

February 27, 2014

CC:PA:LPD:PR
REG-134417-13
Room 5205
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
1111 Constitution Avenue NW
Washington, DC 20044

Re: Comments on REG-134417-13 (relating to degree of permissible campaign intervention by social welfare organizations)

Dear Sir or Madam:

These comments are submitted on behalf of Representative Chris Van Hollen, Public Citizen, Inc., Democracy 21 and the Campaign Legal Center in response to the Notice of Proposed Rulemaking REG-134417-13, “Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities,” 78 Fed. Reg. 71535 (November 29, 2013).¹

Our comments address the question raised in the Notice of Proposed Rulemaking (NPRM) about the quantity of permissible campaign intervention by social welfare organizations under § 501(c)(4) of the Internal Revenue Code (IRC), 25 U.S.C. § 501(c)(4). Representative Van Hollen, Democracy 21 and the Campaign Legal Center are filing separate comments addressed to the related questions raised in the NPRM about the definition of “candidate-related political activity.” Public Citizen, Inc., in conjunction with its Bright Lines Project, is also filing separate comments on those questions.

¹ Rep. Van Hollen is a leading congressional proponent of disclosure of political contributions and other campaign finance reform measures. Public Citizen, Democracy 21, and the Campaign Legal Center are nonprofit organizations that advocate, among other things, the enactment and enforcement of campaign finance laws that protect against corruption of public officials and ensure an informed electorate. Together, the commenters were plaintiffs in *Van Hollen v. Internal Revenue Service*, No. 13-1276 (D.D.C.), a lawsuit challenging the IRS’s failure to commence rulemaking to revise TR § 1.501(c)(4)-1(a)(2)(i), which they voluntarily dismissed when the IRS initiated this rulemaking proceeding and included reconsideration of the regulation within its scope. Democracy 21 and the Campaign Legal Center had previously filed a petition for rulemaking seeking revision of TR § 1.501(c)(4)-1(a)(2)(i), which is attached hereto and incorporated by reference.

We applaud the IRS for initiating a rulemaking on the critically important issues raised by the NPRM and, in particular, for recognizing that a rulemaking addressing electoral activity by tax-exempt nonprofit organizations should include reconsideration of the IRS's current, and in our view fundamentally erroneous, position that such groups may engage in substantial electoral campaign activity as long as such activity is not their "primary" activity. We request the opportunity to testify at any public hearing held on this rulemaking.

Introduction

Section 501(c)(4) of the IRC provides tax exemption for "[c]ivic leagues or organizations not organized for profit but operated *exclusively* for the promotion of social welfare" (emphasis added). The IRS has long recognized that "promotion of social welfare" under § 501(c)(4) "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. (TR) § 1.501(c)(4)-1(a)(2)(ii). Yet the IRS has permitted purported social welfare organizations to engage in massive intervention in political campaigns by supplanting the statutory requirement that such organizations be operated *exclusively* for the promotion of social welfare with a regulatory standard under which "[a]n 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." TR § 1.501(c)(4)-1(a)(2)(i) (emphasis added).

By replacing the statutory command that § 501(c)(4) organizations exclusively pursue social welfare with the very different requirement that they do so only primarily, the IRS has permitted such organizations to maintain tax exemption even if they devote almost half of their resources to the most overt forms of electoral campaign intervention, as long as they are able to maintain that the slight majority of their activities have some plausibly non-electoral social welfare purpose. In so doing, the IRS has not only flouted the clear command of the governing statute, but has undermined congressional intent that tax exemption for organizations devoted to electoral activity be conditioned on compliance with the reporting and disclosure requirements applicable to political organizations under IRC § 527. The result has been, and will continue to be, a flood of campaign spending from undisclosed sources by purported social welfare organizations, in derogation of the strong public interest in the "transparency [that] enables the electorate to make informed decisions and give proper weight to different speakers and messages." *Citizens United v. FEC*, 558 U.S. 310, 371 (2010).

In its Notice of Proposed Rulemaking (NPRM) concerning Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, the Internal Revenue Service (IRS) acknowledged the apparent disjunction between the statutory requirement that § 501(c)(4) organizations pursue social welfare "exclusively" and the regulatory standard under which they need do so only "primarily," and requested comments "on what proportion of an organization's activities must promote social welfare for an organization to qualify under § 501(c)(4) and whether additional limits should be imposed on any or all activities that do not further social welfare." 78 Fed. Reg. 71535, 71538 (Nov. 29, 2013). These comments are addressed to those questions.

Although the NPRM does not propose a specific change to the existing regulation setting forth the "primarily" standard, we believe that addressing this issue is the most important aspect

of this rulemaking proceeding. Indeed, unless the IRS brings its regulations, and its practices in implementing them, into conformity with the statutory requirement that § 501(c)(4) organizations operate exclusively to promote social welfare, any clarifications of the definition of “candidate-related political activity” that it may achieve in this rulemaking will likely be ineffective in achieving the IRS’s stated objectives of “defin[ing] which organizations may receive the benefits of § 501(c)(4) tax-exempt status and ... promot[ing] tax compliance.” 78 Fed. Reg. at 71538. In the absence of a standard that meaningfully limits § 501(c)(4) organizations to their purpose of promoting social welfare, redefining the boundaries between electoral and social welfare activities will only underscore that § 501(c)(4) organizations may devote huge quantities of resources to the former as long as they can claim that the bare majority of their activity falls on the social welfare side of the line—even if that activity is, for example, heavily dominated by advertising that criticizes or promotes candidates but falls just outside the IRS’s definitions of “candidate-related political activity.” The result of leaving the “primarily” standard in place will thus be to further the transformation of § 501(c)(4) organizations into vehicles for the mobilization and use in electoral campaigns of undisclosed contributions on a massive scale.

1. The Plain Language of Section 501(c)(4) Requires That Organizations Pursue Social Welfare Purposes Exclusively, Not Primarily.

The IRS’s existing regulation, and the manner in which the IRS administers it, cannot be squared with the plain language of the governing statute. Although the statute requires that § 501(c)(4) organizations engage exclusively in social welfare activity, and the IRS acknowledges that intervening in electoral campaigns in support or opposition to candidates is not social welfare activity, the IRS allows § 501(c)(4) organizations to engage in substantial amounts of electoral activity because its regulation equates engaging “exclusively” in social welfare activity with engaging “primarily” in such activity. As the IRS itself put it in an August 2012 letter to Senator Carl Levin, the IRS has “interpreted ‘exclusively’ as used in section 501(c)(4) to mean primarily.”²

Although the IRS has not officially explained exactly what it means by “primarily” engaged in social welfare, there is a widely held understanding that the standard requires only that a bare majority—51%—of an organization’s activities qualify as promotion of social welfare, and that the remainder, as much as 49%, may be entirely devoted to electoral campaign activity or other non-social welfare activity. *See, e.g.*, Nicholas Confessore, “New Rules Would Rein In Nonprofits’ Political Role,” *N.Y. Times* (Nov. 26, 2013) (“Many election lawyers and their clients use an unofficial rule of thumb: If a tax-exempt group spends less than 50 percent of its budget on political activity, then its primary purpose is not winning campaigns.”). IRS training materials released in response to a Freedom of Information Act request confirm that the IRS itself follows the same rule of thumb, allowing § 501(c)(4) organizations to “make expenditures for political activities so long as such activities, in conjunction with any other non-

² Letter from Steven T. Miller, Deputy Commissioner for Services and Enforcement, Internal Revenue Service, to Hon. Carl Levin, Aug. 24, 2012, at 1, available at <https://www.levin.senate.gov/download/?id=e113a062-73bb-42dd-bf16-ea881142d007>.

qualifying activities, do not constitute the organization’s primary activity (51%).”³ In short, the IRS’s position, as expressed in the current regulation and the manner in which it is enforced, is that an organization engages exclusively in social welfare activity if the bare majority of its activity promotes social welfare.

The language of the governing statute unambiguously forecloses the possibility that an organization may legitimately qualify for tax exemption under § 501(c)(4) if it engages only “primarily” in promoting social welfare and has other substantial purposes and activities. The IRS’s current practice of requiring only that § 501(c)(4) organizations be *mostly* devoted to promoting social welfare contradicts the plain meaning of the statutory requirement that an exempt organization promote social welfare *exclusively*.

The IRS, no less than other agencies, “must give effect to the unambiguously expressed intent of Congress.” *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837, 842–43 (1984); *see also Loving v. IRS*, ___ F.3d ___, 2014 WL 519224, at *9 (D.C. Cir. Feb, 11, 2014). Thus, “no deference is due to agency interpretations at odds with the plain language of the statute itself. Even contemporaneous and longstanding agency interpretations must fall to the extent they conflict with statutory language.” *Public Employees Retirement System v. Betts*, 492 U.S. 158, 171 (1989). The agency’s “interpretation, whether old or new, must be consistent with the statute.” *Loving*, 2014 WL 519225, at *8.

Determining whether an agency’s interpretation of a statute comports with the law’s plain meaning, like all other questions of statutory construction, “must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose.” *Milner v. Dept. of Navy*, 131 S. Ct. 1259, 1264 (quoting *Park ’N Fly, Inc. v. Dollar Park & Fly, Inc.*, 469 U.S. 189, 194 (1985)). Here, the ordinary meaning of the statutory language enacted by Congress is incompatible with the existing regulation.

In common usage, to be engaged “exclusively” in a type of activity means to perform that activity to the exclusion of all else—to pursue *only* that activity. The relevant meanings of “exclusive,” as defined by widely available dictionaries, include “SINGLE, SOLE <exclusive jurisdiction>” and “WHOLE, UNDIVIDED <his exclusive attention>.” Merriam-Webster On-Line Dictionary, <http://www.merriam-webster.com/dictionary/exclusively>. Likewise, Webster’s Second New International Dictionary, Unabridged (1950), a source roughly contemporaneous with the enactment of § 501(c)(4), defines “exclusive” in the relevant sense as “Single; sole; as, an *exclusive* agent; an *exclusive* jurisdiction; also, singly devoted; undivided; as, giving his *exclusive* attention to the matter.” *Id.* at 890. The Oxford American Dictionary (1980) similarly defines “exclusive” as “not admitting something else; *the schemes are mutually exclusive*,” “(of terms etc.) excluding all but what is specified,” and “done or held etc. so as to exclude everything else, *his exclusive occupation; we have the exclusive rights*, not shared with others.” *Id.* at 299.

³ IRS, Exempt Organizations Determinations Unit 2, Student Guide, Training 29450-002 (Rev. 9-2009), at 7-19.

Thus, being operated “exclusively” to promote social welfare means being operated solely or only to that end. “Primarily,” on the other hand, means only “for the most part : CHIEFLY <has now become primarily a residential town ...>.” Merriam-Webster On-Line Dictionary, <http://www.merriam-webster.com/dictionary/primarily>. The word is “used to indicate the *main* purpose of something, reason for something, etc.,” *id.* (emphasis added)—not, unlike “exclusively,” its *sole* purpose. Equating “exclusively” with “primarily,” as the IRS’s current regulation does, amounts to defining “only” as “mostly.”

Tellingly, the IRS’s own general counsel, in a 1962 memorandum, acknowledged that the Service took the view “that an organization may qualify for exemption as a 501(c)(4) organization as long as it is primarily engaged in social welfare activities,” “*notwithstanding the statutory language*”—a clear recognition that the IRS’s regulation is in no sense an interpretation of the statute’s words.⁴ The regulation’s distortion of the language is comparable to that of a person who claims to be in an “exclusive” relationship with someone else because he cheats on her only 49% of the time.

2. The IRS’s Construction of “Exclusively” Is Irreconcilable With the Supreme Court’s Definitive Interpretation of the Statute.

The IRS’s “interpretation” of “exclusively” to mean “primarily” not only violates the statute’s plain language, but also the definitive construction of that language by the Supreme Court of the United States. In *Better Business Bureau v. United States*, 326 U.S. 279 (1945), the Supreme Court construed the meaning of a provision of a previous version of the IRC that exempted from social security taxation organizations “operated exclusively for religious, charitable, scientific, literary or educational purposes.” *Id.* at 280 n.1. The Better Business Bureau, an organization formed in part for educational purposes but also for the purposes of promoting the commercial interests of its members, sought exemption under the provision.

The Supreme Court rejected the claim of exemption on the ground that education was not the “sole aim” of the organization. *Id.* at 284. The Court stressed that, notwithstanding the argument that the exemption should be liberally construed, “[e]ven the most liberal of constructions does not mean that statutory words and phrases are to be given unusual or tortured meanings unjustified by legislative intent or that express limitations on such an exemption are to be ignored.” *Id.* at 283. The Court held that the statute meant exactly what it said:

[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.*

⁴ IRS, General Counsel Memorandum, GCM 32394, 1962 WL 14007, at *2 (Sept. 14, 1962) (emphasis added).

Id. (emphasis added). Because it was “apparent beyond dispute that an important if not the primary pursuit of petitioner’s organization” was promotion of non-educational ends, the Court held that the organization was not eligible for exemption. *Id.*

A number of aspects of the Court’s holding are significant. First, the Court gave the term “exclusively” its plain meaning, equating it with “sole,” *id.* at 284, and therefore recognizing that even a single non-exempt purpose was incompatible with an exclusive devotion to exempt purposes. *Id.* at 283. Second, the Court emphasized that the issue was not whether the quantity of exempt activity achieved some threshold level: Rather, pursuit of non-exempt ends was sufficient to deny exemption “regardless of the number or importance” of exempt purposes. *Id.* Third, the Court made clear that non-exempt activity did *not* have to be the “primary pursuit” of an organization to render exemption unavailable; a “substantial” or “important” non-exempt purpose was enough. *Id.* Fourth, the Court emphasized that the “operated exclusively” language it was construing was derived from the IRC provisions defining organizations exempt from income taxation (then-26 U.S.C. § 101, the forerunner of today’s § 501), and should receive the same construction in both contexts. *See id.* at 284–85.

The IRS’s existing regulation allowing tax exemption under § 501(c)(4) for organizations “primarily” engaged in promoting social welfare is incompatible with the Supreme Court’s construction of the plain meaning of the governing statutory language in *Better Business Bureau*. The regulation permits an organization to claim tax exemption if it has one or more substantial non-exempt purposes, in contradiction of the Supreme Court’s conclusion that the exempt purpose must be the organization’s “sole aim” and that even a “single” substantial non-exempt purpose suffices to “destroy” the exemption. *Id.* at 284, 283. The regulation also contradicts *Better Business Bureau* by making exemption turn on an assessment of the “number or importance,” *id.* at 283, of activities promoting the exempt purpose—that is, whether they are “primary”—as opposed to whether they are exclusive. Moreover, the regulation allows exemption of organizations whose “important” albeit “not primary pursuits,” *id.*, are non-exempt, again contrary to *Better Business Bureau*’s construction of the statutory language.

That the Supreme Court has construed the statutory term “exclusively” to have a meaning incompatible with the IRS regulation’s interpretation of it to mean “primarily” definitively establishes that the IRS regulation is unlawful. As the Supreme Court recently explained in *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836, 1843 (2012), where the Court has “already interpreted” the statutory language, “there is no longer any different construction that is ... available for adoption by the agency.” *Home Concrete* involved an IRS regulation purporting to interpret a provision of the IRC in a manner opposite to the construction the Supreme Court had given to “materially indistinguishable” language, *id.* at 1840, in an earlier version of the Code in its 1958 decision in *Colony, Inc. v. Commissioner*, 357 U.S. 28. The Court in *Home Concrete* emphasized that its earlier decision construing “identical” “operative language,” not the IRS’s subsequent contrary regulation, “determines the outcome in this case.” 132 S. Ct. at 1841. The Court specifically rejected the IRS’s contention that its subsequent regulation was entitled to deference as a construction of the statute: The court’s own definitive construction of the statute’s meaning, the Court concluded, left no interpretive “gap” for the agency to fill through regulation. *Id.* at 1844.

The same is even more true with respect to *Better Business Bureau* and the meaning of “exclusively.” In *Home Concrete*, the IRS was able to point to the fact that the Court in *Colony* had referred to the statutory language as ambiguous. That characterization of the statutory language provided at least an argument that the Court should defer to the agency’s own subsequent regulatory construction under *National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967, 982 (2005), which held that an agency’s regulation construing an ambiguous statute could take precedence over a previous judicial interpretation rendered in the absence of agency guidance. *Home Concrete* distinguished *Brand X* in part because the statutory construction in *Colony* preceded decisions articulating the requirement of deference to agency construction of ambiguous statutes in such cases as *Chevron v. NRDC*, *supra*, and thus the Court’s reference to ambiguity in *Colony* did not reflect a “conclusion that Congress had delegated gap-filling power to the agency.” 132 S. Ct. at 1836. *Better Business Bureau*, like *Colony*, long preceded *Chevron*. In the case of *Better Business Bureau*, however, there is no need to rely on that chronology to distinguish *Brand X*, because in *Better Business Bureau*, unlike *Colony*, the Court relied explicitly on the *unambiguous* nature of the statutory language, stating that it “plainly means” that even a single non-exempt purpose is fatal to exemption. 326 U.S. at 283. Where, as in *Better Business Bureau*, a “prior court decision holds that its construction follows from the unambiguous terms of the statute,” there is no question that the “court’s prior judicial construction of [the] statute trumps an agency construction.” *Brand X*, 545 U.S. at 982.

Better Business Bureau thus confirms that the plain words of the statute, prohibiting § 501(c)(4) organizations from pursuing even a single purpose other than promotion of social welfare, leave no room for the IRS’s regulatory standard, which permits such organizations to be operated for substantial non-exempt purposes as long as the bare majority of their activities promote social welfare. The IRS’s equation of “exclusively” with “primarily,” moreover, can claim no support in *Better Business Bureau*’s suggestion that “exclusively” permits some minimal level of pursuit of non-exempt purposes if those purposes are not “substantial.” 326 U.S. at 283. The Court’s recognition that an insubstantial non-exempt purpose may not defeat tax exemption under the statutory requirement that the organization be operated exclusively for exempt purposes merely reflects the principle that trifling deviations from statutory requirements may often (though not always) be overlooked under the principle “*de minimis non curat lex*.” See *Sandifer v. U.S. Steel Corp.*, 134 S. Ct. 870, 880 (2014); *Wisc. Dept. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 231–32 (1992).

That the statutory requirement of exclusivity may admit the possibility of *de minimis* or insubstantial activities directed to non-exempt aims cannot justify the existing regulation’s replacement of “exclusively” with “primarily.” Permitting § 501(c)(4) organizations to devote just short of half of their efforts to pursuing non-exempt purposes goes well beyond allowing *de minimis* or insubstantial deviations from the statutory requirement that they be operated exclusively to promote social welfare.⁵ Even if “exclusively,” as construed in *Better Business Bureau*, is ambiguous enough to allow *de minimis* exceptions, by reading it to mean no more than “primarily,” the IRS “has exceeded the scope of available ambiguity.” *John Hancock Mut.*

⁵ In *Haswell v. United States*, for example, the Court of Claims determined that activities constituting between 16.6 and 20.5 percent of an exempt organization’s budget in relevant tax years were “not *de minimis*” and “more than insubstantial.” 500 F.2d 1133, 1146, 1147 (Ct. Cl. 1974).

Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86, 109 (1993); *see also City of Chicago v. EPA*, 511 U.S. 328, 339 (10994) (rejecting agency construction that “goes beyond the scope of whatever ambiguity [the statute] contains”); *MCI Telecommun. Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218, 229 (1994) (“[A]n agency’s interpretation of a statute is not entitled to deference when it goes beyond the meaning that the statute can bear.”). “Put in *Chevron* parlance, the IRS’s interpretation fails ... because it is foreclosed by the statute.” *Loving*, 2014 WL 519224, at *9.

In sum, the IRS’s current regulation allowing § 501(c)(4) organizations to claim exemption as long as they devote less than half of their efforts to non-exempt activities (such as intervention in elections) is contrary to the statutory language and its interpretation by the Supreme Court. Conformity with the statute requires that the IRS amend its regulation to require that § 501(c)(4) organizations pursue promotion of social welfare to the exclusion of other activities, including electoral activity, that do not constitute promotion of social welfare; or, at most, that such non-social welfare activities be *de minimis* and insubstantial.

3. Requiring Section 501(c)(4) Organizations to Pursue Social Welfare Objectives to the Exclusion of Electoral Activity Is Consistent With Other IRC Provisions.

a. Section 501(c)(3).

That § 501(c)(4), unlike § 501(c)(3), does not in so many words prohibit an organization from “interven[ing] in ... any political campaign on behalf of (or in opposition to) any candidate for public office” does not imply that it permits substantial electoral activities. The clarity of the § 501(c)(3) proscription of political intervention in no way detracts from the clarity of § 501(c)(4)’s requirement that an organization be operated exclusively for social welfare purposes. Different statutory provisions may plainly have similar effect despite different wording. *See, e.g., Levin v. United States*, 133 S. Ct. 1224, 1234 (2013).

Moreover, giving effect to the “operated exclusively” requirement—which is applicable to § 501(c)(3) organizations as well as § 501(c)(4) organizations—does not render § 501(c)(3)’s proscription on campaign intervention superfluous, as the latter appears to be an even more categorical ban on a particular form of non-exempt activity (campaign intervention) than would flow from the “operated exclusively” requirement alone. Section 501(c)(3)’s campaign-intervention language has been consistently construed by courts and the IRS alike as imposing a complete ban, untempered by any *de minimis* exception or requirement that the prohibited activity be substantial. *See Branch Ministries v. Rossotti*, 211 F.3d 137, 142 (D.C. Cir. 2000); *Ass’n of the Bar of the City of New York v. Comm’r*, 858 F.2d 876, 881 (2d Cir. 1988); *United States v. Dykema*, 666 F.2d 1096, 1101 (7th Cir. 1981); *see also* IRS Pub. 557, *Tax-Exempt Status for Your Organization* 23 (Oct. 2013) (“If any of the activities (*whether or not substantial*) of your organization consist of participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for public office, your organization will not qualify for tax-exempt status under section 501(c)(3).” (Emphasis added)). By contrast, the statutory “operated exclusively” requirement, as construed by the Supreme Court in *Better Business Bureau*, does not exclude the possibility that an organization may retain its entitlement to tax exemption if it engages in insubstantial or *de minimis* electoral or other non-social welfare activity.

b. Section 527(f).

Nor does the fact that a § 501(c)(4) organization is subject to tax under IRC § 527(f) on expenditures it makes to influence the election of candidates imply that a § 501(c)(4) organization is permitted to make such expenditures, or to make them in substantial amounts. That such activity is taxable does not mean that it is permissible at all, let alone that it is permissible beyond a *de minimis* level. After all, § 501(c)(3) organizations that violate § 501(c)(3)'s complete prohibition of campaign intervention are also subject to the same tax on their political expenditures under § 527(f), as well as to additional taxes under IRC § 4955. Indeed, the IRS has explicitly stated that the taxability of political expenditures by § 501(c)(3) organizations does not imply that such expenditures are permissible even in insubstantial amounts: the IRC's taxation provisions for § 501(c)(3) political expenditures "do not permit a *de minimis* amount of political intervention." Final Regulations, *Political Expenditures by Section 501(c)(3) Organizations*, 60 Fed. Reg. 62209 (Dec. 5, 1995). That § 501(c)(4) political expenditures are subject to taxation under § 527(f) likewise says nothing about whether they are or are not permissible, or to what degree they are consistent with an organization's entitlement to tax exemption under § 501(c)(4).

c. Taxation of Unrelated Business Income.

Similarly, that § 501(c)(4) organizations, like § 501(c)(3) organizations, are subject to tax under IRC § 511 on their "unrelated business income" does not imply that they need not be operated exclusively for exempt purposes or that they may engage in substantial activities that do not serve those purposes. Again, that unrelated business income is subject to taxation by itself says nothing about the *degree* to which an organization may engage in activities generating such income without jeopardizing its tax status, and still less about whether it may engage in other types of activities, such as electoral campaign intervention, that are not exclusively aimed at promoting social welfare.

To be sure, the unrelated business income provisions contemplate that § 501(c) organizations will in some circumstances have income derived from business activities that would not themselves be eligible for tax exemption. But that does not mean that § 501(c)(4) (or (c)(3)) organizations may deviate from their statutorily required exclusive operation for exempt purposes in order to generate unrelated business income. Rather, long before the enactment of the provisions for taxation of unrelated business income, the Supreme Court had held that if unrelated business activities were "incidental" to the organization's exempt functions and were used *solely* to provide financial support for the pursuit of exempt purposes, they were consistent with the statutory requirement that the organization be operated *exclusively* for exempt purposes. *Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578, 581–82 (1924). In determining whether an organization's income-generating activities were consistent with its claim of tax exemption, later courts applied the same definition of "exclusively" that the Supreme Court adopted in *Better Business Bureau*, and held that engaging in business activity was inconsistent with tax exemption if it evinced "a single [non-exempt] purpose, if substantial in nature." *Stevens Bros. Fdn., Inc. v. Comm'r of Internal Revenue*, 324 F.2d 633, 638 (8th Cir. 1963) (quoting *Better Business Bureau*, 326 U.S. at 283); *see also C.F. Mueller Co. v. Comm'r of Internal Revenue*, 190 F.2d 120, 121 (3d Cir. 1951) ("[T]he exclusive purpose required by the statute is met when the *only* object of the organization involved originally was and continues to be

religious, scientific, charitable or educational, without regard to the method of procuring the funds necessary to effectuate the objective.” (Emphasis added.)).

The addition to the IRC of the provisions for taxation of unrelated business income in 1950 was not intended to *broaden* the ability of 501(c) organizations to engage in unrelated income-generating activities or eliminate the requirement that any such activities support the organizations’ exclusive pursuit of exempt purposes; rather, it was intended to place a further *constraint* on such organizations by limiting competitive advantages they might otherwise obtain over for-profit businesses.⁶ The unrelated business income provisions do not in any way eliminate the requirement that an organization be “operated exclusively” for exempt purposes; rather, an organization will continue to be denied exemption if its income-generating activities reveal a non-exempt purpose. *See, e.g., Ohio Teamsters Educ. & Safety Training Trust Fund v. Comm’r of Internal Revenue*, 692 F.2d 432 (6th Cir. 1982); *Parker v. Comm’r of Internal Revenue*, 365 F.2d 792, 796 (8th Cir. 1966). The IRC’s provisions for taxation of unrelated business income thus provide no support for the notion that the requirement that a § 501(c)(4) organization be “operated exclusively” for social welfare purposes means only that it need be operated “primarily” for such purposes.

Moreover, the rationale for considering incidental business activities that generate income used solely to support an organization’s exempt purposes to be consistent with the statutory requirement that the organization be “operated exclusively” for exempt purposes is inapplicable to activities, such as political campaign intervention, that involve the outlay of organizational resources for non-exempt purposes rather than the generation of resources to be used for exempt purposes. The latter activities cannot be considered “incidental to the pursuit of [exempt] purposes,” *Trinidad*, 263 U.S. at 581, nor do they generate “income ... devoted exclusively to [exempt] purposes.” *Id.* Rather, such activities reveal a substantial non-exempt purpose that defeats tax exemption under the “operated exclusively” standard.

4. Promotion of Social Welfare Does Not Include Electoral Activity.

For all the reasons explained above, the IRS’s current practice of permitting § 501(c)(4) organizations to engage in substantial electoral campaign activities is unsustainable to the extent that it rests on the IRS’s regulatory redefinition of the statutory requirement that an organization be “operated exclusively” for social welfare purposes to mean that the organization need only be “primarily” operated for such purposes. Under a proper interpretation of “exclusively,” any activity by a § 501(c)(4) organization to support or oppose a candidate for election to public office that rises above an insubstantial or *de minimis* level should disqualify it from tax exemption.

⁶ *See* Francis R. Hill, *Exemption and Commercial Activities: Approaches to Rationalizing the Unrelated Business Income Tax*, in Joint Comm. on Taxation, Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986, Vol. III, at 175, 178, 107th Cong., 1st Sess. (2001); *see also United States v. Amer. Coll. of Physicians*, 475 U.S. 834, 837–38 (1986); *C.F. Mueller*, 190 F.2d at 122 n.6.

This conclusion does share one significant premise with the IRS’s current position that a § 501(c)(4) organization may not engage primarily in electoral activity—namely, that “promotion of social welfare” under § 501(c)(4) “does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.” TR § 1.501(c)(4)-1(a)(2)(ii). This longstanding view of the IRS—unlike the agency’s equation of “exclusively” with “primarily”—is correct and should be retained as the basis for future regulatory treatment of electoral activity by social welfare organizations.

To begin with, unlike the Service’s view that “exclusively” means “primarily,” the IRS’s long-held view that social welfare activity does not include electoral campaign intervention does not conflict with either the plain meaning of any statutory language or any definitive judicial interpretation of such language. Nothing in the term “promotion of social welfare” unambiguously signifies that it includes electoral activity. Where, as in this instance, there is no unambiguous common meaning and “[t]he statute does not define the term ... and does not otherwise attend to the precise question,” the IRS’s definition is entitled to *Chevron* deference. *Mayo Found. for Med. Educ. & Research v. United States*, 113 S. Ct. 704, 711 (2011). Because the statute does not “unambiguously forbid” it, the agency’s “longstanding position” is entitled to “particular deference” under *Chevron* principles. *Barnhart v. Walton*, 535 U.S. 212, 218, 219, 220 (2002).

The IRS’s position that social welfare activity does not include campaign intervention also reflects accepted principles that have long guided interpretation of the term “social welfare.” Courts have “characterized the promotion of social welfare as involving the serving of ‘purposes beneficial to the community as a whole,’ or the promotion of the ‘welfare of mankind’ in the manner generally of the charitable, educational and religious organizations exempted by like provisions of the Code.” *People’s Educ. Camp Soc’y v. Comm’r of Internal Revenue*, 331 F.2d 923, 930 (2d Cir. 1964). Partisan electoral activity in support of specific political candidates and parties, by contrast, benefits not the community as a whole, but particular private interests. *See, e.g., Am. Campaign Acad. v. Comm’r of Internal Revenue*, 92 T.C. 1053 (1989) (holding that an organization providing training for Republican campaign staffers served a private interest).

That participation in partisan electoral activity does not constitute promotion of social welfare within the meaning of § 501(c)(4) finds strong confirmation in Congress’s 1975 enactment of IRC § 527, which for the first time provided tax exemption for political organizations, defined generally as organizations that accept contributions and make expenditures for the purpose of “influencing or attempting to influence the selection, nomination, election, or appointment of any individual” to public office. IRC § 527(e)(1). The enactment of § 527 reflected Congress’s understanding that organizations engaged in these activities were not otherwise entitled to tax exemption. *See* S. Rep. 93-1357, at 25–26 (1974). If, however, promotion of social welfare comprised electoral activity, even exclusively political organizations could simply have claimed tax exemption under § 501(c)(4)—and, indeed, could still do so—and the enactment of § 527 would have been superfluous.

Congress’s inclusion in § 527 of subsection (f), providing for taxation of § 501(c) organizations on expenditures aimed at influencing candidate elections, tends to confirm that § 527 reflects congressional ratification of the view that such electoral activity is not otherwise within the scope of the exempt purposes of § 501(c)(4) organizations and the other § 501(c)

organizations that are subject to the tax imposed by § 527(f). It would, after all, be anomalous to tax a tax-exempt organization for engaging in the very activity that gives rise to its exemption. By effectively creating a dichotomy between candidate-related political activity (taxable if engaged in by a 501(c) organization and exempt if undertaken by a § 527 organization) and other types of tax-exempt activities (exempt from taxation if undertaken by a § 501(c) organization operated for the purpose of engaging in such activities, but taxable if engaged in by a § 527 organization), § 527 strongly indicates that promotion of social welfare (and other purposes that serve as bases for tax exemption under § 501(c)) and candidate-related political activity are mutually exclusive. Section 527 thus reinforces the IRS's long-held position that promotion of social welfare does not include intervention in electoral campaigns.

5. Congress Has Not Acquiesced in the IRS's Permission of Substantial Electoral Activity by Section 501(c)(4) Organizations.

While legislation subsequent to the enactment of § 501(c)(4) does, as just indicated, reinforce the IRS's view that promotion of social welfare does not include intervention in campaigns for elective office, Congress has never taken any action that could be deemed ratification of the IRS's misconstruction of the statutory term "exclusively" to mean "primarily" and the Service's consequent tolerance of substantial electoral activity by § 501(c)(4) organizations. The critical language has remained unchanged since its enactment. That later Congresses did not affirmatively act to overturn the IRS's misreading of clear statutory language does not alter the meaning of the statute: "Congressional inaction cannot amend a duly enacted statute." *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 186 (1994) (citation omitted). Because "Congress takes no governmental action except by legislation," congressional silence in the face of an agency's construction of a statute generally reflects not "acquiescence," but "Congress's failure to express any opinion." *Rapanos v. United States*, 547 U.S. 715, 750 (2006) (plurality opinion).

Thus, the Supreme Court has generally declined to infer, from congressional silence, acquiescence in an agency's statutory interpretation that departs from the statute's plain language. *See Rapanos*, 547 U.S. at 750; *Solid Waste Agency of N. Cook County v. U.S. Army Corps of Eng'rs*, 531 U.S. 159, 168–72 (2001). Only where evidence clearly shows that Congress was confronted with the "precise issue" (for example, by repeatedly rejecting bills aimed at overturning the agency's construction) is a finding of acquiescence potentially appropriate; "[a]bsent such overwhelming evidence of acquiescence, we are loath to replace the plain text and original understanding of a statute with an amended agency interpretation." *Id.* at 681 n.5 (citing *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983)). There is no such overwhelming evidence here, and thus the statute's text remains controlling over the agency's "longstanding" misconstruction. *Betts*, 492 U.S. at 171.⁷

⁷ The Senate Report accompanying the legislation enacting IRC § 527 notes at one point that "[u]nder present law, certain tax-exempt organizations (such as sec. 501(c)(4) organizations) may engage in political campaign activities." S. Rep. No. 93-1357, at 29. That statement accurately summarized the effect of the IRS's regulation and did not indicate any focus by Congress on the precise question whether the regulation accurately reflected the statute. Moreover, nothing in the statement addresses the *degree* to

(footnote continued)

Any inference of acquiescence here is particularly implausible because the issue of large-scale participation by § 501(c)(4) organizations in political activity is of relatively recent origin. Until very recently, most § 501(c)(4) organizations were barred by federal election law from engaging in electioneering communications and expenditures to influence federal elections by the ban on corporate election spending in 2 U.S.C. § 441b. Only a small subset of nonprofit corporations were permitted to engage in campaign activity notwithstanding § 441b under the ruling in *FEC v. Massachusetts Citizens for Life*, 479 U.S. 238 (1986), which carved out a limited exception to the corporate ban for ideological nonprofit groups that accepted no funding from for-profit corporations. The ban on corporate campaign spending was loosened considerably in *FEC v. Wisconsin Right to Life, Inc.*, 551 U.S. 449 (2007) (*WRTL*), and then struck down in the Supreme Court’s 2010 decision in *Citizens United v. FEC*, 558 U.S. 310. As a result, campaign spending by § 501(c)(4) organizations was relatively small in amount before the 2008 and 2010 elections, the first to be affected by the decisions in *WRTL* and *Citizens United*, respectively; total reported spending by § 501(c)(4) organizations amounted to only \$3.2 million in the 2004 presidential election cycle and \$1.2 million in the 2006 congressional elections. See Center for Responsive Politics, *Political Nonprofits*, http://www.opensecrets.org/outsidespending/nonprof_summ.php. Only in 2008 did the amounts of spending by § 501(c)(4) organization begin to skyrocket, reaching \$82.7 million in the presidential campaigns of that year, \$92.2 million in the 2010 congressional elections, and \$256.3 million in the 2012 presidential election cycle. Thus, for the great bulk of the period in which the IRS’s regulation equating “exclusively” with “primarily” has been in force, its effect of permitting substantial campaign activity by § 501(c)(4) organizations has been a largely theoretical issue, and one unlikely to have engaged significant congressional attention.

6. Enforcement of the Statute’s Limitations on Activities of Section 501(c)(4) Organizations Would Be Consistent With the First Amendment.

Enforcing the statute as written would pose no substantial First Amendment concerns. Limiting § 501(c)(4) organizations, as a condition of their tax exemption, to the exclusive pursuit of the purposes that justify the exemption does not impair their First Amendment rights, but merely denies a tax benefit. That an organization may have a First Amendment right to engage in a particular type of speech does not imply that Congress must grant it a tax benefit when it does so—particularly when, as here, the organization has the option to participate in tax-exempt campaign activities under another section of the IRC if it is willing to comply with the entirely

which such organizations may engage in campaign activities or suggests that campaign activities may permissibly form a substantial part of a § 501(c)(4) organization’s actions. Moreover, as noted above, § 527 imposes tax on any § 501(c) organization that engages in campaign activity, without regard to whether it is permitted to do so, and thus, as the Senate Report elsewhere emphasized, the legislation was not intended to affect the question of the permissible scope of such activities. See *id.* at 30. The Report also reflected Congress’s expectation that with the passage of § 527, section 501(c) organizations seeking to participate in political activities would establish affiliated § 527 organizations, so that “campaign-type activities would be taken entirely out of the section 501(c) organization, to the benefit both of the organization and the administration of the tax laws.” *Id.* The Supreme Court in *Solid Waste Agency of Northern Cook County* specifically declined to find acquiescence in any agency construction that departed from a statute’s plain language on the basis of such equivocal statements in a committee report. See 531 U.S. at 170 n.6.

reasonable and constitutional conditions Congress has imposed on organizations that seek tax exemption for their pursuit of campaign activities.

These conclusions flow directly from the Supreme Court's decision in *Regan v. Taxation With Representation of Washington*, 461 U.S. 540 (1983). There, the Court upheld against constitutional challenge § 501(c)(3)'s prohibition on substantial lobbying activities by organizations claiming exemption under that section. Pointing out that "tax exemptions ... are a form of subsidy that is administered through the tax system," *id.* at 544, the Court held that the denial of such a subsidy for the exercise even of core First Amendment protected speech was constitutional, rejecting the "notion that First Amendment rights are somehow not fully realized unless they are subsidized by the State." *Id.* at 546 (quoting *Cammarano v. United States*, 358 U.S. 498, 515 (1959) (Douglas, J., concurring)). The Court also observed that the statute left the organization free to employ a "dual structure" in which it could obtain tax exemption for lobbying activities if it carried them out through a § 501(c)(4) organization.

The U.S. Court of Appeals for the D.C. Circuit later followed *Regan* in *Branch Ministries v. Rossotti*, *supra*, holding that the flat prohibition on campaign intervention by § 501(c)(3) organizations did not violate the First Amendment rights of a church. 211 F.3d at 143–44. The court noted that, as in *Regan* itself, any impact of the denial of tax exemption was obviated by the possibility of forming affiliated organizations that could obtain exemption for campaign activities under § 527:

As was the case with T[axation] W[ith] R[epresentation], the Church may form a related organization under section 501(c)(4) of the Code. *See* 26 U.S.C. § 501(c)(4) (tax exemption for "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare"). Such organizations are exempt from taxation; but unlike their section 501(c)(3) counterparts, contributions to them are not deductible. *See id.* § 170(c); *see also Regan*, 461 U.S. at 543, 552–53. Although a section 501(c)(4) organization is also subject to the ban on intervening in political campaigns, *see* 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii) (1999), it may form a political action committee ("PAC") that would be free to participate in political campaigns. *Id.* § 1.527-6(f), (g) ("[A]n organization described in section 501(c) that is exempt from taxation under section 501(a) may, [if it is not a section 501(c)(3) organization], establish and maintain such a separate segregated fund to receive contributions and make expenditures in a political campaign.").

Id. at 143.

The same reasoning applies even more directly to a § 501(c)(4) organization: Although it may not receive the subsidy of tax exemption if it violates the terms of § 501(c)(4) by engaging in substantial electoral activities, or other activities that do not serve social welfare purposes, it can create a dual structure under which an affiliated § 527 organization receives a comparable tax benefit for its campaign activity if it complies with the conditions imposed for exemption under § 527. Indeed, a § 501(c)(4) organization loses far less through the use of such an alternative than a § 501(c)(3) organization that must, under *Regan*, pursue lobbying through an affiliated § 501(c)(4) organization, or, under *Branch Ministries*, pursue electoral activities

through a double affiliation with a § 501(c)(4) organization that establishes a § 527 fund. In the latter instance, the affiliated organizations do not have the additional subsidy of tax deductibility for contributions that the § 501(c)(3) organization receives for its permissible activities. A § 501(c)(4) organization that must turn to § 527 to engage in tax-exempt campaign activity faces no comparable loss of its subsidy, as both types of organizations are generally exempt from taxation but may not receive deductible contributions from their supporters.

Of course, requiring that substantial political activities be conducted through a § 527 organization does require compliance with the conditions on tax exemption imposed by that section, including the requirement that large contributors be publicly disclosed. That consequence, however, has no serious First Amendment implications. Even when not imposed as a condition of a tax subsidy, requiring disclosure of political contributions does not violate the First Amendment because it serves the substantial governmental interest in informing the electorate of who is behind campaign messages while imposing only relatively minimal burdens on First Amendment interests. *See Citizens United*, 310 U.S. at 368–71. The imposition of disclosure requirements as a condition of the subsidy of tax exemption does not burden First Amendment speech at all. Rather, as the U.S. Court of Appeals for the Eleventh Circuit has observed, § 527’s disclosure requirements “fall[] squarely under *Regan*.” *Mobile Republican Assembly v. United States*, 353 F.3d 1357, 1361.

Congress has enacted no barrier to the exercise of [§ 527 organizations’] constitutional rights. Rather, Congress has established certain requirements that must be followed in order to claim the benefit of a public tax subsidy. Any political organization uncomfortable with the disclosure of expenditures or contributions may simply decline to register under section 527(i) and avoid these requirements altogether. The fact that the organization might then engage in somewhat less speech because of stricter financial constraints does not create a constitutionally mandated right to the tax subsidy.

Id. Enforcing § 501(c)(4) as written means no more than that organizations seeking to engage in substantial political campaign activity must comply with the entirely reasonable and constitutional conditions on exemption for such activities that § 527 imposes.

7. It Is Essential That the IRS Correct Its Misconstruction of Section 501(c)(4)’s Requirements.

Bringing the IRS’s regulations, and its implementation of them, into conformity with the statutory requirement that § 501(c)(4) organizations be operated exclusively for social welfare purposes—not electoral politics—is critically important. The recent explosion of political spending by § 501(c)(4) organizations, made possible by the IRS’s regulation permitting such organizations to engage in substantial electoral activity, has significantly undermined a fundamental policy reflected in American campaign finance law as well as tax law: Disclosure of the donors that fund political spending. Absent action by the IRS to bring its regulation into conformity with the statute, the floodtide of campaign spending by organizations that do not disclose the donors behind their political activities will continue to rise, with devastating effects on the transparency of our electoral system.

Disclosure of contributors who support campaign spending is a bedrock principle underlying laws regulating campaign finance regulation in both federal and state elections. The importance of such disclosure, and the undoubted constitutionality of requiring it, are the subject of broad consensus across the political and legal spectrum. Justice Kennedy’s opinion in *Citizens United* explained the rationale supporting laws requiring disclosure of political contributions and expenditures: Such laws “impose no ceiling on campaign-related activities” and “do not prevent anyone from speaking,” and they serve “a governmental interest in ‘provid[ing] the electorate with information’ about the sources of election-related spending.” 558 U.S. at 366, 367 (citations omitted). “[T]he public has an interest in knowing who is speaking about a candidate shortly before an election,” and that “informational interest alone is sufficient to justify” disclosure. *Id.* at 369.

[P]rompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. ... [D]isclosure 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.

Id. at 370–71.

Complementary provisions of the IRC and federal campaign finance laws work together to achieve the important purposes of disclosure. The Federal Election Campaign Act (FECA) provides that political committees—entities that have a major purpose of influencing elections and that make electoral expenditures and contributions—must provide comprehensive disclosure of their contributors and expenditures. *See* 2 U.S.C. § 434. Likewise, IRC § 527(j) provides that a tax-exempt political organization must report its contributions and expenditures if not already required to make such disclosures as a political committee under FECA.

Section 501(c)(4) organizations, by contrast, are not required to disclose to the public the sources of their funding, as the balance of interests advanced and potentially impaired by such disclosure where campaign spending is not involved may be very different from the balance with respect to contributions used for electoral campaign intervention. *Cf. NAACP v. Alabama ex rel. Patterson*, 357 U.S. 449 (1958). As a result of this difference, the effect of permitting § 501(c)(4) organizations to engage in substantial campaign spending is to allow evasion of the disclosure requirements otherwise applicable to tax-exempt political spending under § 527. Section 501(c)(4) organizations that engage in large-scale political spending are also likely to avoid the disclosures required for political committees under FECA: If an organization maintains that, notwithstanding major campaign spending, it is still “primarily” engaged in promotion of social welfare under the 51% rule of thumb that guides the IRS, it will also contend that it is not a political committee because its “major purpose” is not influencing federal elections, and at least

for the present it appears that such arguments will be convincing to three Federal Election Commissioners whose votes are sufficient to block enforcement action.⁸

The result is that § 501(c)(4) organizations are now available as vehicles for bypassing campaign contribution disclosure requirements on a massive scale. Section 501(c)(4) organizations can engage in electoral spending that dwarfs that of political committees and § 527 groups without subjecting themselves to comparable disclosure requirements, as long as they can maintain that the bare majority of their activities promote social welfare. Not surprisingly, once *WRTL* and *Citizens United* weakened and then removed the prohibition on corporate political spending that had prevented most § 501(c)(4) organizations from engaging in significant campaign activity, political operatives seeking to mobilize cash from donors who prefer to remain anonymous seized on them as the ideal vehicles for funneling dark money into the political system.

As a result, electoral campaign spending by § 501(c)(4) organizations, backed by anonymous donors, has soared. In the 2008 presidential election cycle, following the decision in *WRTL*, § 501(c)(4) organizations reported to the FEC that they had engaged in election-related spending totaling over \$82.7 million, after having reported only \$3.2 million in the 2004 presidential election cycle, according to the Center for Responsive Politics. See http://www.opensecrets.org/outsidespending/nonprof_summ.php. In the 2010 congressional elections, the first federal elections conducted after *Citizens United*, § 501(c)(4) organizations reported more than \$92 million in election-related spending to the FEC. *Id.* By contrast, in the 2006 congressional elections, § 501(c)(4) organizations had reported spending only \$1.2 million. See *id.* In the 2012 presidential election cycle, § 501(c)(4) organizations increased their reported election-related spending still further, to over \$256 million, a threefold increase over the amount spent in the 2008 presidential elections. See *id.*

Individual § 501(c)(4) organizations spent very substantial amounts in these elections. In the 2008 election cycle, a dozen § 501(c)(4) groups reported election-related spending in excess of \$1 million, with one group spending nearly \$9 million. See <http://www.opensecrets.org/outsidespending/summ.php?cycle=2008&chrt=V&disp=O&type=U>. In the 2010 congressional elections, the number of 501(c)(4) organizations reporting election-related spending exceeding \$1 million rose to 15. See <http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=V&disp=O&type=U>. One of those groups reported spending \$18.9 million, and another spent \$16.7 million. *Id.*

In the 2012 presidential elections, the number of § 501(c)(4) organizations with at least \$1 million in election-related spending had risen to 25, with seven spending more than \$10 million. See <http://www.opensecrets.org/outsidespending/summ.php?cycle=2012&chrt=V&disp=O&type=U>. One group alone spent over \$71 million; another spent \$36.4 million; and another spent \$25.4 million. *Id.* Over the 2010 and 2012 elections combined, one § 501(c)(4)

⁸ See *In re Crossroads Grassroots Policy Strategies*, MUR 6396, Statement of Reasons of Chairman Lee E. Goodman and Commissioners Caroline C. Hunter and Matthew S. Petersen, at 11–12 (Jan. 8, 2014), <http://eqs.fec.gov/eqsdocsMUR/14044350970.pdf>.

group, Crossroads GPS, engaged in more campaign spending—\$88 million—than all but two FEC-registered “super PACs.”

Section 501(c)(4) organizations and their anonymous funders have developed elaborate networks to transfer money among groups to facilitate electoral spending while ensuring the concealment of the identities of donors. The Washington Post recently reported, for example, that a network of ostensible social welfare organizations and other entities associated with billionaires Charles and David Koch raised and distributed approximately \$400 million in the 2012 elections and has plans for similar spending in this year’s congressional elections. Matea Gold, “Koch-backed political network, designed to shield donors, raised \$400 million in 2012,” *Wash. Post* (Jan. 5, 2014). Billionaire Tom Steyer has announced plans to raise and pour \$100 million into the 2014 elections to support pro-environmental candidates, using a 501(c)(4) organization, NextGen Climate Action, as well as an affiliated super PAC. See <http://www.factcheck.org/2014/02/nextgen-climate-action/>. Similar uses of § 501(c)(4) organizations are expected to proliferate in 2014 and beyond.

The increase in election campaign activity by § 501(c)(4) organizations is primarily responsible for a corresponding increase in electoral spending that is not accompanied by donor disclosure. The campaign expenditures of § 501(c)(4) organizations are almost entirely unaccompanied by donor disclosure. Only when donors specifically earmark contributions for particular electoral campaign expenditures, which is extremely rare, do existing campaign finance regulations result in disclosure by § 501(c)(4) organizations. As a result, only about 30% of election-related spending by groups other than the political parties and candidate committees (often referred to as “outside” spending) in the 2012 presidential election was accompanied by donor disclosure, and approximately \$310 million in electoral campaign spending was by non-disclosing groups (including § 501(c)(4) organizations as well as § 501(c)(6) organizations). See <http://www.opensecrets.org/outsidespending/disclosure.php>.

The operators of politically active organizations have openly acknowledged that they make use of § 501(c)(4) precisely because IRS regulations allow § 501(c)(4) organizations to channel large amounts of money into elections while at the same time avoiding donor disclosure requirements applicable to other types of organizations. For example, Carl Forti, an official of the 501(c)(4) group Crossroads GPS and the affiliated Super PAC American Crossroads (which, unlike Crossroads GPS, is a political committee subject to FECA disclosure requirements), has stated that “some donors didn’t want to be disclosed, and, therefore, the (c)(4) was created.” P. Overby, “Group Behind Election Ads Weighs In On Tax Deal,” *National Public Radio* (Dec. 14, 2010), <http://m.npr.org/story/132060878>. Similarly, the founders of a Super PAC supporting President Obama’s reelection in 2012, Priorities USA Action, set up a parallel 501(c)(4) organization, Priorities USA, to allow donors who preferred that their identities not be disclosed to contribute to independent spending in support of President Obama.

The huge and growing electoral campaign expenditures without donor disclosure by § 501(c)(4) organizations are directly attributable to the IRS’s regulation permitting such organizations to engage in substantial electoral campaign activity as long as they are “primarily” engaged in promoting social welfare. Politically active § 501(c)(4) organizations operate on the understanding that they will retain their tax exemption as long as they can plausibly maintain that more than 50% of their activity is aimed at promoting social welfare, even though they engage in

substantial election campaign intervention that itself is outside the scope of social welfare activity under § 501(c)(4). The result is that other participants in the political process, including voters, candidates, and political organizations, as well as persons and organizations who desire to study the sources of influence on the political process, are deprived of critical information about the financial interests served by electoral campaign spending. If the IRS were instead to enforce the requirement that § 501(c)(4) organizations engage exclusively in activity to promote social welfare, and thus refrain from engaging in substantial amounts of election campaign activity and expenditures, much of the electoral campaign spending currently carried out by § 501(c)(4) organizations would shift to other types of organizations—specifically, political committees regulated by FECA and other § 527 tax-exempt organizations—that are subject to donor-disclosure requirements. The resulting disclosures would materially advance the public’s “interest in knowing who is speaking about a candidate shortly before an election.” *Citizens United*, 558 U.S. at 369.

For these reasons, it is critical that the IRS use the opportunity of this rulemaking proceeding to bring its regulations into conformity with the statutory requirement that § 501(c)(4) organizations be “operated exclusively” for the promotion of social welfare—a requirement that precludes electoral spending and other campaign intervention that exceeds an insubstantial or *de minimis* level. The IRS should therefore replace the existing regulatory language permitting organizations to claim exemption under § 501(c)(4) if they are “primarily” engaged in social welfare activities with language making clear that the pursuit of non-social welfare objectives above an insubstantial or *de minimis* level is prohibited, and reinforcing that intervening in elections in support or opposition to candidates for public office is not promotion of social welfare and is not permitted.

Unless the IRS takes such action, any benefits resulting from more comprehensive, precise and accurate definitions of candidate-related political activity for § 501(c)(4) organizations are likely to be minimal. Such definitions will only underscore the activity that § 501(c)(4) organizations will improperly be permitted to pursue as long as they counterbalance it with a bare majority of activities that fall just outside the definition of electoral activity. The result of a rulemaking that does not address the requirement that § 501(c)(4) organizations be operated exclusively for non-electoral social welfare purposes will only be to perpetuate the ongoing misuse of § 501(c)(4) organizations to degrade and evade the disclosure requirements that are fundamental to our campaign finance laws and complementary provisions of the IRC.

8. Intervention in Candidate Elections Is Similarly Outside the Legitimate Tax-Exempt Purposes of Other 501(c) Organizations.

The NPRM requests comment on “whether the same or a similar approach should be adopted in addressing political campaign activities of other section 501(c) organizations.” 78 Fed. Reg. at 711537. With respect to both the question of whether electoral campaign activity is within the scope of the exempt purposes of such organizations, and the issue of how much, if any, such activity is permitted assuming it falls outside an organization’s exempt purposes, we urge the IRS to apply standards similar to those advocated above for § 501(c)(4) organizations.

The IRS has long recognized that electoral campaign intervention is fundamentally different from other kinds of activity undertaken by exempt organizations, including such

activity as lobbying, which, though “political” in some sense, may directly further the social-welfare mission of § 501(c)(4) organizations as well as the labor and business interests of §§ 501(c)(5) and 501(c)(6) organizations. Electoral activity, by contrast, involves the personal political beliefs of candidates and their supporters across a broad spectrum of issues, which “transcend” the types of interests that § 501(c) groups are organized to pursue. IRS, General Counsel Memorandum, GCM 34233, 1969 WL 20405, at *3 (Dec. 3, 1969). Thus, the IRS has taken the view that, just as electoral activity falls outside the scope of promotion of social welfare, it similarly falls outside the exempt purposes of other § 501(c) organizations. *See id.*

The enactment of § 527, providing a home in the tax code for the exemption of electoral activity, while conditioning that exemption on disclosure requirements not applicable to exempt organizations under § 501(c), reinforces this view. The availability of tax exemption for electoral activity under § 527, as well as the dichotomy § 527 generally draws between activities falling under § 527 and those activities engaged in by exempt organizations under § 501(c)—including its provisions concerning the taxation of both § 527 organizations and § 501(c) organizations when they stray beyond their respective spheres—underscores the general separation between electoral activity and activity properly within the exempt purposes of § 501(c) organizations.

In light of these considerations, the IRS should impose limits on the permissible degree of electoral activities of other § 501(c) organizations similar to those appropriate under § 501(c)(4). The failure to do so would allow further massive evasion of the proper limits on both permissible § 501(c)(4) activity and the disclosure requirements on which Congress has conditioned the availability of tax exemption for political organizations under § 527. Absent analogous limits on activities by other § 501(c) organizations, some organizations of the type now seeking to shelter electoral activity under the aegis of § 501(c)(4) are likely to claim exemption under some other category of § 501(c), as business leagues or veterans organizations, for example, and continue to avoid the disclosure obligations imposed on electoral activity properly engaged in by tax-exempt § 527 organizations.

Indeed, it appears that some organizations have already begun using this means of avoidance of the potential enforcement of real limits on electoral activity by § 501(c)(4) organizations. For example, an entity named “Freedom Partners” reportedly raised over \$250 million in 2012 and distributed the bulk of it in “grants” for electoral purposes to other exempt organizations. Although the organization appears to have been established to gather anonymous donations in extremely large amounts from wealthy individuals, it claims tax exemption under § 501(c)(6).⁹

Similar dark-money entities would be likely to proliferate if the IRS did not impose limits on the degree of electoral activity permissible for other § 501(c) organizations comparable to those necessary under § 501(c)(4). Indeed, the IRS has not, up to this time, allowed other § 501(c) organizations greater latitude to engage in electoral activity than § 501(c)(4) organizations. It is critically important that, while giving meaning to the statutory limits on non-

⁹ Mike Allen and Jim VandeHei, “The Koch brothers’ secret bank,” *Politico* (Sep. 11, 2013), <http://www.politico.com/story/2013/09/behind-the-curtain-exclusive-the-koch-brothers-secret-bank-96669.html>.

social welfare activities by § 501(c)(4) organizations, the IRS not simply create new avenues for the pursuit of electoral politics through tax-exempt organizations other than those into which Congress sought to channel such activity—namely, § 527 groups.

Respectfully submitted,

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**Before the Internal Revenue Service
U.S. Department of the Treasury**

Petition for Rulemaking On Campaign Activities by Section 501(c)(4) Organizations

Introduction

1. This petition for rulemaking, filed by Democracy 21 and the Campaign Legal Center, calls on the IRS to revise its existing regulations relating to the determination of whether an organization that intervenes or participates in elections is entitled to obtain or maintain an exemption from taxation under 26 U.S.C. § 501(c)(4). The existing IRS regulations do not conform with the statutory language of section 501(c)(4) of the Internal Revenue Code (IRC) nor with the judicial decisions that have interpreted this IRC provision and are, accordingly, contrary to law.

2. Following the Supreme Court's ruling last year in *Citizens United v. Federal Election Commission*, 130 S.Ct. 876 (2010), which struck down the ban on corporate spending in federal campaigns, non-profit corporations organized as "social welfare" organizations under section 501(c)(4) of the IRC engaged in an unprecedented amount of campaign spending to influence the 2010 congressional elections. According to the Center for Responsive Politics, spending by all section 501(c) groups in the 2010 election is estimated to have totaled as much as

\$135 million.¹ Virtually all of the money used for these campaign expenditures came from sources kept secret from the American people. The 2010 campaign thus witnessed the return of huge amounts of secret money to federal elections not seen since the era of the Watergate scandals.

3. Section 501(c)(4) of the IRC 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). IRS regulations make clear that spending to intervene or participate in political campaigns does not constitute “promotion of social welfare.” 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii).

4. Current IRS regulations, nevertheless, authorize section 501(c)(4) organizations to intervene and participate in campaigns as long as such campaign activities do not constitute the “primary” activity of the organization, which must be the promotion of social welfare. 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i). The “primary” activity standard established by the IRS regulation is not further defined by the IRS. Instead, a revenue ruling explains that “all facts and circumstances are taken into account in determining a § 501(c)(4) organization’s primary activity.” Practitioners, however, have interpreted this “primary” activity requirement to mean that section 501(c)(4) organizations can spend up to 49 percent of their total expenditures in a tax year on campaign activities, without such campaign activities constituting the “primary” activity of the organization.

5. These regulations and interpretations are in direct conflict with the statutory language of the IRC that requires section 501(c)(4) organizations to engage *exclusively* in the promotion of social welfare and with court decisions that have held that section 501(c)(4)

¹ See <http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&disp=O&type=U&chrt=D>.

organizations cannot engage in a substantial amount of “nonexempt activity,” such as campaign activity. Contrary to the IRC language and court decisions, the regulations permit 501(c)(4) organizations to engage in *substantial* campaign activity, as long as this nonexempt activity falls just short of being the organization’s “primary” activity. Thus the regulations permit far more campaign activity by a 501(c)(4) organization than the limited amount allowed by the statute and court decisions. The IRS’s regulations conflict with the IRC and court decisions interpreting the IRC, and are contrary to law.

6. This petition calls on the IRS to expeditiously adopt new regulations to provide that an organization that intervenes or participates in elections is not entitled to obtain or maintain tax- exempt status under section 501(c)(4) if the organization spends *more than an insubstantial amount* of its total expenditures in a tax year on campaign activity. The new regulations should include a bright-line standard to make clear that an “insubstantial amount” of campaign activities means a minimal amount, not 49 percent, of its activities. The bright-line standard should place a ceiling on campaign expenditures of no more than 5 or 10 percent of total annual expenditures in order to comply with the standard used by the courts that a section 501(c)(4) organization may engage in no more than an insubstantial amount of non-exempt activity.

7. Such a bright-line standard is necessary to ensure that the public and the regulated community have clear and proper guidance on the total amount of campaign activity that a section 501(c)(4) organization can conduct and to assist the IRS in obtaining compliance with, and in properly enforcing, the IRC.

8. If a section 501(c)(4) organization wants to engage in more than the insubstantial amount of campaign activities permitted by the IRC and court decisions, the organization can

establish an affiliated section 527 organization to do so. The IRS regulations, however, must make clear that a section 527 organization (or any other person) cannot be used by a section 501(c)(4) organization to circumvent the limit on how much a 501(c)(4) organization can spend on campaign activities. Accordingly, the new regulations should provide that a section 501(c)(4) organization may not obtain or maintain tax-exempt status if the section 501(c)(4) organization transfers funds to a section 527 organization or to any other person during its taxable year with the intention or reasonable expectation that the funds will be used to intervene or participate in campaigns, and if the transferred funds, when added to the amount directly spent by the section 501(c)(4) organization on campaign activities during the same taxable year exceeds the insubstantial amount restriction imposed by the IRC and the courts.

9. The petition calls on the IRS to act promptly to ensure that new regulations are put in place and made effective on a timely basis for the 2012 elections. The IRS must recognize the urgent need to prevent section 501(c)(4) organizations from being improperly used to spend hundreds of millions of dollars in secret contributions to influence the 2012 presidential and congressional elections.

Petitioners

10. Democracy 21 is a nonpartisan, nonprofit organization that works to strengthen our democracy, protect the integrity of our political system against corruption and provide for honest and accountable elected officeholders and public officials. The organization promotes campaign finance reform, lobbying and ethics reforms, transparency and other government integrity measures, conducts public education efforts to accomplish these goals, participates in litigation involving the constitutionality and interpretation of campaign finance laws and engages in efforts to help ensure that campaign finance laws are properly enforced and implemented.

11. The Campaign Legal Center is a nonpartisan, nonprofit organization that works in the areas of campaign finance and elections, political communication and government ethics. The Campaign Legal Center offers nonpartisan analyses of issues and represents the public interest in administrative, legislative and legal proceedings. The Campaign Legal Center also participates in generating and shaping our nation's policy debate about money in politics, disclosure, political advertising, and enforcement issues before the Congress, the Federal Communications Commission, FEC and the IRS.

Factual Background

12. The *Citizens United* decision was issued by the Supreme Court on January 21, 2010. According to one published report, “[O]utside groups were able to adapt quickly and take advantage of the *Citizens United* decision in early 2010 to spend enough to impact congressional elections just nine months later.”² Much of this outside spending was done by section 501(c)(4) organizations that made campaign expenditures without disclosing the sources of these funds.

13. Section 501(c)(4) organizations played an important overall role in the 2010 campaign. A recent article in *Roll Call* states:

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 they do not have to disclose, and Republicans believe their participation in the campaign brought the party to parity with Democrats, who typically benefit from the largesse of organized labor.³

² K. Doyle, “2010 Battle Over Citizens United Ruling Still Unresolved as 2012 Campaign Looms,” *BNA Money & Politics Report* (Jan. 12, 2011)

³ A. Becker and D. Drucker, “Members Weigh in on Draft Disclosure Order,” *Roll Call* (May 24, 2011).

14. The role of secret money in the 2010 congressional races is illustrated by the activities of Crossroads GPS (“GPS” stands for “Grassroots Policy Strategies”), which was organized in July 2010 under section 501(c)(4) and was one of the organizations that engaged in the greatest amount of independent spending to influence the 2010 congressional races.⁴

Crossroads GPS is affiliated with American Crossroads, a non-profit political organization registered under 26 U.S.C. §527. American Crossroads is registered with the Federal Election Commission as a political committee under the Federal Election Campaign Act.

15. According to a report in *Time*, “American Crossroads was the brainchild of a group of top Republican insiders, including two of George W. Bush’s closest White House political advisers, Karl Rove and Ed Gillespie, both of whom remain informal advisers.”⁵ Another published report referred to American Crossroads and Crossroads GPS as “a political outfit conceived by Republican operatives Karl Rove and Ed Gillespie.”⁶ According to the *Los Angeles Times*, both groups “receive advice and fundraising support from Rove.”⁷

⁴ Democracy 21 and the Campaign Legal Center filed an IRS complaint against Crossroads GPS on October 5, 2010, requesting the IRS to investigate whether Crossroads GPS was operating in violation of the current requirements for obtaining or maintaining section 501(c)(4) tax status. Even under the existing, overly permissive IRS regulations, the complaint said the IRS “should investigate whether Crossroads GPS has a primary purpose of ‘participation or intervention in political campaigns on behalf of or in opposition to’ candidates for public office, which is not a permissible primary purpose for a section 501(c)(4) organization.” Complaint at 15.

⁵ M. Crowley, “The New GOP Money Stampede,” *Time* (Sept. 16, 2010).

⁶ K. Vogel, “Rove-tied group raises \$2 million,” *Politico* (Aug. 21, 2010).

⁷ M. Reston and A. York, “Karl Rove-linked group launches new hit against Boxer,” *The Los Angeles Times* (Aug. 25, 2010).

16. According to the Center for Responsive Politics, Crossroads GPS spent a total of \$17.1 million on campaign activity, including both independent expenditures and electioneering communications, in the 2010 federal elections.⁸

17. According to published reports, Crossroads GPS was created as a section 501(c)(4) group to receive contributions to pay for campaign expenditures from donors who wanted to secretly influence federal elections and did not want their names disclosed, as they would have been if the contributions had gone instead to its section 527 affiliate, American Crossroads, which is required to disclose its donors.

18. As one published report states:

A new political organization conceived by Republican operatives Karl Rove and Ed Gillespie formed a spin-off group last month that – thanks in part to its ability to promise donors anonymity – has brought in more money in its first month than the parent organization has raised since it started in March.⁹

The same article quotes Steven Law, the head of both American Crossroads and Crossroads GPS as saying that “the anonymity of the new 501(c)(4) GPS group was appealing for some donors.”

Id. The article also states:

[A] veteran GOP operative familiar with the group’s fundraising activities said the spin-off was formed largely because donors were reluctant to see their names publicly associated with giving to a 527 group, least of all one associated with Rove, who Democrats still revile for his role in running former President George W. Bush’s political operation.

⁸ See [http://www.opensecrets.org/outsidespending/detail.php?cmte=Crossroads+ Grassroots+ Policy+Strategies&cycle=2010](http://www.opensecrets.org/outsidespending/detail.php?cmte=Crossroads+Grassroots+Policy+Strategies&cycle=2010).

⁹ K. Vogel, “Rove-linked group uses secret donors to fund attacks,” *Politico* (July 21, 2010) (emphasis added).

Id. In another article, Law is quoted as saying, “I wouldn’t want to discount the value of confidentiality to some donors.”¹⁰

19. Another published report calls Crossroads GPS a “spinoff of American Crossroads” and states that “this 501-c-4 group can keep its donor list private – a major selling point for individuals and corporations who want to anonymously influence elections.”¹¹ At a public appearance, Carl Forti, the political director for Crossroads GPS and its affiliate, American Crossroads, made clear that campaign spending was directed through a 501(c)(4) arm precisely because American Crossroads is seeking to provide donors with the opportunity to secretly finance these campaign expenditures:

Forti acknowledged that his group relied heavily on its nonprofit arm, which isn’t required to name the sources of its funding, simply because “some donors didn’t want to be disclosed. . . .I know they weren’t comfortable.”¹²

In another article, Forti is quoted as saying, “You know, disclosure was very important to us, which is why the 527 was created. But some donors didn’t want to be disclosed, and, therefore, the (c)(4) was created.”¹³

20. According to press reports, Crossroads GPS will remain very active in the 2012 elections. One report states that American Crossroads, the section 527 arm, engaged in heavy

¹⁰ K. Vogel, “Crossroads hauls in \$8.5M in June,” *Politico* (June 30, 2010).

¹¹ H. Bailey, “A guide to the ‘shadow GOP’: the groups that may define the 2010 and 2012 elections,” *The Upshot-Yahoo News* (Aug. 5, 2010).

¹² S. Peoples, “Groups Target Democrats Using Nancy Pelosi,” *Roll Call* (Dec. 14, 2010).

¹³ P. Overby, “Group Behind Election Ads Weighs In On Tax Deal,” *National Public Radio* (Dec. 14, 2010).

spending in a special congressional election in New York State held in May, 2011. According to this report:

Crossroads and its nonprofit affiliate, Crossroads GPS, have vowed to raise \$120 million for the 2012 cycle.

Crossroads spokesman Jonathan Collegio said. . .Crossroads will continue to spend heavily in many competitive races through next November.

“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.¹⁴

The statement by the Crossroads spokesman makes clear that Crossroads GPS, the section 501(c)(4) arm, will be “heavily” involved in spending to influence the 2012 federal elections. According to another recent report, “American Crossroads and Crossroads GPS, two groups that have relied heavily on fundraising help from political guru Karl Rove, have said they’re aiming to raise \$120 million for the next election, versus the \$71 million they raised in 2010. . . .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.”¹⁵

21. Section 501(c)(4) groups will be used by both Democratic and Republican groups in 2012 as vehicles to allow anonymous donors to secretly finance campaign expenditures. (In the 2010 congressional races, the section 501(c)(4) groups were primarily pro-Republican groups.) According to an article in the *Los Angeles Times* (April 29, 2011), former Obama

¹⁴ D. Eggen, “Political groups, now free of limits, spending heavily ahead of 2012,” *The Washington Post* (May 21, 2011) (emphasis added).

¹⁵ P. Stone, “Obama groups raise \$4-5 million in first two months,” *iWatch News – The Center for Public Integrity* (June 24, 2011) (<http://www.iwatchnews.org/2011/06/24/5025/obama-groups-raise-4-5-million-first-two-months>).

White House officials and Democratic political operatives Bill Burton and Sean Sweeney have formed a new section 501(c)(4) group to participate in the 2012 presidential election:

Priorities USA has been formed as a 501(c)(4) organization – a nonprofit social welfare group that can raise unlimited amounts of money without disclosing the identity of its donors. It putatively is designed to focus on issues – in this case, “to preserve, protect and promote the middle class” – but can spend up to half its money on political activities.¹⁶

An article in the *New York Times* states:

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 the 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.

Like Crossroads GPS, Democrats connected to the groups – including a close onetime aide to Mr. Obama, the former deputy White House spokesman Bill Burton, and Sean Sweeney, a former aide to the former White House chief of staff Rahm Emanuel – said that Priorities USA would be set up under a section of the tax code that allows its donors to remain anonymous if they so choose (as most usually do).¹⁷

22. According to information compiled by the Center for Responsive Politics, there were 45 groups organized under section 501(c) of the Internal Revenue Code that reported making “independent expenditures” of \$100,000 or more in the 2010 congressional elections, and which in aggregate totaled more than \$50 million. These groups, with minor exceptions, did not disclose their donors.¹⁸ “Independent expenditures” are defined as expenditures for

¹⁶ M. Gold, “Former Obama aides launch independent fundraising groups,” *Los Angeles Times*, April 29, 2011.

¹⁷ J. Rutenberg, “Democrats Form Fund-Raising Groups,” *The New York Times* (April 29, 2011) (emphasis added).

¹⁸ See <http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=D&disp=O&type=I>.

communications that contain “express advocacy” or the “functional equivalent” of express advocacy. 2 U.S.C. § 431(17)(a). The top section 501(c)(4) groups in this category included:

501(c)(4) Corporation	Amount Spent on Independent Expenditures in 2010 Elections	Disclosure of Contributors Funding Independent Expenditures in 2010
Crossroads GPS	\$16 Million	None
American Future Fund	\$7.4 Million	None
60 Plus Association	\$6.7 Million	None
American Action Network	\$5.6 Million	None
Americans for Tax Reform	\$4.1 Million	None
Revere America	\$2.5 Million	None

23. According to the Center for Responsive Politics, there were 20 section 501(c) groups that reported spending \$100,000 or more for “electioneering communications” in the 2010 congressional elections, expenditures that in aggregate totaled more than \$70 million. These groups, with minor exceptions, did not disclose their donors.¹⁹ “Electioneering communications” are defined as expenditures for broadcast ads that refer to federal candidates and are aired in the period 60 days before a general election or 30 days before a primary election. 2 U.S.C. § 434(f)(3). The top section 501(c)(4) groups in this category included:

501(c)(4) Corporation	Amount Spent on Electioneering Communications in 2010 Elections	Disclosure of Contributors Funding Electioneering Communications in 2010
American Action Network	\$20.4 Million	None
Center for Individual Freedom	\$2.5 Million	None
American Future Fund	\$2.2 Million	None
CSS Action Fund	\$1.4 Million	None
Americans for Prosperity	\$1.3 Million	None
Crossroads GPS	\$1.1 Million	None

¹⁹ See <http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=V&disp=O&type=E>.

24. The Center for Responsive Politics reports that, in aggregate, section 501(c) groups that disclosed none of their donors spent a total of more than \$137 million on independent expenditures and electioneering communications to influence the 2010 elections.²⁰

25. Campaign spending by section 501(c)(4) organizations is expected to greatly increase in the 2012 presidential and congressional races. As one published report states,

[W]ith a full two years instead of a few months to adapt to the changed legal landscape, such outside groups may be poised to have even bigger impact, experts say. Additionally, Democratic-leaning groups were somewhat subdued in 2010, due at least partly to the public stance of Obama and top congressional Democrats in opposition to the *Citizens United* ruling and its impact on campaign spending. This may not be the case in 2012, as many observers predict that Democratic-leaning groups will gear up to compete more effectively.²¹

Since 2012 involves a presidential election as well as congressional races, and since it is expected that Democratic and Republican groups will use section 501(c)(4) organizations to make campaign expenditures in 2012, section 501(c)(4) organizations are expected to spend far greater amounts of secret contributions in the 2012 elections than they did in 2010, absent the IRS adopting new regulations on a timely basis to ensure that section 501(c)(4) organizations can engage in no more than an “insubstantial” amount of campaign activities, in compliance with the IRC and court decisions.

²⁰ See <http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=D&disp=O&type=U>.

²¹ Doyle, *BNA Report*, *supra*.

Basis for New Rulemaking

26. 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).

27. IRS regulations state that spending to intervene or participate in campaigns does not constitute promotion of social welfare. Section 1.501(c)(4)-1(a)(2)(ii) of the IRS regulations 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).

28. Contrary to the statutory language of the IRC, IRS regulations construe the requirement that a 501(c)(4) organization be “operated exclusively” for the promotion of social welfare to be met if the organization is “primarily engaged” in social welfare activities. This is a highly unusual interpretation of the word “exclusively.” According to the 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. An organization embraced within this section is one which is operated primarily for the purpose of bringing about social betterments and civic improvements.” 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) (emphasis added).

29. In a revenue ruling, the IRS has stated, “Although the promotion of social welfare within the meaning of section 501(c)(4)-1 of the regulations does not include political campaign activities, the 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 engaged primarily in activities that promote social

welfare.” Rev. Rul. 81–95, 1981–1 C.B. 332 (emphasis added). The “primarily engaged” standard established by the IRS regulation is not further defined by the IRS. Instead, a revenue ruling explains that “all facts and circumstances are taken into account in determining a § 501(c)(4) organization’s primary activity.” Rev. Rul. 68-45, 1968-1 C.B. 259.

30. In the absence of guidance from the IRS, practitioners have interpreted the “primarily engaged” standard to mean that a section 501(c)(4) organization can spend as much as 49 percent of its total expenditures in a taxable year on campaign activities and still be in compliance with the IRC. A report by the Congressional Research Service (CRS), for instance, states with regard to the “primarily engaged” standard, “some have suggested that primary simply means more than 50%”²² The report notes that “others have called for a more stringent standard,” but explains that even this “more stringent” standard would still permit substantial campaign expenditures of up to 40% of total program expenditures. *Id.*

31. Under the IRS “primarily engaged” standard, section 501(c)(4) groups have engaged in substantial campaign activity. This is contrary to the language of the IRC, which requires (c)(4) organizations to be “operated exclusively” for social welfare purposes and contrary to court rulings interpreting the IRC to mean that section 501(c)(4) organizations are not allowed to engage in a substantial amount of an activity that does not further their exempt purposes. As IRS regulations have made clear, intervention or participation in campaigns does not further the “social welfare” purposes of section 501(c)(4) organizations, and so the court rulings mean that section 501(c)(4) organizations cannot engage in more than an insubstantial amount of campaign activities.

²² Congressional Research Service, “501(c)(4) Organizations and Campaign Activity: Analysis Under Tax and Campaign Finance Law,” R40183 (January 29, 2009) at 2.

32. 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. 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).

33. 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 “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).

34. 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.

35. Given that a number of section 501(c)(4) organizations have spent millions of dollars on campaign activities, and that it is reasonable to anticipate more will do so in 2012, it is clear that the current regulations are not preventing section 501(c)(4) organizations from impermissibly engaging in “substantial” campaign activities.

36. Accordingly, this petition calls on the IRS to promptly issue new regulations that properly define the statutory requirement for section 501(c)(4) organizations to be “operated exclusively” for social welfare purposes to mean that campaign activity may not constitute more than an insubstantial amount of the activities of a group organized under section 501(c)(4). These regulations are necessary to bring IRS rules into compliance with the IRC and with court rulings interpreting the IRC. The regulations also would have the effect of greatly diminishing the practice of section 501(c)(4) groups being improperly used to spend large amounts of secret contributions in federal elections.

37. In order to provide a clear definition of what constitutes an insubstantial amount of campaign activity, the IRS regulations should include a bright-line standard that specifies a cap on the amount that a section 501(c)(4) organization can spend on campaign activities. *See, e.g.*, 26 U.S.C. §501(h) (providing specific dollar limits on spending for lobbying activities by

section 501(c)(3) organizations). In order to comply with court decisions that limit spending for non-exempt purposes to an insubstantial amount, the bright line standard in the regulations should limit campaign expenditures to no more than 5 or 10 percent of the expenditures in a taxable year by a section 501(c)(4) organization.

38. The new regulations should ensure that a section 501(c)(4) organization cannot do indirectly through transfers what it is not permitted to do directly through its own spending. In order to accomplish this, the new regulations should provide that a section 501(c)(4) organization may not obtain or maintain its tax-exempt status if the it transfers funds to a section 527 organization or to any other person with the intention or reasonable expectation that the recipient will use those funds to intervene or participate in campaigns if, during the same taxable year, the amount of funds so transferred, when added to the amount spent directly for campaign activity by the section 501(c)(4) organization, exceeds an insubstantial amount of the total spending for the taxable year by the section 501(c)(4) organization.

Conclusion

39. Political operatives have established, and are continuing to establish, section 501(c)(4) organizations for the explicit purpose of providing a vehicle for donors to secretly finance campaign expenditures by these organizations. The overriding purpose of a number of these 501(c)(4) organizations is to conduct full-scale campaign activities in the guise of conducting “social welfare” activities.

40. IRS regulations that are contrary to law are enabling section 501(c)(4) organizations to conduct impermissible amounts of campaign activities and in doing so to keep secret from the American people the sources of tens of millions of dollars being spent by the

section 501(c)(4) organizations to influence federal elections. In so doing, the IRS regulations are serving to deny citizens essential campaign finance 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.” 130 S.Ct. at 916.

41. The Supreme Court in *Citizens United* explained the importance to citizens of this disclosure, stating:

With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters.

Shareholders can determine whether their corporation’s political speech advances the corporation’s interest in making profits, and citizens can see whether elected officials are “‘in the pocket’ of so-called moneyed interests.”

Id. By an 8-1 vote, the Supreme Court in *Citizens United* held that disclosure of campaign activities by corporations, including tax-exempt corporations, is constitutional and serves important public purposes. Such disclosure, however, is being widely circumvented and evaded by section 501(c)(4) organizations as a result of improper IRS regulations and the failure of the IRS to properly interpret and enforce the IRC to prohibit section 501(c)(4) organizations from making substantial expenditures to influence political campaigns. This failure comes at great expense to the American people who have a right to know who is providing the money that is being spent to influence their votes.

42. The large scale spending of secret contributions in federal elections by section 501(c)(4) organizations is doing serious damage to the integrity and health of our democracy and political system. The IRS needs to act promptly to address this problem by issuing new regulations to stop section 501(c)(4) organizations from being improperly used to inject tens of

millions of dollars in secret contributions into federal elections. The new regulations must conform with the IRC and with court rulings interpreting the IRC. The regulations should provide a bright-line standard that implements the insubstantial expenditures standard set forth by the courts and specifies a limit on the amount of campaign activity that a section 501(c)(4) organization may undertake consistent with its tax-exempt status. The IRS needs to act expeditiously to ensure that the new regulations are in effect in time for the 2012 elections.

Respectfully submitted,

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