

July 23, 2012

Hon. Douglas H. Shulman
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20224

Lois Lerner
Director of the Exempt Organizations Division
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Petition for rulemaking on campaign activities by Section 501(c)(4) tax-exempt organizations

Dear Commissioner Shulman and Director Lerner:

Democracy 21 and the Campaign Legal Center acknowledge and welcome the letter we received from Ms. Lerner on July 17, 2012 in response to our letter of July 27, 2011 which transmitted a “Petition for Rulemaking on Campaign Activities by Section 501(c)(4) organizations,” and our subsequent letter of March 22, 2012 following up on the Petition request.

Our letters and Petition urged the Internal Revenue Service (IRS) to undertake a rulemaking to clarify and bring into compliance with the law the IRS regulations that govern campaign activity by “social welfare” organizations claiming tax-exempt status under section 501(c)(4) of the Internal Revenue Code (IRC).

In her July 17, 2012 letter, Ms. Lerner stated:

The IRS is aware of the current public interest in this issue. These regulations have been in place since 1959. We will consider proposed changes in this area as we work with the IRS Office of Chief Counsel and the Treasury Department’s Office of Tax Policy to identify tax issues that should be addressed through regulations and other published guidance.

As you know from our letters, we believe the “proposed changes in this area” that Ms. Lerner says the IRS will now consider are crucially important and need to be made with urgency.

The circumstances surrounding the role being played today by a number of section 501(c)(4) groups in presidential and congressional elections are dramatically different than the circumstances that existed 53 years ago when the current IRS regulations were put in place.

We believe the letter from Ms. Lerner recognizes the controversy that currently exists over the role that groups claiming status as “social welfare” organizations are playing in our elections, post-*Citizens United*.

One year ago, on July 27, 2011, Democracy 21 and the Campaign Legal Center submitted a Petition for rulemaking to the IRS on this important matter.

The Petition challenged as contrary to law the existing regulations that define eligibility for an organization to qualify for section 501(c)(4) tax status. The Petition called on the IRS to initiate a rulemaking proceeding to revise and clarify its regulations regarding the extent of candidate election activities that a “social welfare” organization can engage in under 26 U.S.C. § 501(c)(4).

The Petition called for expeditious action by the IRS in order to protect the integrity of the 2012 federal elections:

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 presidential and congressional elections.

Petition at 18-19 (emphasis added).

We wrote to you again on March 22, 2012 to urge you to take action on our Petition and initiate a rulemaking proceeding.

Meanwhile, developments in the course of the 2012 national elections have served to underscore that IRS regulations that are contrary to law are facilitating widespread misuse and abuse of the tax laws by organizations claiming tax-exempt status under section 501(c)(4) as

“social welfare” organizations, in order to keep secret the donors financing their campaign-related expenditures.

Campaign-related spending by section 501(c)(4) groups whose overriding purpose clearly appears to be influencing elections, has grown exponentially since we first called on the IRS to conduct a rulemaking proceeding a year ago.

For example, we have written to you previously on several occasions challenging the claim by Crossroads GPS, a group affiliated with the American Crossroads super PAC, that it is entitled to section 501(c)(4) tax-status. We have repeatedly asked you to investigate this matter.

According to a recent news article, Crossroads GPS and American Crossroads together “are poised to inject up to \$70 million into a battle for the Senate on behalf of the Republicans.”¹

Another article recently noted, “The GOP independent spending goliath American Crossroads and its affiliate group Crossroads GPS are launching a new barrage of attack ads in six competitive Senate races, assailing a range of Democratic candidates as big-spending, liberal, ethically challenged and overly close to President Barack Obama.”² The article states that American Crossroads is targeting the Nebraska, Nevada and Virginia Senate contests “while 501(c)(4) Crossroads GPS is funding the ads in North Dakota, Missouri and Ohio.”

An earlier article reported that a \$25 million advertising campaign by Crossroads GPS in 10 swing states that began on May 23, 2012 “is expected to become one of the most heavily broadcast political commercials of this phase of the general election.” According to the article, Crossroads GPS conducted “18 different focus groups” that took place “over nearly a year” and that provided “a clear rationale for voters to deny Mr. Obama a second term.”³

There is little doubt that Crossroads GPS is spending tens of millions of dollars to influence the 2012 national elections and also little reason to doubt that influencing elections, and not “social welfare activities,” is the overriding purpose of the group.

While Crossroads GPS may be the biggest and most blatant example of massive campaign spending by a group claiming tax-exempt status as a section 501(c)(4) “social welfare” organization, it is by no means the only such group.

We have also previously written to you on several occasions challenging the claims to 501(c)(4) tax-exempt status by American Action Network, Priorities USA and Americans Elect,

¹ D. Drucker and S. Toeplitz, “American Crossroads’ \$70 Million Senate Blitz,” *Roll Call* (July 11, 2012).

² A. Burns, “Crossroads bombards six Dem Senate candidates, hits Berkley on ethics,” *Politico* (June 13, 2012).

³ J. Peters, “Subtler Entry From Masters of Attack Ads,” *The New York Times* (May 22, 2012)

and asking for IRS investigations of these groups which have also been spending large sums to influence federal elections.

For example, we informed you in our letter of December 14, 2011 that American Action Network in 2010 reportedly spent \$26 million of its total expenditures of \$30 million, or 87 percent, on campaign-related activities that the group reported to the FEC as “independent expenditures” and “electioneering communications.”⁴ It is hard to see on what conceivable basis this group could qualify for tax-exempt status as a section 501(c)(4) “social welfare” group.

The reason that section 501(c)(4) groups are being used as vehicles for spending large amounts to influence elections is that they are providing anonymity to their donors. A recent article about Crossroads GPS and one of its donors, casino executive Steve Wynn, stated:

Unlike super PACs, Crossroads GPS is registered under a section of the tax code for so-called “social welfare” groups – 501(c)(4) – that does not require groups to reveal their donors’ names, only donation amounts. The promise of anonymity is one of the main reasons GPS was established – it allows Wynn and like-minded contributors to avoid the controversy that has dogged top political donors like competing casino mogul Sheldon Adelson, as well as the libertarian industrialist Koch Brothers or the liberal financier George Soros.⁵

Political operatives are using “social welfare” organizations as conduits for injecting secret money into federal elections by attempting to exploit what they claim to be purported ambiguities in existing IRS standards.

These operatives argue, for example, that as long as ads do not contain “express advocacy” they can attack or promote candidates in whatever way they want and such ads do not constitute “intervention or participation” in campaigns, and thus may be run without limit by a section 501(c)(4) organization.

The IRS, however, has made clear that ads do not need to contain “express advocacy” in order to be treated as “intervention or participation” in campaigns for purposes of section 501(c)(4). *See, e.g.*, Rev. Rul. 2004-6 (listing six factors that “tend to show” that an ad is for the purpose of influencing a candidate election.)

The political operatives also argue that a “social welfare” organization can spend up to 49 percent of its revenues on overt campaign intervention, without running afoul of the rules that currently require a section 501(c)(4) organization to be “primarily engaged” in social welfare activities. *See* 26 C.R.F. 1.501(c)(4)-1(a)(2)(i).

⁴ P. Stone, “Fine line between politics and issues spending by secretive 501(c)(4) groups,” *iWatch News* (Oct. 31, 2011).

⁵ K. Vogel & S. Friess, “Karl Rove hits big: The birth of a mega-donor,” *Politico* (July 13, 2012) (emphasis added).

Such claims have gone unchallenged by the IRS, despite the fact that the IRS has never set forth a “49 percent” rule. The IRS has failed to clarify its rules regarding the amount of candidate election-related activity a section 501(c)(4) “social welfare” group is permitted to conduct. As a result, groups claiming status as section 501(c)(4) organizations have been allowed to become major players in influencing the 2012 federal elections and to use secret contributions to do so.

The failure of the IRS to take action on this matter has allowed groups that are in reality campaign operations – but claim to be 501(c)(4) “social welfare” groups – to make assertions about IRS rules that are unsupported by law, and thereby to provide a veil of secrecy for the donors financing their campaign-related expenditures.

We welcome Ms. Lerner’s statement in your July 17 letter that the IRS “will consider proposed changes” in the regulations governing eligibility for tax-exempt status under section 501(c)(4). But we want to stress once again that the need for urgent action we noted in our July 27, 2011 letter is all the more true today.

We strongly urge the IRS to promptly institute a rulemaking proceeding to address this matter. We also strongly urge the IRS to act expeditiously in the interim to stop the blatant abuses of the tax laws that are resulting in massive amounts of secret money being laundered into our national elections by groups claiming to be “social welfare” organizations.

Sincerely,

/s/ Gerald Hebert

/s/ Fred Wertheimer

J. Gerald Hebert
Executive Director
Campaign Legal Center

Fred Wertheimer
President
Democracy 21