April 3, 2015

John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

Re: Standards for tax exemption for social welfare organizations

Dear Commissioner Koskinen:

Democracy 21, the Campaign Legal Center and Public Citizen are writing in regard to a published report which quotes you as stating that Congress established a framework that allows groups organized under section 501(c)(4) of the Internal Revenue Code (IRC) to spend up to 49 percent of their expenditures on campaign activities.

According to a report in *Tax Notes and Tax Analysis*:

> "The framework Congress has is you get to pick where you want to be," Koskinen said March 24, referring to the different 501(c) categories nonprofit groups can fall under. "If you spend at this point less than 49 percent of your money on politics, you can be a (c)(4)."
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> The commissioner made the remark to reporters after a meeting of the Tax Executives Institute in downtown Washington. He several times referred to Congress laying the ground rules for different 501(c) groups, as well as section 527 tax exempts.
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> He described 501(c)(4)s as being able to "spend a significant amount on politics," and repeated, "This is the framework Congress has set up."

P. Barton, "Koskinen's Comments on Political Spending of Nonprofits Disputed," *Tax Notes and Tax Analysis* (March 31, 2015) (emphasis added).

Contrary to your statements, however, this is not the framework Congress set up. Congress did not authorize section 501(c)(4) groups to spend 49 percent of their money, or even "significant" amounts, on political activities.

In fact, as you know, what Congress said was that a social welfare organization must be operated "exclusively" for the promotion of social welfare. 26 U.S.C. § 501(c)(4). 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).

The courts have interpreted the section 501(c)(4) standard that requires an organization to be "operated exclusively" for social welfare purposes 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.

Thus, any substantial non-exempt purpose is sufficient to disqualify an organization from exempt status under section 501(c)(4). Many court decisions reflect this view.[1] In *Better Business Bureau v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court held that identical language in a previous version of the IRC relating to the charitable exemption for an educational institution meant 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." 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. U.S.*, 12 Ct. Cl. 476, 483 (1987) (group not organized exclusively for a tax exempt purpose under section 501(c)(3)).[2]

However, the IRS, by regulation, 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 cannot be squared with the plain language of the governing statute. Nor can it be squared with court decisions interpreting the statute to allow, at most, insubstantial non-social welfare activity. Far from reflecting the "framework" that Congress has established, the IRS regulation is in derogation of Congress' mandate.

In the decades since the adoption of this regulation, the IRS has compounded the problem by failing to define "primarily." Aggressive practitioners have argued that anything up to 49 percent would be permissible under the regulation, and this view has not been challenged by the IRS as it should have been.

Thus, your position that a social welfare organization can spend up to 49 percent of its expenditures on campaign activity and still be "exclusively" engaged in social welfare activity is contrary to the statute and to a long line of court decisions construing the relevant provisions of the Internal Revenue Code.

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[1] *See 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. U.S.*, 759 F.2d 792, 796 (10th Cir. 1985) (same; section 501(c)(4)).

[2] *See also New Dynamics Foundation v. United States*; 70 Fed. Cl. 782, 799 (Fed. Cl. Ct. 2006); *Nonprofits Ins. Alliance of California v. U.S.*, 32 Fed. Cl. 277, 282 (Fed. Cl. Ct. 1994).

Democracy 21 and the Campaign Legal Center provided our views on this matter at length in a Petition for Rulemaking that we submitted to the IRS in July 2011. The same views were provided again to the IRS in February 2014 in comments submitted by Representative Chris Van Hollen, Public Citizen, Democracy 21 and the Campaign Legal Center in the ongoing IRS rulemaking proceeding to reexamine the 501(c)(4) regulations. We have attached a copy of those comments for your information.

Since 2010, the "49 percent" approach has resulted in the growing improper use of section 501(c)(4) organizations to hide the identity of donors whose money is used for campaign activities to influence federal elections. In fact, section 501(c)(4) organizations have been the vehicle of choice for those who want to channel dark money into federal elections.

Unless the "49 percent" approach is eliminated, and IRS regulation and practice is conformed to the IRC statutory standard forbidding any spending for non-exempt purposes above a de minimis or insubstantial amount, section 501(c)(4) organizations will continue to spend hundreds of millions of dollars in secret contributions on campaign activities in contravention of the IRC.

The IRS has an obligation not only to ensure that the tax laws are properly interpreted and enforced, but also to avoid improperly providing license for activities that abuse the tax laws and undermine the integrity and transparency of federal elections. Given the use of section 501(c)(4) organizations as the primary vehicle for improperly spending secret money in federal elections, given the growth and magnitude of this problem to date, and given the likely further expansion of the problem in the absence of corrective action by the IRS, it is imperative that new IRS regulations make clear that a section 501(c)(4) organization cannot spend more than, at most, an insubstantial or de minimis amount of its expenditures on political activities.

Absent such a decision by the IRS, any other changes in IRS regulations governing section 501(c)(4) organizations will be ineffective in preventing such organizations from abusing the tax laws to improperly launder secret money into our elections.

In light of your recent comments, furthermore, we call on you to clarify that Congress did not create the "49 percent" approach and that there is no basis in law for that approach given the statutory provisions of the IRC and court decisions interpreting the provisions.

Sincerely,

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