or profession simply makes the voice of these organizations even more powerful. This is seen quite clearly in the case study below on the development of the AMA and to a certain extent the Cotton Textile Institute as well. Given that the regulatory function is a byproduct of business interests, this case should thus fail as well.

Although no positive case supports tax exemption, might we still choose to exempt the business league from the income tax because (1) it does not matter whether we tax these organizations or not, and (2) it would be an administrative burden anyway? Taxing business leagues would not likely lead to substantial revenue, and it is true that a part of the subsidy consists of accelerated deductions for members. However, the casual acceptance of exempting an organization because it will not likely lead to much revenue seems misguided. It is important that in our income tax system we keep a narrow list of organizational types entitled to exemption, as the greater the number of organizations that do not have to pay tax, the higher the tax rate must be for everyone else. Furthermore, the federal tax-exempt status is a signal good that provides to its owner many other valuable benefits. Many states and local authorities grant tax exemptions to organizations simply because the federal government provides exemption. After a while this can add up to significant money. A change at the federal level might encourage some states and local governments to lessen other subsidies provided to these undeserving organizations.

Today, it is hard to imagine that it is administratively more convenient to place business leagues into the tax-exempt category rather than the taxable category. For the organizations, the regulatory environment has become deeply complex and costly. The Form 990, the informational return for tax-exempt organizations, demands significant attention and the organization must manage to steer clear through an increasingly more complex tax-exempt regulatory landscape.

As for the administrative burden of the IRS, the resources of the IRS in its exempt organization division are inadequate to accomplish its

273. Hansen, *supra* note 36 ("Interest groups' service organizations quite ironically are by-products of their lobbying organizations, not the other way around.").

current level of work.²⁷⁴ Also, recent experience at the IRS suggests that the IRS is not a good agency to task with making political decisions.²⁷⁵ The IRS faced serious political trouble for examining whether certain conservative organizations applying to be exempt as § 501(c)(4) social welfare organizations were engaged in too much politics.²⁷⁶ Business leagues, like social welfare organizations, may similarly not primarily advocate for candidates.²⁷⁷ Thus, the rules regarding these organizations put the IRS in a bad position politically. If they enforce the requirement, the IRS can do damage to its reputation. If the IRS does not enforce the requirement, it can do damage to its reputation as well. Eliminating business-league tax exemption would reduce the number of situations in which the IRS is in significant political danger. Eliminating the necessity of the IRS in making that political call would remove one problematic law that it must enforce.

Finally, as noted above, there are some who contend that business leagues simply pool assets.²⁷⁸ Members of a business league are simply collectively providing services each member could provide on their own; business leagues should therefore not be subject to extra tax on individual activity.²⁷⁹ This argument seems to be based on a claim that the trade associations are nothing more than a conduit. The argument assumes that the organization should bear no tax because there is no realization event when a member pays dues and a business league provides a service. A member is simply putting his money in another pocket.

The first difficulty with this assertion is that it would only apply to the charge for member dues. Investment income and income from the sale of services to nonmembers would not be sheltered under this idea. No member could avoid a tax on that income. However, tax exemption for business leagues treats both these forms of income as exempt.

As to the question of member dues, a review of the collective action literature establishes the importance and political usefulness of the collective activity in and of itself. The importance of carrying out business-league activity in a collective sense makes it hard to conclude that business leagues are simply engaging in activities that the members could perform on their own. The very purpose of collective action is to accomplish goals that individual members could not accomplish on their own.

Some scholars following a similar thread to the pooling claim note that if the organization had to pay tax on its retained earnings it might

274. See Philip T. Hackney, *Should the IRS Never "Target" Taxpayers: A Review of the IRS Tea Party Affair*, 48 VAL. U. L. REV. (forthcoming 2015).

275. See *id.*

276. See *id.*

277. See *supra* Part II.C.

278. See Halperin, *supra* note 9, at 134.

279. *Id.* at 134–36; see also Bittker & Rahdert, *supra* note 248, at 357.

simply zero out its income every year.²⁸⁰ A business league could for instance issue a refund to its members on the premise that it charged too much earlier in the year. Effectively, this is the argument that it is administratively convenient to treat business-league activity as tax-exempt. The administratively efficient claim has already been handled above. However, I believe there would be no harm in encouraging these organizations to spend currently. It would ensure that the organization was not building up a war chest to fight future battles aided in part from a subsidy from the government.

D. Concluding Thoughts

Ending tax exemption for these powerful organizations may be politically impossible. A second best option would be to maintain tax exemption but to impose a net investment income tax as is already imposed on other mutual-benefit nonprofit organizations, such as the social club under § 501(c)(7) and the political organization under § 527. This would mean that of the three types of income, only net investment income would be taxed. Thus, while not perfect, it would be a move to slightly reduce the subsidy to business leagues. The Clinton administration proposed this move in the late 1990s, but it was unsuccessful.²⁸¹ One additional positive aspect of this move would be that it would maintain a right to public disclosure of business-league activities.²⁸² We as a society might value that public disclosure via the Form 990 more than the taxes derived from member income or commercial income. Additionally, this move could even one day support a right to obtain disclosure regarding donors for political purposes based on the provision of a subsidy. This could aid in ensuring that the information provided by business leagues is more truthful and thus helpful to legislators and agencies.²⁸³ Thus, the strongest argument for maintaining exempt status might be to use that grant as a means to obtain greater information from these organizations.

What implications might this review have for other tax-exempt organizations beyond business leagues? It has little implication for the charitable sector because charitable organizations are expressly prohibited from intervening in political campaigns and may only do modest amounts of lobbying.²⁸⁴ In other words, while charitable organizations may act as interest groups at times, their ability to do so is quite limited.

280. Bittker & Rahdert, *supra* note 248, at 357.

281. See STAFF OF JOINT COMM. ON TAXATION, 106TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2000 BUDGET PROPOSAL, at 278–81 (Comm. Print 1999); see also Jacob M. Schlesinger, *Clinton Plan to Tax Lobbyists' Investment Gains Hits Home in a Fury of Faxes, Letters, Web Sites*, WALL ST. J., Feb. 17, 1999, at A24.

282. 26 U.S.C. § 6033(a)(2) (2012).

283. See, e.g., Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities*, 71 TEX. L. REV. 1269, 1274 (1993) (arguing for improving the lobbying regulatory regime to encourage “educational advocacy”).

284. 26 U.S.C. § 501(c)(3) (2012).

This analysis in fact could support these lobbying and electoral limitations in part. The analysis should be quite relevant to other mutual-benefit organizations that participate substantially in the political process. Namely, the analysis has ramifications for both social welfare organizations,²⁸⁵ and labor and agricultural organizations,²⁸⁶ both of which typically act in a primary capacity as interest groups. The analysis calls exemption for these organizations into question as well on a presumption that the law gives a subsidy to many of the wrong groups that would have organized whether tax exemption existed or not. One could consider whether exemption is warranted where a certain segment of society, such as the poor, or labor interests, face more severe collective action problems, and suffer significant political voice inequality as a result.²⁸⁷ This question is beyond the scope of this Article, but I plan to turn to these questions in a later article.

III. THE BUSINESS OF BUSINESS LEAGUES: THREE CASE STUDIES

This Part describes the three main types of business leagues and uses three case studies to illustrate their activities. This is offered to provide more context regarding business leagues and to promote a larger understanding of their activities within the legal literature as it relates to taxation. Additionally, it provides an opportunity to test some of the ideas expressed above.

There are no groups that are more engaged in the pressure group business than business interests.²⁸⁸ However, in addition to lobbying, business leagues collect statistics, standardize processes, institute uniform cost accounting, settle trade disputes, and establish codes of ethics.²⁸⁹ Business leagues also work to "stabilize" the market, including sometimes engaging in price fixing.²⁹⁰ Typically, the most significant activity of a business league is as a liaison for the particular business interest to Congress or state and local governments.²⁹¹

Business leagues fall into three main categories: (1) peak organizations (think highly generalized business organizations such as the United States Chamber of Commerce (Chamber), and the National Federation of Independent Business (NFIB)); (2) specific industry trade associations (think the National Beer Wholesalers Association, the Motion Picture Association of America, and the National Council of Textile Organizations); and, (3) professional associations (think bar associations and med-

285. *Id.* § 501(c)(4).

286. *Id.* § 501(c)(5).

287. SCHLOZMAN, VERBA & BRADY, *supra* note 105, at 312-27, 344-46.

288. *See, e.g.*, E. PENDLETON HERRING, GROUP REPRESENTATION BEFORE CONGRESS 78 (1929).

289. *Id.* at 98.

290. *See, e.g.*, LOUIS GALAMBOS, COMPETITION & COOPERATION: THE EMERGENCE OF A NATIONAL TRADE ASSOCIATION 3-10 (1966).

291. HERRING, *supra* note 291, at 98.

ical associations that implement and monitor state-backed licensing systems and establish minimum education requirements). Each of these different types of business leagues provides some other service in addition to political influence, but all share the commonality of attempts to influence governmental policy, i.e., they are interest groups.

A. Peak Organizations

Peak organizations are made up of diverse interests from every spectrum and size of business. Their primary function tends to be to protect and enhance their members' interests before the federal government.²⁹² In addition to representation, peak organizations provide some other selective and purposive incentives to their members, such as discounts on products, subscriptions to publications, and opportunities to network. The Chamber, founded in 1912 at the behest of President Taft,²⁹³ is probably the best known peak organization. In its early iteration, the leaders of the Chamber saw that its most important function was to obtain "the matured judgment of business on national questions and to present and interpret these views to the agencies of government and to the public."²⁹⁴ Its members include both individuals and entities. It includes for-profit and nonprofit businesses in its membership.

The Chamber, like most peak organizations, only takes a position on an issue when it has a supermajority of its membership interested in and agreed upon that issue.²⁹⁵ It cautiously avoids particularistic issues that are of interest to only parts of its membership and lets corporations and trade associations fight these battles instead.²⁹⁶ The Chamber says its members "count on the Chamber to be their voice in Washington, D.C."²⁹⁷ Of all the different types of business leagues, the peak organizations appear to suffer the greatest collective-action problems likely because of the lack of homogeneity of interest—the prime commonality of the peak organization is the interest in business in general.

1. National Federation of Independent Business

The formation and operation of the NFIB is an excellent example of the purposes and activities of a peak organization.²⁹⁸ Its formation story

292. See *supra* Part I.

293. TRUMAN, *supra* note 48, at 85.

294. HERRING, *supra* note 291, at 86 (internal quotation mark omitted).

295. MARK A. SMITH, AMERICAN BUSINESS AND POLITICAL POWER: PUBLIC OPINION, ELECTIONS, AND DEMOCRACY 41 (2000).

296. *Id.*

297. *About the U.S. Chamber of Commerce*, U.S. CHAMBER OF COMMERCE, <https://www.uschamber.com/about-us-chamber-commerce> (last visited June 23, 2015).

298. McGee Young, *Advocacy Innovation and Political Opportunity: Assessing the Rise of the NFIB*, Address Prepared for the 2003 Annual Meeting of the American Political Science Association, 2–3 (Aug. 28–31, 2003), available at http://citation.allacademic.com/meta/p_mla_apa_research_citation/0/6/3/4/5/pages63453/p63453-

fits Salisbury's exchange theory of interest group formation well.²⁹⁹ Founded by an entrepreneur, its salesmen hawked memberships to small businesses around the country.³⁰⁰ It primarily sold purposive incentives. Consistent with the suggestion of Olson, we see that the NFIB as a peak association appeared to face a real collective-action problem.

The NFIB is today an organization of approximately 350,000 members.³⁰¹ It reported revenue of \$103 million and expenses of \$100 million in 2012.³⁰² Its mission is "to organize the independent or small business men into an association to the end that his voice may be heard effectively in local, state, and national affairs affecting small business."³⁰³ It vigorously engages with the political process. For example, it helped Republicans to victory in the mid 1990s and helped to stymie Bill Clinton's health reform.³⁰⁴ Most recently, it tried to stop the Barack Obama's Affordable Care Act.³⁰⁵

C. Wilson Harder founded the NFIB in 1943 in the San Francisco Bay area.³⁰⁶ Harder, a small business owner active in the Chamber, formed the NFIB in response to frustration that the Chamber represented the interests of large businessmen rather than small businessmen.³⁰⁷ World War II imposed challenges on businesses by increasing demand for their services while also depleting the labor force. During the war, after prodding by the Chamber, the government implemented rules that Harder believed helped large businesses at the expense of the small businesses.³⁰⁸ Harder took umbrage at unfair trade practices and issues of distribution that he believed these rules protected and encouraged. Harder believed the government implemented these rules because the small businessman lacked a sufficient voice in Congress.³⁰⁹

To make the NFIB work, Harder believed he needed a strong sales model; but he made a decision to only seek members from independent

1.php. Much of the information for this case study on the NFIB comes from McGee Young's examination of the NFIB.

299. See Part I.B.2.

300. See *id.* at 7.

301. *Members of Congress Honored as Guardians of Small Business by NFIB*, NAT'L FED'N OF INDEP. BUS. (Sept. 12, 2012), <http://www.nfib.com/article/?cmsid=60967>.

302. National Federation on Independent Business 2012 Tax Form, I.R.S. Income Tax Form 990, pt. I, *ll.* 12, 18, [hereinafter 2012 NFIB Form 990], available at <http://www.guidestar.org/FinDocuments/2012/940/707/2012-940707299-097ff0c2-90.pdf> (last visited June 23, 2015).

303. *National Federation of Independent Business Inc. Mission Statement*, GUIDESTAR, <http://www.guidestar.org/organizations/94-0707299/national-federation-independent-business.aspx> (last visited June 23, 2015).

304. Young, *supra* note 301, at 3.

305. See *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

306. Young, *supra* note 301, at 3.

307. *Id.* at 4.

308. *Id.*

309. *Id.*

businesses that did not dominate a field.³¹⁰ He sold small businessmen the right to effective representation in Washington D.C. In addition to representation before Congress, the NFIB provided a newsletter to its members called the *Mandate*.³¹¹ With one lobbyist in Washington, Harder kept a lean policy staff but employed a large sales force that extended over 200 districts across the country.³¹² Entitled to a 50% commission on first year dues, the sales force, not unsurprisingly, aggressively recruited members.³¹³

The sales force recruited members using the anger harbored by many smaller businessmen toward the government from post-New Deal programs that privileged large firms over small.³¹⁴ In the opinion of many small businessmen, the large firms set all industry-wide codes and those codes were set intentionally to assist large industry to the detriment of independent business.³¹⁵ To sell NFIB membership, salesmen would bring a copy of the newsletter *Mandate* to the small businessmen they visited.³¹⁶ The *Mandate* conducted a monthly poll of its members on an issue important to small businessmen.³¹⁷ In the poll it provided the members the pros and cons on the issue that it was polling.³¹⁸ The organization would then share the results of these polls with congressmen to attempt to sway them.³¹⁹ While this model was successful at enrolling members, the NFIB experienced a high membership turnover rate.³²⁰

Harder focused on sales, while the NFIB lobbyist represented the organization in Washington D.C.³²¹ The lobbyist, George Burger, had a strong connection to the National Association of Independent Tire Dealers.³²² Burger pushed the NFIB to advocate the issues that concerned independent tire dealers—namely issues surrounding an anti-monopoly position.³²³ Burger ignored opportunities for war contracts for small businessmen, and problems with the consolidation of small manufacturers.³²⁴

The NFIB developed a model of influence based on providing effective polling of constituents.³²⁵ The evidence, however, does not show

310. *Id.*

311. *Id.* at 5.

312. *Id.*

313. *Id.*

314. *Id.*

315. *Id.*

316. *Id.* at 6.

317. *Id.*

318. *Id.*

319. *Id.*

320. *Id.* at 6, n.15.

321. *Id.*

322. *Id.* at 7. See also, HARMON ZEIGLER, THE POLITICS OF SMALL BUSINESS 28 (1961).

323. Young, *supra* note 301, at 7.

324. *Id.* at 8.

325. *Id.* at 9.

that the effort had tremendous impact on legislation. Even the small business legislation that was passed, the Small Business Act of 1953 (SBA), did not have the backing of NFIB.³²⁶ Although the SBA did specify a pro-small-businessman policy, the NFIB strongly preferred that small businessmen be able to appeal directly to Congress rather than have to work through a governmental agency to influence policy. Nevertheless, Congress established the Small Business Administration anyway.³²⁷ This happened in spite of some opposition from the small business lobby.³²⁸ Because the NFIB had little interest in the bill, the bill ended up being drafted to satisfy the interests of members of Congress rather than the interests of the members of the NFIB.³²⁹ In the 1980s the NFIB helped to dismantle the program.³³⁰

With the death of Harder in 1968, the organization changed its lobbying efforts.³³¹ It instituted systems to keep track of congress members' votes and conspicuously recognized those members who supported the organization's positions.³³² The NFIB showed its strength in the early 1990s in the battle over President Clinton's planned health care overhaul.³³³ Knowing that they had most Republican's on board, the NFIB went after Democrats in their districts. They hosted meetings in the districts of the targeted Democrats to put them on the spot regarding how they would vote on healthcare.³³⁴ The NFIB quickly won the support of Max Baucus, an influential Democratic senator from Montana.³³⁵ They managed to be one of the main groups to have stopped the Clinton health plan momentum.³³⁶ They did this by applying local pressure to targeted congressmen.

The NFIB quickly became, and appears to continue to be, closely aligned with the Republican Party. The NFIB recruits candidates, funds candidates, and encourages its members to vote for these candidates on an election day.³³⁷ It continues to rely on a strong sales effort to attract members but also sells some selective incentives, such as insurance, financial services deals, and human resources support.³³⁸ It appears, though, to rely heavily on the sale of purposive incentives. Judging from its continued partisan stance, such as being the primary plaintiff in the

326. *Id.* at 11.

327. *Id.* at 11–13.

328. *Id.* at 11.

329. *Id.*

330. *Id.* at 15.

331. *Id.* at 16.

332. *Id.* at 17.

333. *Id.* at 24–28.

334. *Id.* at 25–26.

335. *Id.*

336. *Id.* at 27.

337. *Id.* at 29.

338. See *Member Vantage*, NAT'L FED'N OF INDEP. BUS., <http://www.nfib.com/member-vantage/> (last visited June 23, 2015).

major case against Obamacare,³³⁹ its members appear to join because of the strong free-market stance they see the organization take.

The NFIB raised \$86 million of its \$103 million in revenue in 2012 from membership fees.³⁴⁰ It has historically earned most of its money through these membership fees.³⁴¹ Until 2010 its largest single donation from a group outside its membership was \$21,000.³⁴² In 2010, though, and the years following, it received larger contributions such as a \$3.7 million contribution from Karl Rove's Crossroads GPS.³⁴³ The NFIB also earned about \$2 million in investment income and around \$5 million from a combination of advertising, affiliate management income, and sponsorship income.³⁴⁴ Presumably some of these amounts are from the various products and services, i.e., selective incentives, the NFIB makes available on its website such as discounts on business and financial services, insurance, and HR support for its members.³⁴⁵ In 2012 the NFIB acknowledged \$65,000 in political expenditures to support candidates, and spent \$44 million of its \$100 million to lobby Congress and other legislative bodies.³⁴⁶

The following is an extremely rough, non-scientific, attempt at determining whether the NFIB has solved its collective-action problem. The Small Business Administration estimates that there are 23 million small businesses in the United States³⁴⁷ and the NFIB counts around 350,000 members. If we made a likely incorrect assumption that none of those 350,000 members represented double counting for any business, then NFIB enrolled about 1.5% of its potential audience.³⁴⁸ This could suggest that the NFIB faces a real collective-action problem. Perhaps though, it is possible to view the NFIB's audience differently than all small businesses. Unlike the Chamber, the NFIB adopts a strident political stance; thus, the NFIB's potential members are drawn from a much smaller set. Given the strident stance, it is possible that the total possible audience that the NFIB appeals to is some smaller fraction of those 23 million small businesses. Some estimate that obtaining more than 5% of a relevant group suggests the collective-action problem has been

339. See *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

340. 2012 NFIB Form 990, *supra* note 305, at pt. I, l. 9.

341. Josh Harkinson, *Meet the Front Group Leading the Fight Against Taxing the Rich*, MOTHER JONES (July 23, 2012, 6:00 AM), <http://www.motherjones.com/politics/2012/07/national-federation-independent-businesses>.

342. *Id.*

343. *Id.*

344. 2012 NFIB Form 990, *supra* note 305, at pt. I, ll. 10–11.

345. *Member Vantage*, NAT'L FED'N OF INDEP. BUS., <http://www.nfib.com/member-vantage/> (last visited June 23, 2015).

346. See 2012 NFIB Form 990, *supra* note 305, at pt. I, l. 18, pt. IX, l. 25, sched. C, pt. I-A, l. 1, sched. C, pt. III-B, l. 1.

347. See *Small Business Trends*, SMALL BUS. ADMIN., <http://www.sba.gov/content/small-business-trends> (last visited Mar. 29, 2014).

348. See *About NFIB*, NAT'L FED'N OF INDEP. BUS., <http://www.nfib.com/about-nfib> (last visited June 23, 2015).

solved.³⁴⁹ If it turned out that the NFIB only appealed to 25% of the small business audience, this would represent 6% of the desired audience. Determining whether an organization has solved a collective-action problem depends on the group you determine it is trying to appeal to. In any case, it has been quite successful as a peak association at raising money and accomplishing some real results with its 350,000 members.

B. Trade Associations

Trade associations represent the interests of the owners and managers of industries like car manufacturers or textile mills. In addition to organizing to minimize competition in their line of business, industry players form trade associations to lobby government for beneficial laws and to stop the government from harming industry interests. Just like peak associations, trade associations formed in greatest numbers during times of legislative change and during war. In the case study below you will see the cotton trade organizing to fight labor laws it found harmful to industry interests. Additionally they formed to obtain government assistance to scientifically manage the output of the industry to reduce what they perceived as harmful competition.

In 1921 Emmett Naylor reported that there were about 1,000 trade associations in the United States.³⁵⁰ They have grown significantly since that time, although an exact number is hard to obtain. We have IRS data on the total number of business leagues, but we do not have a breakdown of how many trade associations there are within that group. In 2012 the IRS indicated that there were around 64,000 total business leagues registered with the IRS.³⁵¹

1. Cotton Textile Institute

Louis Galambos provides a case study on the formation, activity, and maintenance of a national trade association by tracing the origins of the Cotton Textile Institute.³⁵² The overwhelming message is that trade associations form to stabilize the business of the current industry players. Northern and southern cotton firms competed mightily in the late 1800s and the industry players saw this competition as disastrous to the industry. While the industry appears never to have been successful in stabilizing, its organizing effort led to some fairly significant lobbying success.

The Cotton Textile Institute began with loose associations at a regional level. Three organizations, two in the northeast and one in the

349. MARK IRVING LICHBACH, *THE COOPERATOR'S DILEMMA* 7–13 (1996).

350. EMMETT HAY NAYLOR, *TRADE ASSOCIATIONS: THEIR ORGANIZATION AND MANAGEMENT* 13 (1921).

351. There were around 63,000 business leagues registered with the IRS in 2012 according to the Nonprofit Almanac 2012 based on data from the IRS. KATIE L. ROEGER, AMY S. BLACKWOOD & SARAH L. PETTIJOHN, *THE NONPROFIT ALMANAC 2012*, at 4 tbl.1.1 (2012).

352. GALAMBOS, *supra* note 293, at viii, 3–7, 10.

south, stand out: the New England Cotton Manufacturers Association and the Arkwright Club in the northeast, and the Southern Cotton Spinners Association in the south.³⁵³

The New England Cotton Manufacturers Association was the first to form in 1865 in the wake of the Civil War as the cotton industry faced significant technological change and increase in demand.³⁵⁴ Mill agents sought an opportunity to commune with other agents to stay on top of rapidly changing technological developments.³⁵⁵ Starting with forty agents in 1865, the organization grew to almost 500 individual members in twenty different states, including the north and the south.³⁵⁶ It contained almost all of the mills in New England.³⁵⁷ Until the late 1800s it operated with almost no staff and little money.³⁵⁸ For those forty years it primarily operated as a gathering place of cotton mill operators seeking to share technological information at formally arranged dinners and conferences.³⁵⁹ In the 1890s, some members sought to use the Association as the political voice of the mills, but this effort was shot down.³⁶⁰

Only the leading mill manufacturers formed the Arkwright Club in 1880.³⁶¹ These manufacturers intended to engage in “concerted action” to protect the interests of the mills.³⁶² The leading cause of the formation of the Club appears to be legislation in Massachusetts limiting the work hours of women and children.³⁶³ The Arkwright started with a limit of fifty members who had to be officers; it grew to 114 members by 1900.³⁶⁴ The Arkwright was well financed by members who came primarily from the older, larger, more established mills.³⁶⁵ It imposed a charge on the payroll amount of member mills, which allowed the Arkwright to develop a professional staff by the 1890s.³⁶⁶ Its primary purpose was to lobby.³⁶⁷

Over dinner, Arkwright members would determine the position they should take on state or federal legislation.³⁶⁸ Members themselves handled most of the lobbying; the Arkwright at this time would only occasionally hire an agent to lobby on its behalf.³⁶⁹ In addition to lobbying,

353. *Id.* at 11.

354. *Id.* at 20.

355. *Id.*

356. *Id.* at 21.

357. *Id.*

358. *Id.*

359. *Id.* at 21–22.

360. *Id.* at 22.

361. *Id.* at 23.

362. *Id.*

363. *Id.* at 24.

364. *Id.*

365. *Id.*

366. *Id.* at 25.

367. *Id.*

368. *Id.*

369. *Id.*

the members attempted to stabilize prices in the industry by establishing "curtailment programs" and sharing price lists.³⁷⁰

The southern organization was later to organize; the cotton textile industry began in the northeast and only later moved to the south.³⁷¹ Although loose affiliations formed from time to time in the south, they typically folded quickly.³⁷² In 1897, with anemic participation, forty cotton manufacturers from the south formed the Southern Cotton Spinners Association.³⁷³ Made up of any officer of a mill, the organization accepted individual members rather than corporate memberships and thus did not have the money of an Arkwright.³⁷⁴ The southern group focused on stabilizing the industry through price control and product control.³⁷⁵

Galambos refers to this period as the "dinner-club" period of trade associations.³⁷⁶ The primary form of organization were loosely knit groups that met over dinner to discuss shared issues and ideas that members wanted to promote within the industry, and sometimes in a more public sense.³⁷⁷ Trade associations did not become sophisticated professional, staff-operated associations until the next century. In the early 1900s this movement began as the northern mills began to experience the intense competition from the southern mills.³⁷⁸ Although World War I stymied competition a little because of increased opportunity for the trade, after the war the competition made the northern mill operations look dire. In a new twentieth century vision of industry cooperation the mills developed "stability, teamwork, and systematic controls" by working together through these associational structures.³⁷⁹

Cotton textile associations also worked to counter the success of the progressive movement on the labor and regulatory front. In the early 1900s the progressive movement achieved some success in opening government to public pressure.³⁸⁰ New regulatory agencies such as the Food and Drug Administration and the Federal Trade Commission also made it necessary for business to have a larger infrastructure with skilled individuals capable of communicating to a sophisticated bureaucratic structure.³⁸¹ To respond to these new forces, the cotton textile industry created a service association with the professional staff. The Arkwright Club and the New England Association both expanded and created divisions to

370. *Id.* at 27-29.

371. *Id.* at 30.

372. *Id.*

373. *Id.* at 30-31.

374. *Id.* at 31.

375. *Id.*

376. *Id.* at 33.

377. *Id.*

378. *Id.* at 40.

379. *Id.* at 46.

380. *Id.* at 49.

381. *Id.* at 50.

handle new needed functions; these included: dispute resolution, classification of products, gathering of statistics, and legislative relations³⁸² By 1913, the organizations were able to form an interregional group to represent the entire industry.³⁸³

During the First World War the government worked hard to organize the mills. The government used the associations to coordinate the war effort.³⁸⁴ Herbert Hoover, head of the Department of Commerce at the time, strongly encouraged the efforts of trade associations to stabilize industry through standardization of products, and to cooperate on cost accounting methods, all in order to improve efficiency.³⁸⁵ However, even with government help, the cotton textile mills could not cooperate to fix prices or limit production.³⁸⁶ The southern mills had a significant labor cost advantage and were unwilling to engage with the larger cotton textile mills.³⁸⁷

In the mid 1920s the industry went into a depression; this financial crisis led to the formation of the Cotton Textile Institute (CTI), a national organization with substantial resources. The formation of this organization was made possible by changes at the executive and judicial levels of government. Many policymakers, such as Herbert Hoover, believed strongly in the need to liberalize the US policy on antitrust.³⁸⁸ Additionally, in the 1920s a couple decisions of the Court liberalized anti-trust policy and finally provided industry leeway to coordinate action and prices.³⁸⁹ These changes in ideology regarding competition at the executive and judicial level allowed the cotton textile sector to feel freer to seek cooperation from both the mills of the south and the north. In order to get the backing of the federal government, the mill owners agreed that this new national organization would not seek to influence legislation.³⁹⁰ The CTI was founded in October 1926 to establish an open price plan in order to avoid producing excess capacity.³⁹¹

While today many may harbor concerns regarding price fixing, or even open price plans, it is interesting to consider the ingredients that the CTI used to accomplish these goals. These ingredients are still a major part of trade association work today. To accomplish the open price plan

382. *Id.* at 55–56.

383. *Id.* at 57.

384. *Id.* at 65–66.

385. *Id.* at 67.

386. *Id.* at 70–71.

387. *Id.* at 71.

388. *Id.* at 93.

389. GALAMBOS, *supra* note 293, at 89–112. *Maple Flooring Mfrs. Ass'n v. United States*, 268 U.S. 563, 580–84 (1925) (citing *Am. Column & Lumber Co. v. United States*, 257 U.S. 377 (1921); *United States v. Am. Linseed Oil Co.*, 262 U.S. 371 (1923)).

390. *Id.* at 102.

391. *Id.* at 103–04.

the CTI had to standardize cost accounting techniques.³⁹² They had to normalize the sharing of information and the coordination of product lines.³⁹³ These activities all helped to naturally ease the worst problems of excess capacity because the members now were freely sharing information using a common language.³⁹⁴ A further implication though was that “The association programs were created to preserve an existing industrial structure which included, most prominently, the organization’s members.”³⁹⁵ In other words, this trade association worked to preserve in place the members of the association, and to either maintain or increase their respective market share. It is likely that most business leagues work towards some similar effort.

Even with significant pressure from CTI and the government during the Depression, the mills could not cooperate to fix prices.³⁹⁶ CTI did achieve success, however, as the central mouthpiece of the cotton manufacturing trade. The Institute’s leaders came to be respected voices of the industry, particularly before the government.³⁹⁷ CTI was particularly successful in persuading Congress to pass the constitutionally ill-fated National Industrial Recovery Act.³⁹⁸ As Galambos says, “voluntarism was being replaced by majority control with coercion of the recalcitrant minority.”³⁹⁹ CTI formed a committee under authority of the Recovery Act to draft a code to govern the cotton textile industry. Cotton manufacturers took a command of their industry and became its main voice.⁴⁰⁰ However, the Court struck down the Recovery Act that had provided the support for the development of an industry code with the backing of the government, in 1935, and the industry had to go back to its normal associative activity.⁴⁰¹

CTI no longer exists. It appears that the modern day representative of CTI is the National Council of Textile Organizations (NCTO) through a circuitous route of a somewhat dying US industry.⁴⁰² In the 1940s, CTI primarily represented the northern mills; it joined forces with the Cotton Manufacturer’s Association, representing mostly southern mills to form the American Cotton Manufacturer’s Institute (ACMI).⁴⁰³ ACMI changed its name in 1962 to the American Textile Manufacturer’s Institute (ATMI) to recognize the reality of competing synthetic fabrics par-

392. *Id.* at 106.

393. *Id.*

394. *Id.*

395. *Id.* at 111.

396. *Id.* at 164–66.

397. *Id.* at 137–38.

398. *See* A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 542 (1935).

399. GALAMBOS, *supra* note 293, at 201.

400. *Id.* at 233.

401. *Schechter Poultry*, 295 U.S. at 542.

402. *See* Aminul Haque, *Textile Organizations*, TEXTILE TERMINAL (Mar. 16, 2013, 8:13 PM), <http://textilestand.blogspot.com/2013/03/textile-organizations.html>.

403. D. CLAYTON BROWN, KING COTTON IN MODERN AMERICA 291 (2011).

ticularly from foreign markets.⁴⁰⁴ The new organization worked to protect the American industry from foreign competitors, but it appears that these efforts were generally unsuccessful.⁴⁰⁵

On April 1, 2013, the ATMI merged with two other trade associations from other parts of the textile industry to form the NCTO.⁴⁰⁶ The NCTO is small, with a little less than \$2 million in revenue. It describes its current mission as being the representative of the textile industry.⁴⁰⁷ “From fibers to finished products, from machinery manufacturers to power suppliers, NCTO is the voice of the U.S. textile industry,” and seeks “to advance the interests of the U.S. textile sector” on an international stage.⁴⁰⁸

This history of CTI shows at once the challenges of forming and maintaining a trade association, but also the incipient nature of such associations as a result of the availability of readily identifiable players, the resources to organize, and a strong identification of goals. War efforts tend to make the U.S. government feel dependent upon such organizations; this dependency provides trade associations extra force in their organizing effort. The government will provide assistance to ensure these organizations are able to form. The cotton trade associations were able to regularly organize well over a majority of the industry and had particularly easy success on the issue of organizing to speak for the industry in front of government. Interestingly in comparison to the NFIB, the Cotton Textile Institute mounted a strong effort against anti-trust policy, while the NFIB, expressly created for small businessmen, pushed exactly the other way.

C. Professional Associations

Professional associations represent groups such as lawyers, doctors, scientists, architects, historians, engineers, and the specialty groups associated with such professions.⁴⁰⁹ In general, the professions require a certain prescribed course of education that the association establishes; professional associations typically require a college degree.⁴¹⁰ Like business leagues in general, professional associations come in the form of peak associations as well as regional and specialty associations.

404. *Id.* at 295.

405. See PIETRA RIVOLI, *THE TRAVELS OF A T-SHIRT IN THE GLOBAL ECONOMY* 145–47 (2d ed. 2009).

406. *We've Moved!*, NAT'L COUNCIL OF TEXTILE ORG., <http://www.nationaltextile.org> (last visited June 23, 2015).

407. *Mission Statement*, NAT'L COUNCIL OF TEXTILE ORGS, <http://www.ncto.org/about-ncto/mission-statement/> (last visited June 23, 2015).

408. *Id.*

409. SCHLOZMAN, VERBA & BRADY, *supra* note 105, at 327.

410. *Id.*

This section examines the American Medical Association (AMA). It is one of the oldest professional associations in the United States and has managed to amass a large percentage of the doctors of the United States into its membership. Approximately 15% of all doctors belonged to the AMA in 2011, down from 75% in the early 1950s.⁴¹¹ It has been studied from many different angles, especially in Paul Starr's, *The Social Transformation of American Medicine*.⁴¹² The AMA states that its mission is to "promote the art and science of medicine and the betterment of public health."⁴¹³

1. American Medical Association

State-based medical societies began forming in the late 1700s contemporaneously with the formation of medical schools.⁴¹⁴ State societies worked to elevate their profession by instituting licensing mechanisms and required education.⁴¹⁵ Nathan Smith Davis, a leader in the New York Medical Society, helped organize the AMA in 1847.⁴¹⁶

The New York Medical Society felt the need for a national organization because it was considering adopting new standards to apply to New York medical schools.⁴¹⁷ The New York medical schools feared that if national standards were not raised, their new standards would be for naught.⁴¹⁸ If New York were to put more stringent standards on its students, but the rest of the country's medical societies failed to act in this way, it was believed that students would largely leave the New York medical education institutions.⁴¹⁹ To further this motivation, in its first acts, the AMA established standards for medical education and drafted a medical code of ethics.⁴²⁰ In 1849 the AMA established a board to "analyze quack remedies" and to educate the public about such matters.⁴²¹ It founded the *Journal of the American Medical Association* in 1883, which

411. Roger Collier, *American Medical Association Membership Woes Continue*, 183 CANADIAN MED. ASS'N J., no. 1, 2011, at E713, available at <http://www.cmaj.ca/content/183/11/E713.full>.

412. PAUL STARR, *THE SOCIAL TRANSFORMATION OF AMERICAN MEDICINE* (1982).

413. *AMA Mission & Guiding Principles*, AM. MED. ASS'N, <http://www.ama-assn.org/ama/pub/about-ama/our-mission.page> (last visited Mar. 29, 2014).

414. OLIVER GARCEAU, *THE POLITICAL LIFE OF THE AMERICAN MEDICAL ASSOCIATION* 14 (1961).

415. *Id.*

416. *See Our Founder, Nathan Smith Davis*, AM. MED. ASS'N, <http://www.ama-assn.org/ama/pub/about-ama/our-history/the-founding-of-ama/our-founder-nathan-smith-davis.page> (last visited June 23, 2015).

417. STARR, *supra* note 415, at 90–91.

418. *Id.*

419. *Id.*

420. *AMA History Timeline*, AM. MED. ASS'N, <http://www.ama-assn.org/ama/pub/about-ama/our-history/ama-history-timeline.page> (last visited June 23, 2015).

421. *Id.*

for a long time was the AMA's chief moneymaker and perhaps chief reason for joining the AMA.⁴²²

The founders of medical societies in the nineteenth century were neither the elite doctors, who had nothing to fear from "quacks," nor the hacks at the very bottom of the medical profession, who rightly feared no longer being able to practice their craft, but those folks in the middle who wanted to establish some distinction between themselves and the quacks and the hacks.⁴²³ Starr notes that while the AMA was successful in organizing, the AMA was generally unsuccessful in its first half century in its primary goal of implementing a licensing regime to exclude certain physicians from entry into the profession.⁴²⁴ Because the AMA was not successful during this period in enacting these licensing schemes, it was difficult to achieve significant membership.⁴²⁵ Additionally, the members of the medical profession did not need capital or hospitals to practice their craft so there were not significant pressure points the AMA could use to force membership.⁴²⁶

As in the case of cotton interests, the AMA began achieving organizing success at the turn of the twentieth century. By 1900, while the AMA had persuaded states to adopt licensing regimes, it still only had 8,000 members, which amounted to about 8% of all doctors at that time.⁴²⁷ By contrast, 33,000 doctors belonged to the state medical societies and another 77,000 belonged to no society.⁴²⁸

The AMA modified its membership and organizational structure at the turn of the century from a member-driven organization to one controlled by the state medical societies. In 1901, the AMA adopted new rules creating its house of delegates that still exists today.⁴²⁹ The state medical societies elect representatives to serve on this policy making body of the AMA.⁴³⁰ The move from direct democracy to representative democracy allowed the state societies to exercise greater control of the national organization.⁴³¹ This change was tremendously effective for both the state societies and the AMA. State societies experienced huge increases in membership from 1902 to 1904.⁴³²

With these significant successes in hand, the AMA turned to medical education. The doctors of the AMA still believed there were too

422. GARCEAU, *supra* note 417, at 16.

423. STARR, *supra* note 415, at 90.

424. *Id.* at 91.

425. *Id.* at 92.

426. *See id.* at 90.

427. *Id.* at 109.

428. *Id.*

429. GARCEAU, *supra* note 417, at 15.

430. STARR, *supra* note 415, at 109.

431. *Id.* at 110.

432. *Id.* For example the membership in Ohio went from 992 to 2640, and in Tennessee from 386 to 1,097.

many doctors.⁴³³ While medical education became more rigorous in the late nineteenth century,⁴³⁴ medical schools continued to form and the number of doctors practicing medicine increased at a rate faster than the AMA desired.⁴³⁵ The AMA directly attacked this problem by reducing the number of medical schools. In 1904, the AMA created a Council on Medical Education which immediately imposed more rigorous requirements on medical schools.⁴³⁶ The AMA required that to enter medical school, a student needed four years of high school.⁴³⁷ Further, to graduate from medical school, a medical student needed four years of medical education and was required to pass a licensing test.⁴³⁸ Finally, the AMA began to inspect medical schools to ensure accord with these new requirements.⁴³⁹

The changes altered the economics of medical education. The number of medical schools decreased from 162 to 131 in four years (i.e., by 1910) and decreased to 95 by 1915.⁴⁴⁰ Most fundamentally though, the AMA made a cultural change in who trained new doctors. Instead of practicing doctors training new doctors, scientists and researchers took over this role.⁴⁴¹ These changes caused a tremendous homogenization in the social makeup of doctors, and while women had been going to medical schools, it now pushed them away.⁴⁴² The new requirements shut down five of seven medical schools that trained black students.⁴⁴³ Finally, these changes reduced access to doctors in rural and poor areas.⁴⁴⁴

Closing the ranks of the profession was not the sole goal of the AMA. It also saw patent drug makers as a competitor as well.⁴⁴⁵ By joining forces with muckraking journalists, the AMA managed to significantly alter the drug business to the benefit of doctors.⁴⁴⁶ After the turn of the century, with political pressure, the AMA helped to pass the Pure Food and Drug Act regulating acceptable food and drugs.⁴⁴⁷ The AMA established the Council on Pharmacy and Chemistry to test drugs in its own laboratory to enforce the new law itself.⁴⁴⁸ This began a shift in the sale of drugs in the United States—instead of a drug company selling drugs

433. *Id.* at 112.

434. *Id.* at 115.

435. *Id.* at 112.

436. *Id.* at 117.

437. *Id.*

438. *Id.*

439. *Id.* at 118.

440. *Id.* at 118, 120.

441. *Id.* at 123.

442. *Id.* at 124.

443. *Id.*

444. *Id.* at 125.

445. *Id.* at 127.

446. *Id.* at 129.

447. Food and Drug Act of 1906, ch. 3915, 34 Stat. 768 (repealed 1938); STARR, *supra* note 415, at 131.

448. STARR, *supra* note 415, at 129, 131.

directly to the public, the drug companies began to sell drugs through physicians.⁴⁴⁹ “This strategic gatekeeping role permitted the AMA, in effect, to levy an advertising toll on the producers.”⁴⁵⁰

These legislative forays that generated power for the medical profession over matters related to the medical business were effective for doctors. Doctor income grew twice as fast as the rest of the economy from the turn of the century to about 1928.⁴⁵¹ Additionally, the social status of doctors increased tremendously.⁴⁵² Thus unlike the cotton trade manufacturers, who perhaps had an easier time organizing, the doctors appear to have achieved greater success in the price stabilization game, and in fact, in the increasing price game.

Twenty trustees govern the AMA today.⁴⁵³ Its House of Delegates still acts as its policy making body.⁴⁵⁴ The delegates come from medical associations (state or territorial), national medical specialty organizations, professional interest medical associations, the five federal services, and several of the AMA’s member sections and groups.⁴⁵⁵ There are over 500 voting members of the governing body; many other members are allowed to observe twice annually held meetings.⁴⁵⁶ The AMA also operates seven councils that develop and share expertise on issues of ethics, science, and medical education.⁴⁵⁷

The AMA offers a variety of selective incentives to members, and also some incentives that appear to have a compulsory nature. It sells regulatory administrative help, insurance, legal assistance, education, and information.⁴⁵⁸ More significantly, it controls an important code called the Current Procedural Technology code (CPT Code) that determines how any medical procedure is reimbursed by Medicare, and consequently other insurers.⁴⁵⁹ The AMA made about 28% of its revenue from the

449. *Id.* at 132.

450. *Id.* at 134.

451. *Id.* at 142.

452. *Id.* at 143.

453. *Biographies of the Members of the AMA Board of Trustees*, AM. MED. ASS’N, <http://www.ama-assn.org/ama/pub/about-ama/our-people/board-trustees/our-members.page?> (last visited June 25, 2015).

454. *The Delegates*, AM. MED. ASS’N, <http://www.ama-assn.org/ama/pub/about-ama/our-people/house-delegates/the-delegates.page> (last visited June 23, 2015).

455. *Id.*

456. *Id.*

457. *Our People*, AM. MED. ASS’N, <http://www.ama-assn.org/ama/pub/about-ama/our-people.page?> (last visited June 23, 2015).

458. *AMA Resources*, AM. MED. ASS’N, <http://www.ama-assn.org/ama/pub/physician-resources.page> (last visited June 23, 2015).

459. See Avik Roy, *Why the American Medical Association Had 72 Million Reasons to Shrink Doctors’ Pay*, FORBES (Nov. 28, 2011, 11:50 AM), <http://www.forbes.com/sites/theapothecary/2011/11/28/why-the-american-medical-association-had-72-million-reasons-to-help-shrink-doctors-pay/>; John Weeks, *The AMA’s \$70-Million Taxation Without Representation: Is it Time for a “CPT Party” Revolt?*, THE INTEGRATOR BLOG (Oct. 20, 2010), http://theintegratorblog.com/index.php?option=com_content&task=view&id=701&Itemid=1.

CPT code in 2012.⁴⁶⁰ In order to practice in the health field today, a medical practitioner or medical entity must purchase the rights to this Code. The AMA makes almost twice as much off its operation of the CPT Code as it does from membership revenue.⁴⁶¹

According to its 2012 Form 990 the AMA earned almost \$250 million in revenue.⁴⁶² Approximately \$39 million came from membership fees.⁴⁶³ It earned another \$56 million from what it refers to as subscriptions and also from items such as credentialing services, educational programs and graduate medical programs.⁴⁶⁴ It earned about \$10 million through investment income and another \$70 million from royalty income (the income from the CPT Code).⁴⁶⁵ The AMA earned another \$8 million from the sale of securities and earned a little over a million from rental of property.⁴⁶⁶ Finally the sale of inventory brought the AMA \$32 million, while the advertising brought in \$19 million.⁴⁶⁷

AMA revenue exceeded expenses by about \$15 million in 2012.⁴⁶⁸ Its revenues exceeded expenses by \$21 million in 2011.⁴⁶⁹ It reports that at the end of 2012 it had net assets of \$385 million.⁴⁷⁰ It reported to the IRS that it spent about \$16 million on lobbying.⁴⁷¹ According to *OpenSecrets.org* the AMA was one of the largest lobbying spenders in 2013.⁴⁷² In the 113th Congress, the AMA lobbied on over sixty different bills including on matters such as the Medicare Patient Empowerment Act of 2013, Protecting Seniors' Access to Medicare Act of 2013, and the SKILLS Visa Act.⁴⁷³

D. Case Study Conclusion

This section demonstrated the idiosyncratic and in part historical nature of different types of business leagues that have formed, but also

Peter Whoriskey & Dan Keating, *Medical Panel Uses Data that Distort Doctors' Pay*, WASH. POST, July 20, 2013, at A01.

460. See 2012 AMA Form 990, *supra* note 244, at pt. VIII, ll. 5, 12; see also Roy, *supra* note 462.

461. See 2012 AMA Form 990, *supra* note 244, at pt. VIII, ll. 1b, 5.

462. See 2012 AMA Form 990, *supra* note 244, at pt. VIII, l. 12.

463. See *id.* at pt. VIII, l. 1b.

464. See *id.* at pt. VIII, l. 2.

465. See Roy, *supra* note 462; Weeks, *supra* note 462.

466. See 2012 AMA Form 990, *supra* note 244, at pt. VIII, ll. 6a, 6c.

467. See *id.* at pt. VIII, ll. 10c, 11a.

468. See *id.* at pt. XI, l. 3.

469. See American Medical Association 2011 Tax Form, I.R.S. Income Tax Form 990, pt. XI, l. 3, available at <http://www.guidestar.org/FinDocuments/2011/360/727/2011-360727175-08d94e94-90.pdf> (last visited June 23, 2015) (showing AMA's completed I.R.S. Form 990 for the 2011 tax year).

470. See 2012 AMA Form 990, *supra* note 244, at pt. XI, l. 10.

471. See *id.* at sched. C, pt. III-B, l. 2a.

472. *Organization Profiles*, OPENSECRETS, <http://www.opensecrets.org/orgs/> (last visited June 23, 2015).

473. *American Medical Assn: Bills Lobbied*, OPENSECRETS, <http://www.opensecrets.org/orgs/lobby.php?id=D000000068> (last visited June 23, 2015).

demonstrates the incipient nature of the organizations of well-defined business interests. Notably, each of the organizations studied is, at heart, an interest group seeking to influence the governmental process. A strong anti-market and protectionist flavor imbues both the trade associations and the professional associations. Some peak organizations, like the NFIB oppose this big business perspective. Finally, we see the readily identifiable finite groups that business leagues represent. These business interests possess the skilled individuals and well structured organizations that allow business interest to organize efficiently and effectively. Furthermore, the government often provides support and power to these organizations and relies on them to support various government interests.

Most importantly perhaps for purposes of this Article each of these organizations would have formed with or without the subsidy of exemption. We should thus expect as argued above that the subsidy of exemption brings more of these organizations into existence leading to some oversupply of a good or service that is already provided in sufficient quantity.

CONCLUSION

This Article demonstrated that the organizations we exempt from income tax under § 501(c)(6) are first and foremost interest groups. Business leagues seek to obtain goods and services from the government that can be helpful to their membership. Because tax exemption for these mutual-benefit organizations is a subsidy, we should want to justify this treatment. The predominant theory of tax exemption holds that tax exemption provides a subsidy to aid the formation of groups that provide public goods or goods subject to market failure. While business leagues do provide certain public goods, and some business leagues face a collective action challenge, these organizations are not subject to the depth of a collective-action problem as are other groups, such as the poor. Tax exemption for business leagues thus subsidizes many organizations that need no subsidy, and fails to subsidize a great number of interests, likely even within the business community itself that under the traditional theory of tax exemption are presumably deserving of subsidy.

Because the subsidy is not structured to only help those organizations that truly need the help, we should expect that it leads to an oversupply of business leagues and the goods and services they provide. As the review of empirical literature shows, business leagues dominate the interest group sector. Even if tax exemption only modestly enhances this bias, it is unclear why we would want to enhance the bias at all. Additionally, because federal tax exemption is a signal good entitling certain nonprofit organizations to additional rights and benefits, a removal of tax exemption could have a greater impact beyond just the subsidy from tax exemption.

This Article also assessed three positive cases to be made for exemption for business leagues including that they enhance pluralism, that they serve an important informational function, and that they serve to regulate professions and industries for public benefit. The pluralism case is dismissed on the basis of theoretical and empirical work demonstrating that business interests already dominate the interest group domain. Because we have reason to believe the interest group sector is finite, we have reason to believe the subsidy to business leagues may very well crowd out other interests that have a harder time organizing. The information theory is also dismissed. Again, the evidence is that business interests will largely provide information to legislators in any case, and that we have no reason to believe that nonprofit organizations will provide more truthful information. If it could be shown that nonprofit organizations might provide more truthful information, the case for business leagues as constructed might become stronger. Finally, the claim that these organizations help to regulate the industry and should therefore be exempted on that basis is dismissed for two reasons: (1) the exemption is built to be much more inclusive than this narrow justification, and (2) even where these organizations regulate, they regulate primarily as a means to greater power as an interest group.

The best choice, therefore, is to end tax exemption for business leagues. Legislators would need to take care to make it clear that business associations could not otherwise qualify under § 501(c)(4). On issues of disclosure of donors, it would be best to fight such battles outside of the Code in order to reduce the amount of attention the IRS needs to give to issues of politics. Finally, a second best solution would be to impose a net investment income tax on business leagues in order to lessen the value of this ill-designed subsidy.