

September 28, 2011

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: Request for IRS investigation into whether certain organizations are ineligible for tax exempt status under section 501(c)(4).

Dear Commissioner Shulman and Director Lerner:

Democracy 21 and the Campaign Legal Center call on the Internal Revenue Service (IRS) to conduct an investigation into whether Crossroads GPS, Priorities USA, American Action Network and Americans Elect, all of which claim to be tax exempt groups organized under section 501(c)(4) of the Internal Revenue Code (IRC), 26 U.S.C. § 501(c)(4), are ineligible for the tax exempt status provided to section 501(c)(4) organizations.¹

Under the IRC, IRS regulations and court decisions interpreting the IRC, section 501(c)(4) organizations are required to primarily engage in the promotion of social welfare in order to obtain tax exempt status. 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.

Thus, the claim made by some political operatives and their lawyers that section 501(c)(4) organizations can spend up to 49 percent of their total expenditures on campaign activity and maintain their tax exempt status has no legal basis in the IRC and is contrary to court decisions regarding eligibility for tax-exempt status under section 501(c)(4). An expenditure of 49 percent of a group's total spending on campaign activity is obviously far more than an insubstantial amount of non-social welfare activity.

¹ Last October, we asked for an investigation of Crossroads GPS on similar grounds. By this letter we re-state and supplement our earlier request for an investigation of Crossroads GPS.

The IRS applies the “primarily engaged” test on the basis of the “facts and circumstances” of an organization’s formation and operations. Here, we believe, the “facts and circumstances” show that each organization has engaged in far more than an insubstantial amount of participation or intervention in elections and that the overriding purpose of each organization is to influence elections.

Thus, under the IRC and court decisions interpreting the IRC, these organizations are not eligible to receive section 501(c)(4) tax exempt status.

In a 2008 Letter Ruling, the IRS stated that a group is not eligible for tax exempt status under section 501(c)(4) where the facts and circumstances show that the group’s “first and primary emphasis” is to get candidates elected to public office.

This standard is different than, and in conflict with, the standard applied by the courts. But even under this standard, we believe the “facts and circumstances” relating to the formation and activities of the four organizations discussed in this letter show that each group was organized and is operated for the overriding purpose of participating or intervening in elections.

Therefore, none of the four groups meets the standard for tax exempt status under section 501(c)(4) because they are not primarily engaged in “the promotion of social welfare.”

By claiming tax-exempt status under section 501(c)(4), these groups allow their donors to evade the public disclosure requirements that would apply if the organizations were registered under section 527 as “political organizations.” In fact, it appears that avoiding disclosure of their donors is the basic reason that these groups organized under section 501(c)(4).

Absent timely and appropriate action by the IRS, widespread abuses of the tax code by groups organized under section 501(c)(4) are likely to become commonplace in the 2012 presidential and congressional races. These abuses will come at the expense of the integrity and credibility of the tax laws and of the right of the American people to know the identity of the donors providing money to influence elections.

Accordingly, we request that the IRS promptly investigate the groups discussed in this letter and take appropriate enforcement action and impose appropriate penalties for any violations of section 501(c)(4) that the agency may find.

I. Crossroads GPS

On October 5, 2010, Democracy 21 and the Campaign Legal Center filed a letter with the IRS requesting an investigation into whether Crossroads GPS was operating in violation of the requirements for obtaining tax-exempt status under section 501(c)(4). Here, we supplement the information set forth in that earlier letter and continue our request for an investigation.

Crossroads GPS was organized in June, 2010 under section 501(c)(4) of the IRC “as an organization for the promotion of social welfare.” (“GPS” stands for “Grassroots Policy Strategies.”)

Crossroads GPS is affiliated with American Crossroads, a non-profit political organization registered under section 527 of the IRC. American Crossroads is registered with the Federal Election Commission (FEC) as a political committee under the Federal Election Campaign Act. As such, the major purpose of American Crossroads is to raise and spend money to influence federal campaigns. As a registered political committee, American Crossroads must report all of its contributions and expenditures to the FEC under federal campaign finance laws. As a section 501(c)(4) organization, Crossroads GPS does not publicly disclose its donors.

An article in *Politico*, dated April 29, 2011, notes that Crossroads GPS was “founded under the guidance of GOP strategists [Karl] Rove and Ed Gillespie. . . .” and that it “accepts unlimited contributions from donors whose identities can be kept secret.”² The article notes:

In response to [the *Citizens United*] ruling, Rove and Gillespie helped form American Crossroads, which did disclose donors, and Crossroads GPS, which didn’t. During last year’s midterms, they raised a combined \$70 million, of which the donors of about \$43 million are still secret. The vast majority of that money was spent attacking Democratic candidates for the House and the Senate.

Id. According to another report:

Crossroads GPS took advantage of elements of the tax code to collect unlimited donations from individuals and corporations to spend tens of millions of dollars against Democratic candidates in the 2010 election.³

Another report noted that Crossroads GPS was formed for the very purpose of avoiding donor disclosure:

Meanwhile, section 501(c)(4) of the code, under which Crossroads GPS is incorporated, allows groups to shield their donors’ identities, but requires them to spend a majority of their cash on apolitical purposes – an obligation Democratic critics say Crossroads GPS and other right-leaning groups flaunted during the campaign, when they bombarded Democratic candidates with biting critical ads.

“Disclosure was very important to us, which is why the 527 was created,” Forti said. “But some donors didn’t want to be disclosed and, therefore, a (c)(4) was created,” Forti explained, referring to Crossroads GPS.

² J. Cummings, “New Dem money group takes on GOP,” *Politico* (April 29, 2011) (emphasis added).

³ M. O’Brien, “Obama alumni launch new outside group to boost reelection,” *The Hill* (April 29, 2011).

Forti's frank explanation differs from that previously offered by the Crossroads team, which had asserted that they always intended to create a 501(c)(4) because it was better suited to facilitate issue-based advocacy.⁴

A report in *The Wall Street Journal* discussed the plans of Crossroads GPS (and American Crossroads) to play a significant role in the 2012 elections:

Two conservative groups founded last year with the help of Republicans Karl Rove and Ed Gillespie have set a goal of raising \$120 million in the effort to defeat President Barack Obama, win a GOP majority in the Senate and protect the party's grip on the House in the 2012 election. . . .

If the conservative groups meet the target disclosed to *The Wall Street Journal*, they would establish their organizations – American Crossroads and Crossroads GPS – as possibly the largest force in the 2012 campaign, aside from the presidential candidates themselves and the political parties.⁵

According to another report, “‘2010 was only Crossroads’ opening act,’ Steven Law, the group’s president, told the Center for Public Integrity. These two groups hope to rake in \$120 million for 2012 compared to \$71 million last year.”⁶

In February, 2011, Crossroads GPS launched a radio ad campaign that was specifically designed to counter ads run by the Democratic Congressional Campaign Committee. According to one report:

Crossroads GPS, a 501(c)(4) group associated with GOP heavyweights Karl Rove and Ed Gillespie, is spending \$90,000 on radio ads in 19 districts where the Democratic Congressional Campaign Committee (DCCC) launched ads this week.

The group launched the ads to hit back against the DCCC ads, which accused the Republicans, many of whom are freshmen from swing districts, of wanting to slash spending for education and research and investment.⁷

⁴ K. Vogel, “SEIU, American Crossroads look back at 2010 spending,” *Politico* (Dec. 13, 2010) (emphasis added).

⁵ B. Mullins, “2012 Election Spending Race Heats Up,” *The Wall Street Journal* (March 1, 2011) (emphasis added).

⁶ P. Stone, “Democrats desperately seeking their own Rove,” *Center for Public Integrity –iWatch News* (March 14, 2011).

⁷ M. O’Brien, “Rove-backed group spends to bolster 19 targeted Republicans,” *The Hill* (Feb. 3, 2011).

Crossroads GPS also started to run ads attacking President Obama in key electoral battleground states:

In an early sign of its financial strength, Crossroads GPS announced Friday that it was launching a two-month, \$20 million television ad blitz attacking Obama's record on jobs, the deficit and the overall economy. The first ads will start June 27 and run in key battleground states such as Colorado, Florida, Missouri, Nevada and Virginia.⁸

A subsequent report stated that Crossroads GPS "is about midway through a two-month advertising binge attacking President Barack Obama and congressional Democrats that is expected to cost more than \$20 million, alone."⁹

President Obama announced his candidacy for re-election in the 2012 presidential race on April 4, 2011, well before the Crossroads GPS ads were run.

One report notes that Crossroads GPS is already spending money in Missouri as part of an effort to defeat Senator Claire McCaskill, who is up for reelection in 2012:

With nearly a year and a half to go before Election Day 2012, conservative-leaning national advocacy groups already have spent more than \$500,000 on advertising in Missouri in hopes of unseating incumbent Democratic Senator Claire McCaskill. . . .

The conservative groups, American Crossroads political action committee and its nonprofit affiliate, Crossroads GPS, already have hired southwest Missouri political operative Paul Mouton to help research and manage their efforts against McCaskill. Missouri is the only state with such an on-the-ground presence.

"As long as the race remains competitive, we will remain highly involved," said Jonathan Collegio, communications director for both groups. "Having someone on the ground in Missouri is a testament to how important we view this race."

When all is said and done, American Crossroads and Crossroads GPS expect to spend far and away more in Missouri than they did in 2010, when they spent around \$2.4 million opposing Democrat Robin Carnahan during her unsuccessful campaign for the U.S. Senate.¹⁰

⁸ P. Stone, "Obama groups raise \$4-5 million in first two months," *Center for Public Integrity-iWatch News* (June 24, 2011).

⁹ K. Vogel, "Both sides now in dash for anonymous cash," *Politico* (Aug. 9, 2011).

¹⁰ J. Hancock, "Both sides spending big to win Missouri Senate seat," *St. Louis Post-Dispatch* (Aug. 15, 2011).

Jonathan Collegio, the spokesman for Crossroads GPS and American Crossroads, said “Crossroads will continue to spend heavily in many competitive races through next November.”¹¹ According to this story, “‘The Crossroads groups have stated that we’ll be involved heavily in 2012, both in congressional races and the presidential side as well,’ Collegio said.” *Id.* (emphasis added).

Karl Rove, one of the founders of the Crossroads groups, was recently quoted at an appearance in Ohio as discussing their plans for campaign spending in Ohio in 2012:

Speaking with reporters before addressing an audience last night at Cedarville University, Rove said American Crossroads and its sister group, Crossroads GPS, view Ohio as the battleground where President Barack Obama must be stopped and where it is crucial to defeat incumbent Democratic Sen. Sherrod Brown to help Republicans take control of the Senate.

“Our objective is to be a strong presence in Ohio on the presidential contest, the Senate contest and wherever we might be needed in the House,” Rove said. “We raised \$72 million last time (in 2010); our goal is to raise \$250 million this time.”¹²

Another report indicates that the Crossroads groups may be shifting to emphasize spending through the section 501(c)(4) arm, Crossroads GPS. According to this report, “Crossroads Spokesman Jonathan Collegio said the group’s nonprofit arm, registered as a 501(c)(4) social-welfare organization by the IRS would be ‘more active’ than Crossroad’s main 527 group.”¹³

This may reflect the fact that Crossroads has been more successful in its fundraising of undisclosed contributions through the section 501(c)(4) arm. According to one report, the section 527 arm “has seen its fundraising lag behind its non-disclosing sister group. In the first six months of 2011, . . . it raised only \$3.9 million.”¹⁴

The same report described the evolution of the Crossroads groups as moving toward reliance on the section 501(c)(4) arm as a way to shield donors from disclosure:

[B]ack when Crossroads started out last year, it, too, shunned secret donations and extolled disclosure. Its chairman, Mike Duncan, described himself in May 2010

¹¹ D. Eggen, “Political groups, now free of limits, spending heavily ahead of 2012,” *The Washington Post* (May 21, 2011).

¹² J. Hallett, “Rove-affiliated PACs to spend big in Ohio,” *The Columbus Dispatch* (Sept. 21, 2011).

¹³ J. Gillum, “Priorities USA Raises \$5 Million to Counter Attack Ads From Karl Rove-Backed Crossroads GPS,” *Associated Press* (July 31, 2011).

¹⁴ K. Vogel, “Both sides now dash for anonymous cash,” *Politico* (Aug. 9, 2011).

as “a proponent of lots of money in politics and full disclosure in politics,” and said Crossroads intended to “be ahead of the curve on” transparency.

Less than one month later, with American Crossroads struggling to raise money from donors leery of having their names disclosed, operatives spun off Crossroads GPS, and its fundraising team, led by Rove, began emphasizing to prospective donors the ability to give anonymous contributions.

Fundraising took off, and together, the groups ended up raising more than \$70 in 2010, with the majority of it -- \$43 million – going to Crossroads GPS.

Id.

On September 9, 2011, a published report stated that American Crossroads and Crossroads GPS have set a new fundraising goal that is at least twice the \$120 million announced earlier this year.¹⁵ According to the published report:

We see a pathway to at least doubling our earlier projected goal,” Steven Law, the president of Crossroads, told *iWatch News*. “Everyone is going to stretch as far as they can here because we all feel this is the most important election we have ever been involved with.”

To help achieve its new goal, the two groups have been talking to some prominent GOP figures, notably Mississippi Gov. Haley Barbour. The former Republican National Committee chairman has agreed to lend his Midas like rolodex to the Crossroads efforts.

“Gov. Barbour’s involvement with us gives us the capacity to focus on the presidential race, the Senate and the House at the same time,” Law said.

Id. (emphasis added).

II. Priorities USA.

Priorities USA announced its formation as a social welfare organization under section 501(c)(4) of the tax code by a memorandum distributed “to interested parties” on April 29, 2011. The memorandum makes clear that Priorities USA (and its companion section 527 political organization, Priorities USA Action), are intended to work for the reelection of President Obama by mimicking the structure and function of Crossroads GPS (and American Crossroads). According to the Priorities USA memorandum:

Our groups were formed to answer the hundreds of millions of dollars Karl Rove and the Koch brothers have dedicated to spending in the 2012 election. In 2010, Republicans spent millions distorting the debate on important issues and running

¹⁵ P. Stone, “Karl Rove-linked Crossroads has more than doubled its earlier fundraising goal of \$120 million,” *Center for Public Integrity- iWatch News* (Sept. 8, 2011).

vicious, dishonest attack ads. This is an effort to level the playing field and not allow right-wing activists to hijack the political system.¹⁶

One published report described Priorities USA as follows:

A group of Democrats aligned with the Obama administration today announced that they are starting an outside spending group similar to the conservative groups that President Obama has decried.

The new group has two arms: Priorities USA and Priorities USA Action. While one of the Priorities groups will disclose its donors, the other will not. The model is similar to that used by American Crossroads and Crossroads GPS, the conservative outside groups that raised more than \$70 million in the midterm election cycle to spend on behalf of candidates with a “conservative free-market legislative agenda.”¹⁷

Another report noted:

A group of leading Democrats, including some with close connections to the White House, have officially formed what are expected to be the major outside groups to combat Republicans – and support President Obama – in the 2012 elections with help from huge donations from big money donors and corporations who will have the legal ability to stay in the shadows that Mr. Obama has previously so vocally criticized.

The groups are to be called Priorities USA and Priorities USA Action, and, as such, are modeled after the Republican groups American Crossroads and Crossroads GPS that were started with help from the strategist Karl Rove and were credited with helping greatly in the party’s takeover of the House of Representatives this year – and, it happens, with facilitating a waterfall of anonymous donations from moneyed interests in the November elections.¹⁸

As another report noted:

Bill Burton and Sean Sweeney, two recently departed officials from the Obama White House, are forming Priorities USA, an organization that will seek to raise as much as \$100 million in the 2012 cycle. The group will consist of two branches: a 501(c)(4) nonprofit and a 527 political action committee. The

¹⁶ B. Smith, “In memo, Priorities USA defends secret-money shift,” *Politico* (April 29, 2011).

¹⁷ B. Montopoli, “Democrats launch outside spending group; conservatives charge hypocrisy,” *CBS News* (April 29, 2011).

¹⁸ J. Rutenberg, “Democrats Form Fund-Raising Groups,” *New York Times* (April 29, 2011).

structure will allow the organization to keep some of its donors secret, a practice that Democrats previously deplored when it was used by Republicans.¹⁹

The money raised by Priorities USA and its sister organization, Priorities USA Action, is described as intended to assist President Obama's reelection:

Two Democratic groups seeking big bucks to boost President Obama's re-election have tapped several high-powered fundraisers to help rope in \$4 million to \$5 million in the first two months. They've also snagged pledges for two to three times those sums towards their joint goal of raising at least \$100 million.

The two groups, Priorities USA Action and Priorities USA, are benefiting from the help of leading Democratic fundraisers and donors. . . .

Priorities USA Action is a 527 Super PAC which must disclose its donors and file quarterly reports, but Priorities USA, is a 501(c)(4) group that doesn't have to reveal its donors or file regular reports. Both groups can accept unlimited checks and under law must operate separately from the Obama campaign.²⁰

In discussing the spending plans of the Priorities USA organizations, Burton is quoted as emphasizing the impact on the election that the groups seek to have:

In response to "Rove's negative ads on the economy," Burton said, "we choose to invest in only swing states and, within those states, the most efficient television markets. Dollar for dollar, our spending is having a much greater impact on the voters who will decide the 2012 race."²¹

Another article about Priorities USA highlighted the fact that the group is expressly intended to counter the campaign activities of the Crossroads groups:

To fight his rivals, Burton has chosen to emulate them. His groups may take unlimited amounts, often from anonymous donors and will solicit money from political action committees, corporations and lobbyists that Obama's official election committee disavowed in 2008 and still shuns in the name of good government. . . .

¹⁹ A. Kornblut, "Democrats gear up to match GOP fundraising effort," *The Washington Post* (April 29, 2011).

²⁰ P. Stone, "Obama groups raise \$4-5 million in first two months," *Center for Public Integrity-iWatch News* (June 24, 2011) (emphasis added).

²¹ J. Gillum, "Priorities USA Raises \$5 Million to Counter Attack Ads From Karl Rove-Backed Crossroads GPS," *Associated Press* (July 31, 2011).

“The pool of money available to Karl Rove and the Koch brothers is bottomless and limitless,” said Paul Begala, a Democratic strategist who is advising Burton. [Pollster Geoff] Garin said Priorities USA “represents a way to level the playing field against Karl Rove and the Koch brothers”. . . .

Priorities USA and Priorities USA Action will focus on pointing to the weaknesses of Obama’s opponents, Burton said. The first advertisement criticized former Massachusetts Governor Mitt Romney, the Republican frontrunner in early polling, for supporting a Republican plan to convert Medicare into a system of vouchers to buy health insurance.²²

The same article makes clear that Priorities USA is part of a larger, coordinated campaign operation to support Democrats in the 2012 election:

The Priorities USA organizations, which will focus on the presidential race, will coordinate with three other newly formed Democratic groups: House Majority PAC will focus on House races, Majority PAC will concentrate on the Senate, and American Bridge 21st Century, will conduct opposition research on Republican candidates that other groups can use in advertising or direct mail literature.

Id. Press reports also indicate that the use of section 501(c)(4) organizations for spending is because of the anonymity offered to donors:

The three main anonymously funded Democratic outside groups – Priorities USA, American Bridge 21st Century Foundation and Patriot Majority – collected at least \$3.7 million in untraceable contributions, and probably much more, in the first half of the year, according to voluntary disclosures and anecdotal information on ad buys.

While that’s not as much as the \$5.8 million in fundraising reported in that same period by the sister organizations of those groups, which do disclose donors – Priorities USA Action, American Bridge 21st Century and Majority PAC – the feeling among some in Democratic fundraising circles is that the balance will likely tilt towards undisclosed donations as the groups seek to expand their donor bases. . . .

Many such donors “feel more comfortable donating to groups that don’t disclose,” [a strategist] said, because some are publicity adverse and also because “as soon as their name appears in the paper as having contributed, their phone number goes on the speed dial of every congressman, committee and party that wants to raise money.”²³

²² A Fitzgerald, “Rove Tops President Obama as Drawing Card in Democrat Burton’s Fundraising,” *Bloomberg News* (June 29, 2011).

²³ K. Vogel, “Both sides now in dash for anonymous cash,” *Politico* (Aug. 9, 2011).

III. American Action Network.

American Action Network (AAN) was founded in 2010 by Fred Malek, a leading national Republican fundraiser, and is chaired by former Republican Senator Norm Coleman. According to published reports, AAN shares offices with Crossroads GPS and other related groups.²⁴ AAN made numerous independent expenditures in the 2010 elections. For instance, according to one report:

[A] so-called Section 501(c)(4) group called American Action Network filed an independent expenditure report with the FEC Aug. 5 [2010] indicating that it is spending nearly \$435,000 for cable television and radio ads in the New Hampshire campaign for an open U.S. Senate seat. . . .

The new ad campaign attacks the Democratic Senate candidate, Rep. Paul Hodes (D-N.H.), and supports Republican Senate candidate Kelly Ayotte, New Hampshire's former attorney general.

The American Action Network has indicated on its website that it also sponsored ad campaigns focused on Senate races in Washington state and Florida; however, it filed no reports with the FEC on its spending in those states. The group indicated in press releases that it considered its efforts in these races to be "issue advocacy" not subject to any FEC reporting rules.

The ads that the American Action Network sponsored in Washington included an image of tennis shoes purportedly worn by Sen. Patty Murray (D-Wash.) stepping on the backs of business owners, taxpayers and children. The ad ends by telling Murray that "it's time you got off our backs."²⁵

Another report states:

While the group was intended to serve largely as a policy shop to rival the liberal Center for American Progress, it has mainly just been cutting ads attacking Democrats (including Feingold) who are currently engaged in tight races.

In addition to infusing hundreds of thousands of dollars in outside cash into Feingold's Wisconsin race, Coleman's group has also spent \$750,000 targeting Sen. Patty Murray (D-Wash.) in her tight contest against Republican Dino Rossi and \$450,000 attacking Senate candidate Rep. Paul Hodes (D) in New Hampshire. And because it is incorporated as a 501(c)(4) "social welfare" nonprofit, the D.C.-

²⁴ H. Bailey, "A guide to the shadow GOP": the groups that may define the 2010 and 2012 elections," *Yahoo News-The Uphot* (August 5, 2010).

²⁵ K. Doyle, "Campaign Spending Reports Filed with FEC," *BNA Money in Politics Report* (Aug. 12, 2010).

based AAN does not publicly disclose its donors and has not listed any contributors on the independent expenditure forms it is obliged to file with the FEC.²⁶

In addition to spending on Senate races, in 2010, American Action Network also spent on “really tight” House races:

The [Wall Street] Journal reported that American Action Network will air \$1.7 million in ads boosting the cash-strapped bids of Republicans Ryan Frazier, who is taking on Democratic Rep. Ed Perlmutter (D-Colo), and Jackie Walorski, who is challenging Democratic Rep. Joe Donnelly (D-Ind.). . . .

“The American Action Network has carefully calibrated really tight house races where there are candidates who strongly support our views of limited government and reduced deficits or on the other side candidates who really oppose our views,” said the group’s chairman, veteran GOP fundraiser Fred Malek.²⁷

American Action Network shares space with American Crossroads and Crossroads GPS, and according to press reports, the groups coordinate their political activities:

Sometimes that coordination is as easy as walking across the hall. Sharing office space with American Crossroads is the American Action Network (AAN), a group led by former Minnesota Senator Norm Coleman, a Republican, which may spend up to \$25 million this year. Originally billed as a conservative think tank, the AAN has increasingly turned to raw politics, having spent more than \$1 million on ad buys targeting Democrats such as Senators Patty Murray in Washington and Russ Feingold in Wisconsin. (“We definitely can’t afford him,” an AAN ad says of Feingold and his alleged free-spending record).²⁸

The coordinated focus that American Action Network had on influencing the 2010 elections is illustrated by this quote from Rob Collins, the president of the organization, shortly before the 2010 election:

Many of the conservative groups say they have been trading information through weekly strategy sessions and regular conference calls. They have divided up races to avoid duplication, the groups say, and to ensure that their money is spread around to put Democrats on the defensive in as many districts and states as possible – and more important, lock in whatever grains they have delivered for the Republicans so far.

²⁶ J. Zwick, “Coleman’s American Action Network Infuses Cash into Close Senate Races,” *Washington Independent* (Oct. 4, 2010).

²⁷ K. Vogel, “Rove: Obama’s attacks are helping,” *Politico* (Oct. 13, 2010).

²⁸ M. Crowley, “The New GOP Monday Stampede,” *Time* (Sept. 16, 2010).

“We carpet-bombed for two months in 82 races, now it’s sniper time,” said Rob Collins, president of American Action Network, which is one of the leading Republican groups this campaign season and whose chief executive is Norm Coleman, the former Senator from Minnesota. “You’re looking at the battle field and saying, ‘Where can we marginally push – where can we close a few places out?’”²⁹

According to one report published after the 2010 election, American Action Network “ended up with Republican victories in about 56 percent of the contests it invested in.”³⁰

As one report notes, “Republican political operatives bestow immense credit for their party’s competitiveness in 2010 on organizations such as Crossroads GPS and the American Action Network, both 501(c)(4) organizations. These groups can accept large donations that they do not have to disclose. . . .”³¹

American Action Network, like Crossroads GPS, also spent to influence a special congressional election in May, 2011. According to a published report, American Action Network spent \$94,694 on an election in the New York 26th congressional district.³²

In other spending in 2011, American Action Network has undertaken a \$1 million direct mail and newspaper campaign that “charges Democrats with attempting to ‘balance the budget on the backs of seniors’ . . .”³³ The mail campaign “will reach 22 congressional districts in 14 states, all of them represented in Congress by Republicans. . . . Most of the 22 are freshmen first elected in November 2010.” *Id.* According to another news report, the group subsequently “added 10 vulnerable freshmen House Republicans to its advocacy campaign defending Republicans on Medicare.”³⁴ According to this report, the mailing sent to one Florida congressional district reads, “Florida seniors can count on Congressman Allen West to stand up against the Obama Medicare plan.” *Id.*

²⁹ J. Rutenberg, “Pro-Republican Groups Prepare Big Push at End of Races,” *New York Times* (Oct. 25, 2010).

³⁰ M. Luo and G. Palmer, “Who Got the Most Bang for their Bucks?” *New York Times* (Nov. 4, 2010).

³¹ A. Becker and D. Drucker, “Members Weigh In on Draft Disclosure Order,” *Roll Call* (May 24, 2011).

³² P. Overby, “Outside Groups Spend Big in N.Y. Special Election,” *NPR* (May 25, 2011).

³³ A. Burns, “Ads to back GOPers on Medicare,” *Politico* (July 27, 2011).

³⁴ C. Joseph, “Conservative group defending 10 more House Republicans on Medicare,” *The Hill* (Aug. 3, 2011).

IV. Americans Elect

Americans Elect was initially organized as a “political organization” under section 527 of the tax code, but in October, 2010 changed its designation to a “social welfare” organization under section 501(c)(4) of the tax code.³⁵ It is seeking to gain a place on the 2012 ballot in all 50 states for a presidential candidate it intends to nominate.

According to one article, “Its mission is to upend the traditional party primary process by selecting an alternate presidential ticket through an online, open nominating convention.” *Id.* This report also notes that the manner in which the group is pursuing its aims:

. . . is highly unorthodox. Although it is attempting to qualify as a new party in California and other states, the group’s legal designation is that of a nonpolitical, tax exempt social welfare organization.

Under that designation, Americans Elect has been able to keep private its financiers, raising questions about what forces are driving the massive undertaking. The group has labored largely under the radar for the last 16 months, raising \$20 million while successfully gaining ballot access in Arizona, Alaska, Kansas and Nevada. It is seeking certification in Michigan, Hawaii, Missouri and Florida besides California, with an additional 18 states in the pipeline before the end of the year.

Id. According to the same article, Americans Elect has raised \$20 million, with no contribution exceeding \$5 million. The report noted, “Elliot Ackerman said Americans Elect does not take any money from special interests or political action committees, adding that it is up to donors to determine whether they want to be identified.” *Id.*

The same article notes that the organization plans to nominate a candidate for president:

Americans Elect now plans to hold an online convention in June 2012 that will be open to any registered voters who sign up. They will select a presidential ticket from a slate of candidates, all of whom will have been required to pick a running mate from a different political party.

Id. Another article described Americans Elect as follows:

Funded with at least \$20 million, the majority from large, mostly unnamed donors, Americans Elect is vying to become the most serious third-party insurgency since industrialist H. Ross Perot nearly upended the 1992 presidential campaign.³⁶

³⁵ M. Gold, “Americans Elect seeks to upend primary system,” *Los Angeles Times* (July 28, 2011).

³⁶ P. Jonsson, “Americans Elect launches centrist third-party bid amid Washington dysfunction,” *Christian Science Monitor* (July 29, 2011).

In an opinion piece published by *Politico*, Elliot Ackerman, the group's chief operating officer, described the group's purposes as follows:

We have set up a non-partisan nominating process for the presidency. We plan to hold a secure online convention in June 2012, where any registered voter can participate as a delegate. At this national convention, party functions will become delegate functions. The delegates will draft candidates; develop a platform of questions the candidates must answer, and discuss and debate the convention rules.

We are on our way, with our ballot access initiative, to ensure that our presidential ticket can be on the ballot in all 50 states... .

The Americans Elect nominating convention will be the first time that American voters have gained direct access to the ballot to nominate and elect a presidential candidate.³⁷

According to *The Arizona Daily Star* on July 30, 2011, "Americans Elect was recognized last week as a new political party by the state of Arizona and is eligible to have its presidential nominee on the ballot in the 2012 elections."³⁸

According to *The Detroit Free Press* on September 9, 2011, "Bureau of Elections spokesman Fred Woodhams said American Elect submitted nearly 68,000 petition signatures in May, more than double the 32,261 needed to qualify for the Michigan ballot as a minor party."³⁹

According to *The Oregonian* on September 19, 2011, Americans Elect "has already qualified for the ballot in six states and appears to have turned in enough signatures -- more than 1.6 million -- to make the 2012 ballot in California."⁴⁰

As these examples show, American Elect is not only devoted to intervening in the 2012 elections, it is actually qualifying itself as a political party for purposes of state ballot access laws. A political party is not eligible to qualify as a section 501(c)(4) tax exempt organization.

³⁷ E. Ackerman, "An online political convention," *Politico* (Aug. 10, 2011).

³⁸ M. Casey, "Americans Elect party to appear on '12 ballot," *Arizona Daily Star* (July 30, 2011).

³⁸ D. Bell, "State to vote on certifying new group with 2012 presidential hopes," *The Detroit Free Press* (Sept. 9, 2011) (emphasis added).

⁴⁰ J Mapes, "New effort to establish centrist presidential campaign seeks to qualify for Oregon ballot," *The Oregonian* (September 19, 2011)

V. The IRS Should Investigate Whether Each Organization Is Ineligible for Section 501(c)(4) Tax Status Because Each Is Engaged In More Than An Insubstantial Amount of Campaign Activity.

A. General rule.

Section 501(c)(4) of the Internal Revenue Code establishes tax-exempt status for “[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare....” 26 U.S.C. § 501(c)(4) (emphasis added).

According to IRS regulations, “An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.” 26 C.F.R. § 1.501(c)(4)–1(a)(2)(i) (emphasis added).

Political activity – spending to influence campaigns – does not constitute promoting social welfare. Section 1.501(c)(4)–1(a)(2)(ii) of the regulations provides that political campaign activities do not promote social welfare as defined in section 501(c)(4). The regulation states, “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.” 26 C.F.R. § 1.501(c)(4)–1(a)(2)(ii) (emphasis added).

Although the promotion of social welfare does not include political campaign activities, IRS regulations do not impose a complete ban on such activities for section 501(c)(4) organizations. Thus, “an organization may carry on lawful political activities and remain exempt under section 501(c)(4) as long as it is primarily engaged in activities that promote social welfare.” Rev. Rul. 81–95, 1981–1 C.B. 332 (emphasis added).

B. Section 501(c)(4), as construed by the courts, does not permit a “social welfare” organization to engage in more than an insubstantial amount of campaign activity.

Section 501(c)(4), as construed by the courts, does not permit a group organized under that section to engage in more than an insubstantial amount of campaign activity and still qualify for tax exempt status.

According to court decisions, the statutory requirement for a section 501(c)(4) organization to be “operated exclusively” for “the promotion of social welfare” means that the organization cannot engage in more than an insubstantial amount of activity that is not in furtherance of its social welfare function. This means that section 501(c)(4) organizations cannot engage in more than an insubstantial amount of campaign activities.

The “insubstantial” standard established by the courts certainly does not allow a section 501(c)(4) organization to spend up to 49 percent of its total expenditures in a tax year to participate or intervene in elections and still maintain its tax-exempt status, as some practitioners believe.

Under the statutory language of section 501(c)(4), a social welfare organization must be “operated exclusively” for social welfare purposes. The courts have interpreted this “operated exclusively” standard the same way they have interpreted a parallel provision of section 501(c)(3) that requires an organization that is tax exempt under that provision to be “organized and operated exclusively” for charitable, education or similar purposes.

In *Better Business Bureau v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court construed a requirement that a non-profit organization be “organized and operated exclusively” for educational purposes to mean 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.” (emphasis added).

Based on the *Better Business Bureau* decision, the courts have concluded that the word “exclusively” in the context of sections 501(c)(3) and 501(c)(4) is “a term of art” that does not mean “exclusive” as that term is normally understood and used.

The courts instead have said that, in the context of section 501(c)(4) of the IRC, this term means “that the presence of a single substantial non-exempt purpose 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) (section 501(c)(4)); *American Ass’n of Christian Sch. Vol. Emp. v. U.S.*, 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 Association v. United States*, 759 F.2d 792, 796 (10th Cir. 1985) (same; section 501(c)(4)).

The courts have similarly held, in the context of section 501(c)(3) organizations, that the “operated exclusively” test means that “not more than an insubstantial part of an organization’s activities are in furtherance of a non-exempt purpose.” *Easter House v. United States*, 12 Ct. Cl. 476, 483 (1987) (group not organized exclusively for a tax exempt purpose under section 501(c)(3)); *New Dynamics Foundation v. United States*; 70 Fed. Cl. 782, 799 (Fed. Cl. Ct. 2006) (same); *Nonprofits Ins. Alliance of California v. U.S.*, 32 Fed. Cl. 277, 282 (Fed. Cl. Ct. 1994) (same).

Under these court rulings, a section 501(c)(4) organization cannot engage in more than an insubstantial amount of campaign activity and remain in compliance with the statutory requirements for tax-exempt status under section 501(c)(4). Any “substantial, non-exempt purpose” (such as campaign activity) will defeat an organization’s tax-exempt status under section 501(c)(4). *Christian Sch. Vol. Emp.*, *supra* at 1516.

There is nothing, furthermore, in these rulings, in IRS regulations or in other IRS actions to support the proposition that spending 49 percent of total expenditures on campaign activities constitutes an insubstantial amount of non-exempt activity.⁴¹

⁴⁰ On July 27, 2011, Democracy 21 and the Campaign Legal Center filed a petition for rulemaking with the IRS which seeks revisions in the regulations implementing section 501(c)(4). In particular, the petition contends that the “primarily engaged” standard in section 1.501(c)(4)-1(a)(2)(i) does not correctly

C. Political campaign activity not limited to “express advocacy” communications under the Internal Revenue Code.

IRS regulations make clear that “direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office” is not limited to activities or communications which contain express advocacy or the functional equivalent of express advocacy. Thus, so-called “issue ads” that promote, attack, support or oppose a candidate fall with the meaning of direct or indirect participation or intervention in political campaigns.

Section 527(e)(2) of the Internal Revenue Code describes what constitutes political campaign (*i.e.*, “exempt function”) activity for purposes of the tax code:

The term “exempt function” means the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice Presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed.

26 U.S.C. § 527(e)(2).

Revenue Ruling 2004–6, 2004–4 I.R.B. 328, provides a detailed explanation of what constitutes “exempt function” political campaign activity—illuminating the line between political activities and activities to promote social welfare. The IRS Revenue Ruling states:

Section 1.527-2(c)(1) provides that the term “exempt function” includes all activities that are directly related to and support the process of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to public office or office in a political organization. Whether an expenditure is for an exempt function depends on all the facts and circumstances.

Id. (emphasis added)

Revenue Ruling 2004-6 explains that, because section 501(c)(4) public policy advocacy “may involve discussion of the positions of public officials who are candidates for public office, a public policy advocacy communication may constitute an exempt function (a political activity) within the meaning of § 527(e)(2).” Rev. Rul. 2004-6 at 1. The Ruling states:

All the facts and circumstances must be considered to determine whether an expenditure for an advocacy communication relating to a public policy issue is for an exempt function under § 527(e)(2). When an advocacy communication explicitly advocates the election or defeat of an individual to public office, the expenditure clearly is for an exempt function under § 527(e)(2). However, when an advocacy communication relating to a public policy issue does not explicitly

implement the statutory “operated exclusively” standard in section 501(c)(4) of the IRC, as interpreted by the courts.

advocate the election or defeat of a candidate, all the facts and circumstances need to be considered to determine whether the expenditure is for an exempt function under § 527(e)(2).

Id. (emphasis added)

Thus, even if an ad discussing an issue does not express advocacy, it may nonetheless be treated as “exempt function” electioneering activity under IRS regulations, depending on the “facts and circumstances.” Therefore, even where an ad discusses an “issue,” and where the ad does not contain express advocacy or the functional equivalent of express advocacy, it can still be treated as “direct or indirect participation or intervention in political campaigns” under IRS standards for purposes of determining whether a 501(c)(4) organization is “primarily engaged” in the promotion of social welfare.

Rev. Rul. 2004-6 lists six factors that “tend to show” that an advertisement is “exempt function” political campaign activity, and five competing factors that “tend to show” that an advertisement is not. Rev. Rul. 2004-6 at 3-4. These factors are not in themselves dispositive. In the end, the regulations require a determination to be made based on “the facts and circumstances” of each advertisement.

The “factors that tend to show that an advocacy communication on a public policy issue is for an exempt function (political activity) under § 527(e)(2)” include the following:

- a) The communication identifies a candidate for public office;
- b) The timing of the communication coincides with an electoral campaign;
- c) The communication targets voters in a particular election;
- d) The communication identifies that candidate’s position on the public policy issue that is the subject of the communication;
- e) The position of the candidate on the public policy issue has been raised as distinguishing the candidate from others in the campaign, either in the communication itself or in other public communications; and
- f) The communication is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.

Rev. Rul. 2004-6 at 3.

The “factors that tend to show that an advocacy communication on a public policy issue is not for an exempt function under § 527(e)(2)” include the following:

- a) The absence of any one or more of the factors listed in a) through f) above;

- b) The communication identifies specific legislation, or a specific event outside the control of the organization, that the organization hopes to influence;
- c) The timing of the communication coincides with a specific event outside the control of the organization that the organization hopes to influence, such as a legislative vote or other major legislative action (for example, a hearing before a legislative committee on the issue that is the subject of the communication);
- d) The communication identifies the candidate solely as a government official who is in a position to act on the public policy issue in connection with the specific event (such as a legislator who is eligible to vote on the legislation); and
- e) The communication identifies the candidate solely in the list of key or principal sponsors of the legislation that is the subject of the communication.

Id.

Under this “facts and circumstances” test, each of the organizations discussed in the letter is engaged more than an insubstantial amount of campaign activity and, in fact, is primarily engaged in activities for the purpose of participating and intervening in political campaigns.

In the case of Crossroads GPS and American Action Network, both organizations were created just months before the 2010 congressional elections, and were conceived, organized and staffed by leading political party strategists and operatives. Both organizations defined their activities as spending money to influence the 2010 House and Senate races, and both were closely affiliated with other organizations similarly spending large sums to influence the 2010 elections.

The activities of both groups were targeted to battleground states involving key congressional races, and to supporting Republican candidates or opposing Democratic candidates in those elections.

The ads run by both organizations identified candidates by name, discussed their position on issues in the midst of a campaign, and did so in ways that supported those candidates or criticized their opponents.

Finally, the timing of the groups’ activities did not correspond with external events outside the control of the groups, such as a legislative vote on an issue, but rather corresponded with congressional election campaigns.

With regard to Priorities USA, statements by the founders of the organization make clear that it is modeled on Crossroads GPS, and is to play a similar function with the overriding purpose of conducting campaign activities to support the re-election of President Obama.

Finally, with regard to Americans Elect, the sole thrust of the organization is to obtain

ballot access to use to nominate candidates for president and vice president. The organization is qualifying on ballots as a political party. These activities are *per se* campaign activities in connection with an election.

Accordingly, each of the section 501(c)(4) organizations discussed above has engaged in more than an insubstantial amount of campaign activity, has a “substantial, non-exempt purpose” of participating or intervening in elections and is not entitled to tax-exempt status under section 501(c)(4).

VI. The IRS Also Should Investigate Whether Each Organization Is Ineligible for Section 501(c)(4) Tax Status Because the Organization Is “Primarily Engaged” in Campaign Activity

In a 2008 Letter Ruling, the IRS applied the “primarily engaged” standard to mean that a section 501(c)(4) organization’s primary activities cannot constitute direct or indirect political intervention.

This interpretation of the statutory standard is in conflict with the court rulings interpreting section 501(c)(4), discussed above, that require an exempt organization to engage in no more than an insubstantial amount of campaign activity.

Nevertheless, the organizations discussed in this letter also fail to comply with the standard set forth in this Revenue Ruling. In the 2008 Ruling, the IRS found an organization did not qualify for tax exempt status under section 501(c)(4) because it was not primarily engaged in promoting “social welfare.” The IRS said:

Whether an organization is “primarily engaged” in promoting social welfare is a facts and circumstances determination. Relevant factors include the manner in which the organization's activities are conducted; resources used in conducting such activities, such as buildings and equipment; the time devoted to activities (by volunteers as well as employees); the purposes furthered by various activities; and the amount of funds received from and devoted to particular activities.

2008 TNT 160-33 (May 20, 2008) (emphasis added). The Letter Ruling continued:

In Rev. Rul. 81-95, 1981-1 C.B. 332, we concluded that “an organization may carry on lawful political activities and remain exempt under section 501(c)(4) of the Code as long as it is primarily engaged in activities that promote social welfare.” The corollary to this is that if an organization's primary activities do not promote social welfare but are direct or indirect political intervention, the organization is not exempt under section 501(c)(4). The key is to determine the character of the organization’s primary activities by looking at all of the facts and circumstances.

Id. (emphasis added).

In the Letter Ruling, the IRS considered the organization's claim that it was primarily engaged in lobbying, not campaign intervention. The Letter Ruling states:

A facts and circumstances test is to be used in determining whether an organization's activities primarily constitute political intervention or whether those activities constitute lobbying or educational activities. After reviewing all of the facts and circumstances presented in the administrative file as discussed above, we have concluded that your primary emphasis and primary activities constituted direct and indirect political intervention. While you engage in extensive lobbying activities, they are by no means your primary activity. Your first and primary emphasis is on getting people elected to public office.

Id. The IRS thus concluded:

The emphasis throughout your materials is on electing to office * * * people in order to impact legislation and policy as insiders. The overwhelming majority of the evidence in the administrative record, and thus the facts and circumstances in this case, denotes an organization that is intent upon intervening in political campaigns. . . . While lobbying is usually mentioned, and we recognize that lobbying activities are being pursued, those activities are not your primary activity. An analysis of all of the facts and circumstances contained in the administrative file leads us to the conclusion that your primary activity constitutes political intervention.

Id. (emphasis added).

Therefore, the organization did not qualify for tax exemption under section 501(c)(4):

Based upon the materials submitted in connection with your application, we have concluded that your activities primarily constitute direct and indirect participation or intervention in political campaigns on behalf of or in opposition to candidates for public office. Therefore, you are not primarily engaged in activities that promote social welfare and do not qualify for recognition of exemption under section 501(c)(4) of the Code.

Id.

Here, we believe that an IRS investigation will show that the "first and primary emphasis" of each of the four organizations discussed above is "on getting people elected to public office." In particular, the IRS should investigate whether the "facts and circumstances" show that each of the organizations discussed in the letter is primarily engaged in activities which constitute direct or indirect participation or intervention in political campaigns under IRS regulations. For reasons discussed above, we believe each organization has overriding purpose to engage in campaign activities, and thus is operating contrary to the requirements of section 501(c)(4).

VII. Conclusion.

In the 2010 congressional races, section 501(c) organizations spent more than \$135 million on campaign activities that were financed by secret contributions. The bulk of these expenditures were made by section 501(c)(4) organizations. The amount of secret contributions funding campaign expenditures by section 501(c)(4) organizations is expected to grow dramatically in the 2012 presidential and congressional races.

Crossroads GPS, Priorities USA, American Action Network and Americans Elect are each organized under section 501(c)(4) of the Internal Revenue Code. Based on the information about each organization set forth above, the IRS should conduct an investigation of whether each such organization has engaged in more than an insubstantial amount of non-exempt activity by participating or intervening in political campaigns and accordingly is not primarily engaged in the promotion of social welfare. The IRS should also conduct an investigation of whether each organization's primary activity is campaign activity and is accordingly not primarily engaged in the promotion of social welfare.

If the IRS investigation determines that the facts and circumstances show that the organizations discussed above are not primarily engaged in "the promotion of social welfare," because they have engaged in more than an insubstantial amount of campaign activity or because the organization's primary activity is campaign activity, the organizations should be denied or should lose tax-exempt status. In addition, appropriate penalties should be imposed by the IRS for violations the agency finds. The penalties should take into account the need for strong deterrence to stop similar violations from occurring in the future.

Sincerely,

/s/ Gerald Hebert

J. Gerald Hebert
Executive Director
Campaign Legal Center

/s/ Fred Wertheimer

Fred Wertheimer
President
Democracy 21