February 27, 2014

The Honorable Jacob J. Lew
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

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

Comments on Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities

Dear Secretary Lew and Commissioner Koskinen:

We submit the below as comments regarding the Department of the Treasury and Internal Revenue Service Notice of Proposed Rulemaking pertaining to candidate-related political activities by tax-exempt social welfare organizations.[1]

Introduction

First, we commend Treasury and the IRS for taking this much-needed and long-awaited step toward clarifying limitations on political spending by 501(c)(4) social welfare organizations. As you know, political operatives have for years been using 501(c)(4) organizations as de facto Political Action Committees in order to hide their donors' identities and frustrate campaign finance law disclosure requirements, thereby undermining the integrity of our elections.

Citizens United and Disclosure

In 2010, the Supreme Court struck down provisions of the Bipartisan Campaign Reform Act ("BCRA" or "McCain-Feingold") in *Citizens United v. Federal Election Commission*,[2] allowing unlimited corporate spending in elections. That decision was premised on the belief that BCRA's disclosure requirements, which remained intact, created a regime of "effective disclosure" that would "provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters."[3]

However, following *Citizens United*, that regime of "effective disclosure" has completely broken down with regard to non-profit groups, in large part because of ambiguous and permissive

[1] Prop. Treas. Reg. § 1.501(c)(4), 78 Fed. Reg. 230 (2013).
[2] *Citizens United v. FEC*, 558 U.S. 310 (2010).
[3] *Id.* at 370. The justices upheld BCRA's disclosure requirements by an 8-1 margin. *Id.* at 372.

Treasury rules regarding political spending by these groups. Many of these groups formed as 501(c)(4)s because the current rules allow them to avoid disclosure.[4] According to the Center for Responsive Politics, independent expenditures from undisclosed sources in the 2012 election cycle topped $310 million – a dramatic increase from the corresponding figure of $69 million in 2008, the most recent previous presidential election cycle.[5]

Since *Citizens United*, many of us have supported passage of disclosure legislation such as the DISCLOSE Act, which would require organizations spending large sums on elections to disclose their largest donors. This legislation would help ensure that billionaire donors and multi-national corporations (including foreign donors and corporations) cannot pour unlimited money into elections while using legal loopholes to evade campaign finance disclosure requirements.

Whether or not new disclosure legislation is enacted, Treasury and the IRS should promulgate new rules for 501(c)(4) groups that are consistent with the (c)(4) statute and reflect that designation's true purpose: social welfare.

Failure of the Current 501(c)(4) Rules Pertaining to Political Activity

While 501(c)(4) groups are not the only problem in this arena,[6] they have become one of the most prominent.[7] Yet these groups should not have been allowed to spend hundreds of millions of undisclosed dollars to influence elections in the first place.

The vast majority of 501(c)(4) groups are legitimate organizations that operate to promote social welfare. However, because of the significant minority of 501(c)(4) groups who are abusing their status, several of us have long pointed out the need to reform the current 501(c)(4) rules, which contradict the corresponding statute.[8] Section 501(c)(4) of the Internal Revenue Code establishes tax-exempt status for nonprofits "operated *exclusively* for the promotion of social welfare. . . .".[9] Associated regulations clearly state that "[t]he 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."[10] Nevertheless, Treasury regulations allow 501(c)(4) social welfare organizations to engage in campaign intervention so long as the "primary" activity of the organizations is social welfare.[11]

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[4] *See, e.g.,* Trevor Potter & B. B. Morgan, *The History of Undisclosed Spending in U.S. Elections & How 2012 Became the Dark Money Election*, 27 NOTRE DAME J.L. ETHICS & PUB. POL'Y 383, 463-64 (2013) (discussing the formation of Crossroads GPS, a 501(c)(4) spin off of super PAC American Crossroads, formed to protect donors from disclosure).

[5] Center for Responsive Politics Outside Spending Database, *available at* http://www.opensecrets.org/outsidespending/summ.php?cycle=2008&chrt=D&disp=O&type=A.

[6] For example, there is also concern that some 501(c)(6) groups are primarily engaging in political activities, without any requirements to disclose members or contributors. *See, e.g.*, Michael Beckel, *Major U.S. Companies Quietly Funnel Dark Money to Politically Active Nonprofits,* Center for Public Integrity, Jan. 16, 2014.

[7] *See* Kim Barkey, *How Nonprofits Spend Millions on Elections and Call it Public Welfare,* ProPublica, Aug. 18, 2012.

[8] *See, e.g.*, Letters from Senators to IRS, March 9, 2012 and Feb. 16, 2012; *see also* Democracy 21 and Campaign Legal Center, *Petition for Rulemaking On Campaign Activities by Section 501(c)(4) Organizations*, July 27, 2011.

[9] 26 U.S.C. § 501(c)(4)-1(a)(1)(ii) (emphasis added).

[10] Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (emphasis added).

[11] Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

Treasury and the IRS have never clarified how much political intervention would violate the primary activity standard, nor have they clarified exactly what activities constitute political intervention.[12]

Into this muddle have stepped an army of highly sophisticated political operatives, lawyers, and donors, who have formed 501(c)(4) groups whose primary purpose is to spend money to influence elections without disclosing their donors.

The founders and officers of these 501(c)(4) groups (many of which have no discernible social welfare purpose), claim that the primary activity test requires only that less than half of their spending can be "express advocacy."[13] The IRS has never renounced this "49% rule," so it has become the de facto standard.

These groups also claim that the ambiguities in the existing 501(c)(4) rules pertaining to what constitutes political intervention allow them to spend the other 51% of their money on a combination of "issue ads" (which in many cases are just thinly veiled political attack ads), and transfers to other organizations that spend money on political ads.[14] Again, the IRS has never publicly renounced this interpretation, so it too has become the de facto standard. In some cases, 501(c)(4) organizations have operated in a manner indistinguishable from PACs,[15] and some operatives and donors have created intricate webs of organizations to further thwart disclosure requirements and shield their donors from scrutiny.[16]

The apparent lack of enforcement action by the IRS suggests it is not prepared to pursue civil or criminal action under the current rules. This appears to be true even in the face of open and notorious abuses, such as when organizations heavily engaged in political activity falsely claim that they are not conducting such activity on their applications for exempt status or tax returns.[17]

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[12] The IRS's cases, rulings, training manuals and guidance establish a vague "facts and circumstances" test. *See, e.g.*, Rev. Rul. 78-248, 1878-1 CB 154; Rev. Rul. 80-282, 1980-2 CB 178; Rev. Rul. 6-95, 1986-2 CB 73.

[13] *Ie.*, ads explicitly directing the viewer to "vote for" or "vote against" a particular candidate.

[14] *See, e.g.*, Kim Barker, *New Tax Return Shows Karl Rove's Group Spent Even More on Politics than it Said,* Propublica, Nov. 25, 2013; *See also*, "Thanks a Lot," a Crossroads GPS "issue ad" run in Nevada shortly before the 2010 Senate election in that state, contained the following language: "With spending already out of control, Harry Reid spearheaded the stimulus spending bill. Harry's stimulus sent nearly $2 million to California to collect ants in Africa, $25 million for new chairlifts and snowmaking in Vermont, almost $300,000 to Texas to study weather on Venus. Meanwhile, back in Nevada, we still have the highest unemployment and record foreclosures. Really, Harry, how about some help for Nevada?" Federal Election Commission, *First General Counsel's Report, MUR: 6396* (Crossroads Grassroots Policy Strategies), Nov. 21, 2012. (One of the GPS attack ads in the report).

[15] *See, e.g.*, Tom Hamburger and Matea Gold, *Crossroads GPS Probably Broke Election Law*, Washington Post, Jan. 15, 2014; Federal Election Commission, First General Counsel's Report, MUR: 6396 (Crossroads Grassroots Policy Strategies), Nov. 21, 2012.

[16] *See, e.g.*, Matea Gold, *Koch-Backed Political Coalition, Designed to Shield Donors, Raised $400 million in 2012*, Washington Post, Jan. 5, 2014. (Describing the Koch-backed coalition: "Tracing the flow of the money is particularly challenging because many of the advocacy groups swapped funds back and forth. The tactic not only provides multiple layers of protection for the original donors but also allows the groups to claim they are spending the money on "social welfare" activities to qualify for 501(c)(4) tax-exempt status.").

[17] *See, e.g.*, Hearing: "Current Issues in Campaign Finance Law Enforcement," U.S. Senate Committee on the Judiciary, Subcommittee on Crime and Terrorism, Apr. 9, 2013.

Further, the existing framework of vague and ill-defined standards was a significant contributing factor in the IRS' improper scrutiny of certain organizations for scrutiny based on keyword searches of their names, which was revealed last year.[18]

This scrutiny, which was clearly improper, has been described as a "scandal." We must not lose sight of the fact that the open and notorious use of tax-exempt entities to evade campaign finance disclosure requirements, and the failure of Treasury and IRS to address this issue before now, represent at least as great a scandal.

Guiding Principles

New IRS regulations must put an end to the use of 501(c)(4) status as a means of evading campaign finance disclosure requirements. In particular, the new rules must make clear that it is impermissible for political operatives to create what are for all practical purposes PACs, obtain 501(c)(4) status for those PACs, and then spend essentially unlimited money to influence elections without disclosing their donors, as is now common practice.

Also, as you state in the preamble to the proposed rules, it is imperative that the rules contain objective, unambiguous standards,[19] so the IRS and covered organizations know what conduct is permissible, and that where impermissible conduct occurs, the rules and the statute can be effectively enforced.

Throughout this process, Treasury and the IRS must bear in mind that the corrosive effect of dark money on American elections is amplified by dark money's dark shadow: Threats and promises. What dark money can do, dark money can also threaten (or promise) to do. These threats and promises can have a powerful political effect, and unlike the actual spending, threats and promises never appear in the form of a visible advertisement.[20] This element of the dark money threat has been repeatedly overlooked, but it should be overlooked no longer.

You will undoubtedly receive complaints from certain corners that these proposed rules will infringe on First Amendment speech rights. Such complaints are without merit: these rules would not restrict anyone's right to speak, or to spend money to influence elections. If implemented properly, the rules will only close a loophole that has until now allowed donors to evade campaign finance law disclosure requirements. As noted above, the Supreme Court has

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[18] *See* Report, Treasury Inspector General For Tax Administration, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review*, May 14, 2013, p. 14 ("In April 2012, the Senior Technical Advisor to the Acting Commissioner, Tax Exempt and Government Entities Division, along with a team of EO function Headquarters office employees, reviewed many of the potential political cases and *determined that there appeared to be some confusion by Determinations Unit specialists and applicants on what activities are allowed by I.R.C. § 501(c)(4) organizations. We believe this could be due to the lack of specific guidance on how to determine the 'primary activity' of an I.R.C. § 501(c)(4) organization.* Treasury Regulations state that I.R.C. § 501(c)(4) organizations should have social welfare as their 'primary activity'; *however, the regulations do not define how to measure whether social welfare is an organization's 'primary activity.*'") (emphasis added).

[19] Prop. Treas. Reg. § 1.501(c)(4), 78 Fed. Reg. 230 (2013) ("The Treasury Department and the IRS recognize that more definitive rules with respect to political activities related to candidates—rather than the existing, fact-intensive analysis—would be helpful in applying the rules regarding qualification for tax-exempt status under section 501(c)(4).").

[20] *See American Tradition Partnership v. Bullock*, 132 S. Ct. 2490, Cert. Brief of *Amici* Sens. Sheldon Whitehouse and John McCain in Support of Respondents.

stated unequivocally that these disclosure requirements are not only constitutional, but vital. As Justice Scalia has written, "[r]equiring people to stand up in public for their political acts fosters civic courage, without which democracy is doomed."[21]

Quantitative Limit – A Bright-Line Rule

The Notice of Proposed Rulemaking specifically requests comments on "what proportion of an organization's activities must promote social welfare for an organization to qualify under section 501(c)(4) . . . ."[22] The plain language of section 501(c)(4), that organizations be operated "exclusively to promote the social welfare,"[23] could justify a limitation of zero candidate-related political activity, since, as noted above, such activity does not promote the social welfare.[24] The recent record of abuse would also speak in favor of allowing zero candidate-related political activity.

However, we are aware that there are many legitimate 501(c)(4) groups that devote some portion of their funds and activities to political intervention. Permitting those activities to continue is reasonable as long as such intervention is a small proportion of each organization's total activities.

Courts have held that an organization can be found to be operated "exclusively" for social welfare so long as it is not engaged in a "substantial" non-exempt purpose.[25] While a reasonable standard, "substantial," like "primary" is a subjective concept, and if not defined further, requires the kind of case-by-case, "fact-intensive" analysis that has made enforcement under the current rules impossible, and which Treasury and IRS have stated a desire to avoid.[26]

That being the case, Treasury and the IRS should implement the "insubstantial" standard as a cap of five to fifteen percent on non-exempt activity, including candidate-related political activity, which would be consistent with case law. [27] Whatever the amount, the new rules should set a clear, objective limitation on the amount of political spending allowed by 501(c)(4) groups.

Candidate-Related Political Activity

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[21] *Doe v. Reed*, 130 S. Ct. 2811, 2837 (U.S. 2010) (Scalia, J., concurring).
[22] Prop. Treas. Reg. § 1.501(c)(4), 78 Fed. Reg. 230 (2013).
[23] 26 U.S.C. § 501(c)(4)-1(a)(1)(ii).
[24] Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).
[25] *See Vision Service Plan v. United States*, 96 A.F.T.R.2d 2005-7440, 2005-7443 (E.D. Cal. 2005), affirmed 2008 WL 268075, 1 (9th Cir. 2008)(quoting *Contracting Plumbers Cooperative Restoration Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. N.Y. 1973))("[T]he presence of a single substantial non-exempt purpose precludes exempt status regardless of the number or importance of the exempt purposes."); *See also*, *People's Educ. Camp Soc. Inc. v. Comm'r*, 331 F.2d 923, 931 (2d Cir. 1964)(quoting *Better Business Bureau v. United States*, 326 U.S. 279, 283 (U.S. 1945)("[T]he presence of a single *** (non-exempt) purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly ***(exempt) purposes.").
[26] Prop. Treas. Reg. § 1.501(c)(4), 78 Fed. Reg. 230 (2013).
[27] *See Vision Service Plan v. United States*, 96 A.F.T.R.2d 2005-7440, 2005-7443 (E.D. Cal. 2005), affirmed 2008 WL 268075, 1 (9th Cir. 2008); *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974) (spending between 16.6% and 20.5% of an organization's time on lobbying is substantial); *Seasongood v. Commissioner*, 227 F.2d 907 (6th Cir. 1955) (devoting less than 5% of activities to lobbying is not substantial).

Public Communications

The vast majority of political activity conducted by PACs posing as social welfare organizations has been spending on political television advertisements.[28] We support the definition of candidate-related political activity in the proposed rules as it pertains to public communications, and particularly the provision that candidate-related political activity includes "any communication the expenditures for which are reported to the Federal Election Commission, including independent expenditures and electioneering communications."[29]

All forms of express advocacy, including independent expenditures as defined under federal election law and regulations, must be included in the definition of candidate-related political activity.

It is also important to include spending on electioneering communications in that definition. Under the status quo, 501(c)(4) groups have spent massive amounts on electioneering communications reported to the Federal Election Commission, without reporting that same spending to the IRS as political activity, even for ads that are transparent attacks intended to influence an election.[30]

The organizations financing these ads may justify not reporting them to the IRS by claiming that they are "issue-based" or "educational," but doing so has simply been a convenient way to game the system. Revising the 501(c)(4) rules to classify spending on these ads as political activity is a common sense step to prevent organizations from exceeding political activity limits and from reporting wildly disparate political spending to different government agencies.

We also support the inclusion of communications that are "susceptible of no reasonable interpretation other than a call for or against the selection, nomination, election, or appointment of one or more candidates of a political party."[31] This change will prohibit groups from claiming that financing an ad that has no other purpose than to influence an election is anything other than candidate-related campaign activity.

Transfer Provisions

Under current 501(c)(4) rules, it has been far too easy for groups to transfer funds among themselves in order to evade limitations on political spending by (c)(4)s and Federal Election Campaign Act donor disclosure requirements.[32] We therefore support defining candidate-related campaign expenditures to include all types of contributions and transfers described in the

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[28] *See, e.g.*, Propublica, Campaign 2012, All Nonprofits, *available at* http://projects.propublica.org/dark-money/organizations/all.

[29] Prop. Treas. Reg. § 1.501(c)(4) -1(a)(2)(iii)(A)(3), 78 Fed. Reg. 230 (2013).

[30] For example, American Action Network reported spending $19.4 million on elections to the FEC and only reported $5.54 million in political spending to the IRS for the same date range. Propublica, Campaign 2012, all Nonprofits, *available at* http://projects.propublica.org/dark-money/organizations/all.

[31] Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii)(A)(1)(ii), 78 Fed. Reg. 230 (2013). This includes sham "issue ads" broadcast outside of the 30 or 60-day electioneering communication window.

[32] *See, e.g.*, Matea Gold, *Koch-Backed Political Coalition, Designed to Shield Donors, Raised $400 million in 2012*, Washington Post, Jan. 5, 2014. As the simplest example of such evasion, if 501(4) group A spends 49% of its money on express advocacy, and contributes 51% of its money to 501(c)(4) Group B, which spends all of that money on express advocacy, Group A will effectively have spent 100% of its money on express advocacy without disclosing its donors.

proposed rules, including transfers to "any organization described in section 501(c) that engages in candidate-related political activity."[33] The final rules should be clear, however, that this provision does not apply to transfers made to 501(c)(3) groups engaged in historically permitted nonpartisan activities such as voter registration and get-out-the-vote drives. As noted below, these activities should not be included in the definition of candidate-related political activity.

Additionally, we urge Treasury and the IRS to consider enhancing the transaction provisions to prevent organizations from using pass-through entities to frustrate campaign finance disclosure requirements and limitations on political activity by 501(c)(4) groups. The operatives who create sophisticated webs of entities to evade political spending limitations and disclosure requirements will adjust the structures of their networks in order to evade the new rules. The rules on transfers must be sufficiently flexible to cover known and yet to be developed schemes.

In particular, Treasury and the IRS should consider restricting all donations between shell corporations and 501(c)(4) groups. Alternatively, Treasury and IRS should establish disclosure requirements that require 501(c)(4) organizations to disclose the original source of funds or any funds received or subsequently transferred.[34] The burden of the additional recordkeeping required by such a rule would be far outweighed by the value the rule would have in preventing the illicit transfer of funds to evade disclosure requirements. The rule would also allow law enforcement investigators to "follow the money" when violations occur.

Also, as noted above, and in the NPRM, there is cause for concern that tax-exempt 501(c) groups other than 501(c)(4)s, such as 501(c)(6) groups, are used as vehicles for evasion of campaign finance disclosure rules.[35] Past practice by political operatives suggests that any rules change as applied to one type of tax-exempt organization will lead to creative attempts to exploit the rules as they apply to other types. Treasury and the IRS should keep this in mind, and consider revising regulations pertaining to political spending by all exempt organizations.

Voter Registration Drives, "Get-out-the-vote" Drives, and Activities Related to Nominations

Treasury and the IRS should not include nonpartisan "voter registration drive[s] or "get-out-the-vote" drive[s]" in the definition of candidate-related political activity.[36] These activities are often laudable, nonpartisan civic engagement, and in many cases encourage registration and voting in communities where people have historically struggled to exercise their right to vote.[37]

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[33] Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii)(A)(4)(iii), 78 Fed. Reg. 230 (2013).

[34] Such provisions could be modeled on the transfer provisions of the DISCLOSE Act of 2012 (S. 3369, 112th Congress).

[35] Prop. Treas. Reg. § 1.501(c)(4), 78 Fed. Reg. 230 (2013).

[36] Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii)(A)(5), 78 Fed. Reg. 230 (2013).

[37] *See, e.g.*, Report: Diana Kasdan, *State Restrictions on Voter Registration Drives*, Brennan Center for Justice, November 30, 2012, p. 2 ("Given the deficiencies of the current system, community-based voter registration drives are vital. Drives help citizens navigate the process and once registered, they become engaged in democracy. For decades voter registration drives have added millions of voters to the rolls. This has been particularly important among minority communities: Black and Hispanic voters are much more likely than white voters to register through private voter registration drives. Civic groups are essential for assisting voters who might not register successfully on their own, or who are more likely to do so only after personal encouragement from a community member."). (internal citations omitted), *available at* http://www.brennancenter.org/publication/state-restrictions-voter-registration-drives.

We appreciate that the across-the-board definition eliminates the need for fact-intensive analysis, but in many cases, these activities promote social welfare, and the rules should reflect that fact.

Similarly, Treasury and the IRS should not reclassify all activities seeking to influence nominations and appointments to executive and judicial positions as candidate-related political activity. This change would be a significant departure from the IRS's longstanding position that such activities do not constitute participation or intervention in a political campaign.[38] It would also undercut efforts to enhance the diversity of nominees and appointees, an important non-partisan endeavor.

Revocation of Status

As part of an effective enforcement regime, the new regulations should provide for timely revocation of status. If a 501(c)(4) organization is found to be operating in violation of the rules, the IRS should be able to revoke the organization's 501(c)(4) status as promptly as the requirements of due process provide. Organizations found to be abusing social welfare status for the purposes of evading campaign finance disclosure requirements (or for any other reason) should not be allowed to do so indefinitely, as appears to be the case under the current rules.

Conclusion

We are aware that the IRS is the "tax police," and not the "elections police," and that it is not a core function of the IRS to enforce campaign finance laws. However, the lawless zone that now exists, with essentially no meaningful limits on political activity by 501(c)(4) groups, calls for decisive action that is already long overdue. Such action is also necessitated by the fact that the current regulations in this area, as interpreted by the IRS, are contrary to the relevant statute.

These proposed rules are a step in the right direction, assuming that the new rules include a "bright-line" limit on candidate-related political activity that is in keeping with the statute's requirement that 501(c)(4) groups be operated exclusively for the promotion of social welfare. However, it is important that nonpartisan activities with social welfare benefits, such as voter registration and get-out-the-vote drives, are excluded from the definition of candidate-related political activity. We urge you to give our comments serious consideration as you work to improve the proposed rules. As noted above, and in your NPRM, you should also consider amending rules pertaining to other tax-exempt organizations so that the changes to 501(c)(4) rules do not merely replace one form of mischief with another.

We also urge you to not be swayed by strident but misplaced concerns about the First Amendment. The goal of new rules is not to silence speech, but to require that the speakers with the loudest voices in our elections identify themselves, so that we can truly have "effective

[38] Prop. Treas. Reg. § 1.501(c)(4), 78 Fed. Reg. 230 (2013) ("The Treasury Department and the IRS note that defining 'candidate-related political activity' in these proposed regulations to include activities related to candidates for a broader range of offices (such as activities relating to the appointment or confirmation of executive branch officials and judicial nominees) is a change from the historical application in the section 501(c)(4) context of the section 501(c)(3) standard of political campaign intervention, which focuses on candidates for elective public office only.").

disclosure" that will "provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters."[39]

Sincerely,

[39] *Citizens United v. FEC*, 558 U.S. 310, 370 (2010).