

**United States Senate
Committee on the Judiciary
Subcommittee on Oversight, Agency Action, Federal Rights and Federal Courts**

**Testimony of
Lawrence M. Noble
Senior Counsel
Campaign Legal Center**

Revisiting IRS Targeting: Progress of Agency Reforms and Congressional Options

July 29, 2015

Chairman Cruz, Ranking Member Coons and distinguished Members of the Subcommittee, I appreciate the opportunity to address the Subcommittee on the activities of the Internal Revenue Service (IRS) and progress of agency reforms regarding the oversight of political activity of tax exempt organizations. Specifically, I would like to talk about how the IRS's failure to enforce the laws governing political activity by nonprofit organizations has undermined compliance with our campaign finance laws—especially those requiring disclosure of the sources of campaign spending.

As Justice Kennedy wrote in *Citizens United v. FEC*:

The First Amendment protects political speech; and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages.¹

Just last year, Chief Justice Roberts underscored the importance of transparency in *McCutcheon v. FEC*, where he reaffirmed that “[d]isclosure requirements are in part ‘justified based on a governmental interest in “provid[ing] the electorate with information” about the sources of election-related spending.’”² Yet, the failure of the IRS to ensure nonprofit groups are complying with the tax code, combined with the Federal Election Commission’s (FEC)

¹ 558 U.S. 310, 371 (2010).

² 572 U.S. ___, 134 S. Ct. 1434, 1459 (2014) (second alteration in original) (quoting *Citizens United*, 558 U.S. at 367).

unwillingness to enforce the disclosure laws, has resulted in a system that is anything but transparent.

According to the Center for Responsive Politics, \$6 billion was spent during the 2012 presidential election cycle. Of that \$6 billion, so-called “independent” groups, including SuperPACs and 501(c)(4) organizations using unlimited corporate, union and individual funds, spent around \$1 billion on campaign related activity. In 2014, a non-presidential election year, \$3.7 billion was spent in total, with over \$750 million coming from these outside groups. Of that amount, groups claiming to be exempt under section 501(c)(4) of the Internal Revenue Code (IRC) reported spending over \$257 million in 2012 and over \$118 million in 2014. By comparison, 501(c)(4) organizations reported spending only \$1.26 million in 2006.³ It is important to note that these figures only represent activity that 501(c)(4) groups reported in connection with spending on independent expenditures⁴ or electioneering communications⁵; they do not include spending by organizations that actively sought the election or defeat of candidates but never reported the making of political expenditures to the IRS or FEC. Very few of these politically active nonprofit organizations publicly disclose any of their donors, so even when they do report election-related spending, the informational benefit to voters is marginal. Compounding the problem is the fact that SuperPACs—which are required to report their contributors—often merely disclose receiving a large contribution from a 501(c)(4) organization (which likely bears an anodyne or unfamiliar name). Because the disclosed 501(c)(4)

³ See *Political Nonprofits (Dark Money)*, Center for Responsive Politics, http://www.opensecrets.org/outsidespending/nonprof_summ.php (last visited Jul. 26, 2015). Trade Associations (501(c)(6)) reported spending \$55 million in 2012 and \$41 million in 2014. Unions (501(c)(5)) reported spending almost \$24 million in 2012 and over \$2 million in 2014.

⁴ An “independent expenditure” is an expenditure expressly advocating the election or defeat of a clearly identified Federal candidate that is not made in concert or cooperation with or at the request or suggestion of such candidate, candidate’s authorized political committee, or their agents, or a political party. 52 U.S.C. § 30101(17).

⁵ An “electioneering communication” is “any broadcast, cable, or satellite communication” that “refers to a clearly identified candidate for Federal office,” is made 60 days before a general election or 30 days before a primary election and is targeted to the relevant electorate, 52 U.S.C. § 30104(f)(3)(A).

organization does not disclose who funded its own political activity, the true source of the funds remains hidden.

Already in the 2016 election cycle, these groups committed to hiding the sources of their money are breaking new ground. In some cases, the groups are closely affiliated with the candidates: They were set up by the candidates, are run by people who have worked on behalf of candidates and are financed through the fundraising of the candidates. To believe that they are independent of the candidates they support and do not have as their primary purpose the election of those candidates makes a mockery of the concept of independent political activity, as embraced by the Supreme Court almost 40 years ago in *Buckley v. Valeo*.⁶

In fact, campaign finance reports filed with the FEC by some of the presidential candidates already show these groups are being used to facilitate widespread disregard for the federal campaign finance laws. As this past Sunday's New York Times reported, while "presidential hopefuls have been romancing donors, hiring staff and haunting the diners and senior centers of Manchester and Dubuque" since last year, most of the candidates reported spending "virtually no money exploring a presidential bid until very recently."⁷

Instead, in many cases their extensive travel and other expenses were apparently paid for by their SuperPACs and 501(c)(4) organizations in an effort to avoid the contribution limits and prohibitions on campaign funds and hide the true identity of who is funding their efforts. Now that the candidates have officially announced, they are already talking about using these outside groups not only to produce campaign ads, but also to finance activity normally paid for by the candidate's campaign, such as grassroots outreach, opposition research and campaign strategic

⁶ 424 U.S. 1 (1976).

⁷ Nicholas Confessore, Sarah Cohen, and Eric Lichtblau, *Presidential Race Just Started? Not According to the Spending*, N.Y. Times, July 25, 2015, <http://www.nytimes.com/2015/07/26/us/presidential-race-just-started-not-according-to-the-spending.html>.

planning. At the same time, we can expect to see an increase in spending by 501(c)(4) organizations that are not as directly tied to the campaigns, but are no less dedicated to electing a specific candidate.

Whether they spend the money directly or make contributions to SuperPACs, the goal of these tax-exempt organizations will be to affect the outcome of our elections while hiding the true source of their funding. This means that we have no way of knowing whether the campaign activity of these groups is being funded by thousands of small donors, several wealthy individuals, corporations, or labor unions, or even foreign nationals or foreign governments.

Much of the blame for this collapse of transparency in the funding of our elections and the lack of enforcement of the contribution limits and prohibitions rests on the FEC. Due to deadlocked votes, the FEC has repeatedly failed to enforce the statutory “political committee” standard, which requires that any organization that receives contributions or makes expenditures in excess of \$1,000 in a year and whose major purpose is to influence federal elections must register and report as a political committee. 52 U.S.C. § 30101. Moreover, the FEC refuses to enforce meaningful rules prohibiting coordination between these groups and candidates and the requirement that any organization making an independent expenditure or electioneering communication report the donors supporting that activity. 52 U.S.C. § 30104(c) & (f). This has allowed 501(c)(4) organizations to spend millions of dollars for the express purpose of influencing elections without complying with the rules applicable to political committees or even disclosing the sources of funds spent on independent expenditures or electioneering communication ads.

However, the growing use of these organizations as conduits for spending millions of dollars from unknown sources to elect candidates would not be possible if the IRS was not also

failing in its responsibility to enforce the requirements for organizations claiming to be exempt from taxation under section 501(c)(4) of the IRC. In order to qualify for 501(c)(4) status, an organization must be operated “*exclusively* for the promotion of social welfare.” 26 U.S.C. § 501(c)(4)(A) (emphasis added). As the IRS has long recognized, the “promotion of social welfare” does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii). Court decisions have established that in order to meet this requirement, section 501(c)(4) organizations cannot engage in more than an insubstantial amount of any non-social welfare activity, such as directly or indirectly participating or intervening in elections. If an organization wishes to engage in political activity, it should register with the IRS as a “political organization” under 26 U.S.C. § 527 and, if support of federal candidates becomes its major purpose, it should register with the FEC as a political committee. But that is not happening.

Rather than requiring that section 501(c)(4) organizations be operated “exclusively for the promotion of social welfare,” the IRS allows section 501(c)(4) organizations to engage in substantial amounts of campaign activity. By regulation, the IRS replaced the statutory command that section 501(c)(4) organizations exclusively pursue social welfare goals with the very different requirement that they do so only “primarily.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(i). This regulation is not consistent with the plain language of the governing statute. Nor is it compatible with court decisions interpreting the requirement that an organization be “operated exclusively” for a specific exempt purpose to mean that any substantial non-exempt purpose is sufficient to disqualify an organization from exempt status under section 501(c)(4).⁸ Thus, groups that should

⁸ See *Contracting Plumbers Coop. Restor. Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. 1973) (section 501(c)(4)); *American Ass’n of Christian Sch. Vol. Emp. v. United States*, 850 F.2d 1510, 1516 (11th Cir. 1988) (“the presence of a substantial non-exempt purpose precludes exemption under Section 501(c)(4)”); *Mutual Aid Ass’n v. United States*, 759 F.2d 792, 796 (10th Cir. 1985) (same; Section 501(c)(4)).

be registering under section 527 of the IRC as political organizations and reporting their donors are being allowed to claim 501(c)(4) status.

Moreover, the IRS has failed to give any concrete guidance as to what constitutes “direct or indirect participation or intervention in political campaigns,” or when such activity becomes sufficient so an organization’s purpose is no longer “primarily” social welfare. Instead, it has relied upon a vague “facts and circumstances” test. This has resulted in 501(c)(4) organizations self-defining what is “political” narrowly and deciding that, as long as they keep their campaign-related expenditures to 49% or less of their overall expenditures, they are still “primarily” engaged in social welfare activity. In fact, although the 49% standard has never been endorsed by the IRS, IRS Commissioner John Koskinen told reporters in March that “[i]f you spend, at this point, less than 49 percent of your money on politics, you can be a (c)(4),” and reportedly described 501(c)(4) organizations as able to “spend a significant amount on politics.”⁹

Despite suggestions to the contrary, cases where the IRS has taken action against a 501(c)(4) group for excessive political activity have been few and far between, even as these groups have dramatically increased their political spending. Unfortunately, when the IRS finally did decide to take a closer look at the applications for tax exemption, it looked for certain words in the names of organizations as a shorthand to identify potentially political groups, which gave rise to serious allegations about political targeting and resulted in major ongoing congressional investigations of the agency. But, regardless of whether Congress determines that the IRS targeted groups for partisan purposes, the fact remains that the IRS has a continuing obligation to ensure the law is enforced.

⁹ Paul Barton, *Koskinen's Comments on Political Spending of Nonprofits Disputed*, 147 Tax Notes 31, 31 (2015).

Instead, the IRS is likely to back off any enforcement of the 501(c)(4) rules to avoid new charges of political bias, which is giving a green light to the numerous groups exploiting the 501(c)(4) tax status while undertaking substantial political activity. Even IRS efforts to clarify the law have been attacked, and the agency has come under tremendous pressure from some organizations and members of Congress to withdraw its ongoing rulemaking to revise the 501(c)(4) rules. Thus, rather than being encouraged to develop clear rules and an enforcement program that avoids even the appearance of partisanship to ensure that 501(c)(4)s are meeting the requirements for their tax exemption, the IRS is being encouraged to let the past abuses of 501(c)(4) status flourish.

The ramifications of this inaction extend beyond the IRS. While the FEC and the IRS are responsible for enforcing different laws applicable to political activities, there is no question that 501(c)(4) status is sometimes used as a shield against charges that an organization is a political committee that should have to report its donors. Thus, not only is the IRS allowing organizations engaged in extensive political activity to claim 501(c)(4) tax exempt status, it is supporting the FEC's refusal to make these organizations comply with the campaign finance laws.

To be clear, no one is suggesting that organizations do not have a right to engage in political activity. But organizations do not have a right to claim a tax exemption while undertaking that activity, nor do they have a right to do so without complying with the laws enacted to ensure transparency in political funding. It is up to the IRS to ensure that the taxpayers are not subsidizing groups ineligible for the benefits that come with 501(c)(4) status, and to enforce the requirement that such groups, if they wish to undertake political activity, must register and report as 527 organizations and disclose their donors. Right now, the IRS has failed to protect taxpayers from what amounts to little more than tax fraud, and has enabled

organizations to undertake political activity without disclosing the sources of their funding. The dangers this presents to our democracy should not be underestimated.