August 14, 2014

John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue NW
Washington DC 20024

Re: IRS rulemaking on political activities by non-profit organizations

Dear Commissioner Koskinen:

On May 7, 2014, the American Bar Association Section on Taxation submitted comments to you and to other officials of the IRS and Treasury Department regarding a proposed regulation set forth in the Notice of Proposed Rulemaking issued last November, "Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities" 78 Fed. Reg. 71535 (Nov. 29, 2013).

Given this submission, Democracy 21 and the Campaign Legal Center are writing to summarize the two sets of comments our organizations previously submitted to the IRS in the same rulemaking. In one set of comments submitted on February 27, 2014, Democracy 21 and the Campaign Legal Center, on behalf of ourselves and Representative Chris Van Hollen, addressed issues relating to the amount of campaign activity that social welfare groups are legally permitted to conduct under the Internal Revenue Code and under court interpretations of the Code. In a second set of comments submitted on the same day, we addressed the definition of "candidate-related political activity."

The IRS is expected to issue a new notice of proposed rulemaking in early 2015 that will set forth a revised proposed rule. It is essential for the IRS to adopt a final rule in a timely manner in order to prevent further abuse of the tax laws in the 2016 election cycle by groups that claim to be social welfare organizations in order to hide the donors financing their campaign activities.

In formulating a new proposed rule, we believe the IRS must effectively address the following key issues:

1. The plain language of section 501(c)(4) provides that "social welfare" organizations must be devoted "exclusively," not "primarily," to social welfare activities. The IRS's existing regulation, and the manner in which the regulation is administered by the IRS, cannot be squared with the plain language of the governing statute. Although the statute

requires that section 501(c)(4) organizations be operated "exclusively" for the promotion of social welfare (and the IRS correctly acknowledges that campaign activity is not social welfare activity), the IRS nonetheless currently allows section 501(c)(4) organizations to engage in substantial amounts of campaign activity because its regulation equates being operated "exclusively" for social welfare activities with engaging "primarily" in such activity.

Furthermore, the IRS practice in administering its "primarily" engaged requirement is to allow section 501(c)(4) organizations to spend up to 49 percent of their revenues on campaign-related political activity. This allows such organizations to engage in substantial campaign activities and has resulted in the explosion of political spending by section 501(c)(4) organizations in the wake of the 2010 *Citizens United* decision. This also has seriously undermined a fundamental principle reflected in both campaign finance law and tax law: donors that finance campaign spending are required to be disclosed to the public.

The Code's use of the term "exclusively" plainly does not mean "primarily."

Furthermore, as is made clear by court decisions, to be "primarily" engaged in social welfare activities does not permit more than an "insubstantial" amount of non-social welfare activity.

As the May filing by the ABA Section on Taxation points out:

> [T]he section 501(c)(3) Regulations have language construing "exclusively" in section 501(c)(3) to mean "engages *primarily* in accomplishing one or more [charitable] purposes" (similar to the "primarily" language in the 501(c)(4) Regulations), but the section 501(c)(3) Regulations then state that a section 501(c)(3) organization may not devote "more than an insubstantial part of its activities" to non-charitable purposes.

May 7 ABA letter (text at n. 31) (emphasis and alterations in original).

New regulations should establish a standard of "insubstantial activity" for non-social welfare activities by section 501(c)(4) organizations and should provide a percentage definition for what satisfies the "insubstantial" activity standard, in order to provide all organizations with a bright line test.

"Insubstantial" should be defined to mean that a section 501(c)(4) organization can engage in no more than 10 percent of non-social welfare activity. In no way can "insubstantial" be properly interpreted to mean that a social welfare organization can engage in up to 49 percent non-social welfare activity.

If, on the other hand, a larger percentage than 10 percent is used to cover all non-social welfare activities (a position that we believe would be contrary to the Code), then it is necessary for the IRS to include a sub-limit that would allow no more than 10 percent of a group's activity to be devoted to any single non-social welfare activity, such as campaign activity.

The existing IRS regulation is contrary to law. Absent effective action by the IRS to conform the regulation with the statute and with court interpretations of the statute, the flood of secret contributions into federal elections will continue to rise dramatically, with very damaging effects on the transparency of our electoral system and the interests of the American people.

2. The current IRS rules have allowed section 501(c)(4) organizations to serve as vehicles for bypassing campaign contribution disclosure requirements on a massive scale. Section 501(c)(4) organizations can currently engage in electoral spending without subjecting themselves to campaign contribution disclosure requirements, as long as they can maintain that the bare majority of their activities promote social welfare. Not surprisingly, political operatives seeking to mobilize cash from donors who prefer to remain anonymous are using section 501(c)(4) groups as the ideal vehicles for funneling huge amounts of secret money into the political system. More than $250 million in secret contributions were spent by section 501(c)(4) groups in the 2012 national elections.

3. It is critical that the IRS use the opportunity of this rulemaking to bring its regulations into conformity with the statutory requirement that section 501(c)(4) organizations be "operated exclusively" for the promotion of social welfare and with court interpretations of the statute. In this sense, we agree with the comment of the ABA Section of Taxation that the rules relating to the definition of political activity and the quantity of political intervention permitted for a section 501(c)(4) organization "are inseparably intertwined and are best addressed at the same time." May 7 ABA letter (Exec. Sum. at 3).

4. The "operated exclusively" requirement in the statute precludes electoral spending and other campaign intervention by section 501(c)(4) groups that exceeds an insubstantial level. This conclusion flows from a line of court decisions that have construed similar standards in the Internal Revenue Code. In *Better Business Bureau v. United States,* 326 U.S. 279 (1945), for example, the Supreme Court construed the meaning of a provision of an earlier tax exemption for organizations "operated exclusively for religious, charitable, scientific, literary or educational purposes." The Court held:

> [I]n order to fall within the claimed exemption, an organization must be devoted to educational purposes exclusively. This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes.

Id. at 283.

The fact that the *Better Business Bureau* decision allows an organization to engage in an *insubstantial* amount of activities outside the stated category of permitted activities and still be deemed as "exclusively" engaged in those permitted activities does not provide any legal justification for the existing IRS regulations that permit *substantial* activity outside the permitted activities for section 501(c)(4) groups.

In fact, the Supreme Court's decision in *Better Business Bureau* shows how contrary to law the current IRS regulations and practice are, precisely because the agency allows a section

501(c)(4) group to engage in far-more campaign activity—up to 49 percent of the group's activities—than the "insubstantial" amount that the Supreme Court deemed permissible.

Following the *Better Business Bureau* decision by the Supreme Court, lower federal courts have similarly held "that the presence of a single substantial non-exempt purpose [such as campaign activity] precludes tax-exempt status regardless of the number or importance of the exempt purposes," *Contracting Plumbers Coop. Restor. Corp. v. U.S.*, 488 F.2d 684, 686 (2d. Cir. 1973); and "the presence of a substantial non-exempt purpose precludes exemption under Section 501(c)(4)." *American Ass'n of Christian Sch. Vol. Emp. v. U.S.*, 850 F.2d 1510, 1516 (11th Cir. 1988).

The courts have thus held that any "substantial, non-exempt purpose" (such as campaign activity) will defeat an organization's tax-exempt status under section 501(c)(4). Accordingly, the Code's statutory language as interpreted by the courts means quite simply that a 501(c)(4) organization cannot engage in more than an "insubstantial" amount of campaign activity.

The IRS should replace the existing regulatory language with language making clear that the pursuit of non-social welfare objectives is prohibited above an insubstantial level, such as 10 percent of the groups' annual expenditures, for a group claiming section 501(c)(4) tax status.

5. The IRS should provide clearer standards than the current "facts and circumstances" test with regard to the definition of what constitutes campaign-related political spending. An important factor in the current abuses of existing tax law is the IRS's vague and difficult to administer "facts and circumstances" standard, which has given room for political operatives to wrongly argue that their activities are not campaign related activities.

6. The IRS should adopt a standard for campaign-related activity that uses both a time-frame test and a PASO test to define campaign related spending. A time-frame test should include all public communications that mention a candidate and are made in the period 30 days before a primary or 60 days before a general election—a standard that is currently part of the campaign finance laws and is contained in the initial rule noticed by the IRS. It is also essential to cover the period outside this window beyond an "express advocacy" standard, which is inadequate to capture the real campaign-related spending taking place to influence elections.

Outside the time periods listed above, the IRS should adopt another standard used in the federal campaign finance laws and upheld by the Supreme Court—the so-called PASO test: whether an ad promotes, attacks, supports or opposes a candidate.

In *McConnell v. FEC*, 540 U.S. 93, 170 (2003), the Supreme Court upheld the PASO test, stating that "any public communication that promotes or attacks a clearly identified Federal candidate directly affects the election in which he is participating." The Court explained that the PASO words "'provide explicit standards for those who apply them' and 'give the person of ordinary intelligence a reasonable opportunity to know what is prohibited.'" *Id.* at 170 n.64.

7. The IRS should apply the new regulations to other 501(c) groups, with the possible exception of 501(c)(3) groups (which are prohibited from engaging in any partisan

or campaign activity). Applying the rules to other section 501(c) groups would prevent discriminatory advantage for section 501(c)(5) labor organizations and section 501(c)(6) business trade associations at the expense of section 501(c)(4) groups. This would also prevent groups from moving to other 501(c) groups in order to circumvent and evade the new regulations and continue spending secret contributions in elections. Congress never intended section 501(c) tax-exempt groups to become vehicles for campaign activities. Section 527 of the Code exists for groups that want to engage in campaign activities and provides both tax-exempt status and *disclosure requirements* for such non-profit groups. Any section 501(c) organization that wants to make campaign-related expenditures should do so by raising and spending the money in an affiliated 527 group. This would require disclosure of the group's campaign finance activities.

Conclusion

Since the Supreme Court's 2010 ruling in the *Citizens Untied* case, the amount of secret contributions spent in federal elections has skyrocketed. The IRS's flawed regulations, more than a half century old, have played a major role in facilitating this abuse. The regulations have been used by section 501(c)(4) organizations – which are not subject to campaign finance disclosure requirements – to engage in substantial campaign-related spending, contrary to the statutory language and court decisions interpreting the statute.

The current rulemaking is extremely important to the American people. It presents the IRS with the opportunity to fix its current regulations that are contrary to law and that are being used by organizations to channel hundreds of millions of dollars in secret contributions into federal elections. It is the responsibility of the IRS to fix this fundamental problem. It is imperative that the agency do this on a timely basis and restore effective contribution disclosure in time for the 2016 presidential and congressional elections

Thank you for your consideration.

Sincerely,

/s/ Gerald Hebert	*/s/ Fred Wertheimer*
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