



## Democracy 21

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Fred Wertheimer  
*President*

July 27, 2011

The Honorable Douglas H. Shulman  
Commissioner, Internal Revenue Service  
1111 Constitution Avenue Northwest  
Washington, DC 20224

Dear Commissioner Shulman,

Enclosed is a petition for IRS rulemaking submitted by Democracy 21 and the Campaign Legal Center.

Sincerely,

Fred Wertheimer  
President, Democracy 21

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

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

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**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.<sup>1</sup> 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)

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<sup>1</sup> 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.”<sup>2</sup> 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.<sup>3</sup>

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

<sup>3</sup> 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.<sup>4</sup> 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.”<sup>5</sup> Another published report referred to American Crossroads and Crossroads GPS as “a political outfit conceived by Republican operatives Karl Rove and Ed Gillespie.”<sup>6</sup> According to the *Los Angeles Times*, both groups “receive advice and fundraising support from Rove.”<sup>7</sup>

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<sup>4</sup> 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.

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

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

<sup>7</sup> 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.<sup>8</sup>

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.<sup>9</sup>

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.

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<sup>8</sup> 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).

<sup>9</sup> 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.”<sup>10</sup>

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.”<sup>11</sup> 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.”<sup>12</sup>

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.”<sup>13</sup>

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

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

<sup>11</sup> 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).

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

<sup>13</sup> 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.<sup>14</sup>

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.”<sup>15</sup>

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

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

<sup>15</sup> 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.<sup>16</sup>

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).<sup>17</sup>

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.<sup>18</sup> “Independent expenditures” are defined as expenditures for

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

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

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

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:

<b>501(c)(4) Corporation</b>	<b>Amount Spent on Independent Expenditures in 2010 Elections</b>	<b>Disclosure of Contributors Funding Independent Expenditures in 2010</b>
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.<sup>19</sup> “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:

<b>501(c)(4) Corporation</b>	<b>Amount Spent on Electioneering Communications in 2010 Elections</b>	<b>Disclosure of Contributors Funding Electioneering Communications in 2010</b>
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

<sup>19</sup> 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.<sup>20</sup>

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.<sup>21</sup>

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.

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

<sup>21</sup> 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%. . . .”<sup>22</sup> 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.

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<sup>22</sup> 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 (11<sup>th</sup> 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 (10<sup>th</sup> 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,

*/s/ Fred Wertheimer*

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