March 22, 2012

Hon. Douglas H. Shulman
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20224

Lois Lerner
Director of the Exempt Organizations Division
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Petition for rulemaking on candidate election activities by Section 501(c)(4) groups

Dear Commissioner Shulman and Director Lerner:

On July 27, 2010, Democracy 21 and the Campaign Legal Center submitted to the Internal Revenue Service a "Petition for Rulemaking on Campaign Activities by Section 501(c)(4) Groups."

The Petition challenged as contrary to law the existing regulations that define eligibility for an organization to qualify for section 501(c)(4) tax-exempt status. The Petition called on the IRS to initiate a rulemaking proceeding to revise and clarify its regulations regarding the extent of candidate election activities that a "social welfare" organization can engage in under 26 U.S.C. § 501(c)(4).

Since then, we have heard nothing from the IRS to indicate that such a rulemaking is under consideration.

Meanwhile, developments in the course of the 2012 national elections have served to underscore the fact that inadequate and flawed IRS regulations are facilitating widespread misuse of the tax laws by organizations claiming tax-exempt status under section 501(c)(4) in order to keep secret the donors financing their candidate campaign-related expenditures.

This is seriously undermining the integrity of the tax laws and the credibility of the nonprofit sector. According to a column in *Roll Call*:

> "Charitable organizations depend on the confidence and trust of the public for support," said Diana Aviv, president and CEO of Independent Sector, which represents the nonprofit and philanthropic community. Campaign spending by nonprofits, she added, could pose "a serious reputational risk" to the sector.[1]

We are writing again to strongly urge the IRS to act on our Petition promptly and initiate a rulemaking proceeding. The IRS must take steps to properly interpret and enforce the tax law and stop these abuses from continuing to explode in our elections.

Recently, a group of Democratic Senators and a group of Republican Senators have each separately written to the IRS, both complaining about the agency's administration of section 501(c)(4). One group of Senators argues that the agency is too intrusive in its inquiries into the candidate election activities of applicants for 501(c)(4) "social welfare" status. The other group of Senators argues that the agency is too lax in enforcing the limits on candidate campaign activities by such groups.

The IRS has a statutory responsibility to administer and enforce the tax laws as interpreted by the courts, without regard to political pressure. These letters from the Senators, however, serve to confirm that it is essential for the IRS to initiate a rulemaking to provide clarity and a legally correct bright line standard for determining when a group is eligible to receive tax-exempt status under section 501(c)(4).

The Internal Revenue Code provides that section 501(c)(4) groups must engage "exclusively" in social welfare activities. 26 U.S.C. § 501(c)(4). The regulations implementing this provision state, however, that "social welfare" organizations must be "primarily engaged" in social welfare activities. 26 C.F.R. § 1.501(c)(4)–1(a)(2)(i).

Although the IRS has clearly and correctly stated that "social welfare" activities do not include activities that constitute participation or intervention in candidate elections, it has not clearly or properly defined the "primarily engaged" standard that was established by the agency to serve as a cap on such candidate campaign activities.

In the absence of a proper regulation, the standard has been widely misinterpreted to mean that section 501(c)(4) groups can engage in candidate election activities so long as such activities do not constitute a majority of the group's spending – that is to say, they can spend up to 49 percent of their expenditures on candidate campaign-related activities.

This is in conflict with the statutory language and with court interpretations of this language which hold that "social welfare" organizations cannot engage in any "substantial" amount of non-exempt activity. This means that section 501(c)(4) organizations cannot do more than an *insubstantial amount of candidate election activity*, whether or not it is their "primary" purpose.

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[1] E. Carney, "Rules of the Game: Bad News for Nation's Nonprofits," *Roll Call* (March 20, 2012).

However, as we documented in our Petition and in other letters we have sent to you,[2] a number of groups claiming tax exempt status under section 501(c)(4) are engaging in substantial candidate election activities this election cycle – spending tens of millions of dollars to directly influence the 2012 candidate elections, much as such groups also did to influence the 2010 elections. This candidate campaign activity is bound to increase as the 2012 general election draws closer.

For instance, as we discussed in our letter to you of December 14, 2011, one section 501(c)(4) group, American Action Network, reportedly spent $26 million on candidate campaign-related activities in 2010, which was approximately *87 percent* of the organization's total spending that year. Another supposed "social welfare" organization, Americans Elect, is seeking ballot access as a political party in all 50 states for the purpose of nominating and running its own presidential candidate. The group has already obtained this status as a political party in a number of states. A group cannot be a "political party" and a "social welfare" organization at the same time.

The extent of the candidate election activities by these and other groups appears on its face to violate even the current ineffectual regulatory standard that limits participation in candidate campaign-related activities by section 501(c)(4) "social welfare" organizations. The activities certainly violate both the statutory language of section 501(c)(4) and the court interpretations of that provision.

The IRS must act expeditiously to revise and clarify the "primarily engaged" standard and to conform its regulations to the statute as construed by the courts. Absent action by the IRS, it is a virtual certainty that candidate election activities by groups improperly claiming tax-exempt status under section 501(c)(4) will escalate.

The stakes here are very high for the country and for the integrity of our elections. Organizations are improperly claiming tax-exempt status under section 501(c)(4) in order to keep secret the donors financing their candidate campaign-related expenditures. Citizens have a basic right to know who is giving and spending money to influence their votes.

Since section 501(c)(4) groups (unlike section 527 "political organizations") are not required to publicly disclose their donors, the sources of the money such groups spend for candidate election activities are hidden from public scrutiny.

Recent press reports have taken note of the increased candidate campaign spending by section 501(c)(4) groups, and the use of such "social welfare" groups specifically for the purpose of keeping secret the donors financing their candidate election activities.

One report in *Politico* noted that corporations have generally not contributed to so-called "Super PACs," which are federally registered political committees that are required to report their donors to the FEC. The report explained:

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[2] *See* Letters of October 5, 2010, September 28, 2011, December 14, 2011 and March 9, 2012.

> Instead, corporate lobbyists and others say companies have preferred to give to politically active nonprofits that allow their donations to stay anonymous. . . .
>
> Millionaires and others might see an advantage to giving to super PACs, but one in-house corporate lobbyist told POLITICO that "nondisclosure is always preferred" when it comes to any contribution to mitigate any public perception issues and shareholder controversy.
>
> It's unclear how much money is being directed to nonprofit advocacy organizations – 501(c)(4)s – which do not have to disclose their donors to the Federal Election Commission but are in many cases associated with Super PACs.[3]

By allowing groups to claim tax exempt status under section 501(c)(4) while also engaging in substantial candidate election activity, the IRS is serving to deny citizens essential campaign finance information about the money being spent to influence federal elections.

This is information that the Supreme Court in *Citizens United* said "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." *Citizens United v. FEC,* 130 S. Ct. 876, 916 (2010).

The widespread abuse of the tax laws by groups improperly claiming section 501(c)(4) tax-exempt status will continue and grow until the IRS revises its regulations to conform with the statutory provision in the Internal Revenue Code and with court interpretations holding that tax-exempt groups may not engage in more than an insubstantial amount of non-exempt activity.

The IRS must move promptly to set a new clear, bright-line and administrable standard for determining eligibility for 501(c)(4) tax status, and ensure that such standard complies with the statute. Absent such action by the IRS, the agency will bear direct responsibility for the misuse and abuse of the tax laws by groups that are flooding our elections with secret money.

We strongly urge the IRS to promptly institute a rulemaking proceeding to address this matter. We would appreciate receiving a response from the IRS to our letter regarding what action the agency is prepared to take.

Sincerely,

/s/ Gerald Hebert	*/s/ Fred Wertheimer*
J. Gerald Hebert Executive Director Campaign Legal Center	Fred Wertheimer President Democracy 21

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[3] A. Palmer and A. Phillip, "Corporations not funding super PACs," *Politico* (March 8, 2012).