



## 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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*Counsel for the Campaign Legal Center*

July 27, 2011

March 22, 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 candidate election activities by Section 501(c)(4) groups

Dear Commissioner Shulman and Director Lerner:

On July 27, 2010, Democracy 21 and the Campaign Legal Center submitted to the Internal Revenue Service a “Petition for Rulemaking on Campaign Activities by Section 501(c)(4) Groups.”

The Petition challenged as contrary to law the existing regulations that define eligibility for an organization to qualify for section 501(c)(4) tax-exempt 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).

Since then, we have heard nothing from the IRS to indicate that such a rulemaking is under consideration.

Meanwhile, developments in the course of the 2012 national elections have served to underscore the fact that inadequate and flawed IRS regulations are facilitating widespread misuse of the tax laws by organizations claiming tax-exempt status under section 501(c)(4) in order to keep secret the donors financing their candidate campaign-related expenditures.

This is seriously undermining the integrity of the tax laws and the credibility of the nonprofit sector. According to a column in *Roll Call*:

“Charitable organizations depend on the confidence and trust of the public for support,” said Diana Aviv, president and CEO of Independent Sector, which represents the nonprofit and philanthropic community. Campaign spending by nonprofits, she added, could pose “a serious reputational risk” to the sector.<sup>1</sup>

We are writing again to strongly urge the IRS to act on our Petition promptly and initiate a rulemaking proceeding. The IRS must take steps to properly interpret and enforce the tax law and stop these abuses from continuing to explode in our elections.

Recently, a group of Democratic Senators and a group of Republican Senators have each separately written to the IRS, both complaining about the agency’s administration of section 501(c)(4). One group of Senators argues that the agency is too intrusive in its inquiries into the candidate election activities of applicants for 501(c)(4) “social welfare” status. The other group of Senators argues that the agency is too lax in enforcing the limits on candidate campaign activities by such groups.

The IRS has a statutory responsibility to administer and enforce the tax laws as interpreted by the courts, without regard to political pressure. These letters from the Senators, however, serve to confirm that it is essential for the IRS to initiate a rulemaking to provide clarity and a legally correct bright line standard for determining when a group is eligible to receive tax-exempt status under section 501(c)(4).

The Internal Revenue Code provides that section 501(c)(4) groups must engage “exclusively” in social welfare activities. 26 U.S.C. § 501(c)(4). The regulations implementing this provision state, however, that “social welfare” organizations must be “primarily engaged” in social welfare activities. 26 C.F.R. § 1.501(c)(4)–1(a)(2)(i).

Although the IRS has clearly and correctly stated that “social welfare” activities do not include activities that constitute participation or intervention in candidate elections, it has not clearly or properly defined the “primarily engaged” standard that was established by the agency to serve as a cap on such candidate campaign activities.

In the absence of a proper regulation, the standard has been widely misinterpreted to mean that section 501(c)(4) groups can engage in candidate election activities so long as such activities do not constitute a majority of the group’s spending – that is to say, they can spend up to 49 percent of their expenditures on candidate campaign-related activities.

This is in conflict with the statutory language and with court interpretations of this language which hold that “social welfare” organizations cannot engage in any “substantial” amount of non-exempt activity. This means that section 501(c)(4) organizations cannot do more than an *insubstantial amount of candidate election activity*, whether or not it is their “primary” purpose.

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<sup>1</sup> E. Carney, “Rules of the Game: Bad News for Nation’s Nonprofits,” *Roll Call* (March 20, 2012).

However, as we documented in our Petition and in other letters we have sent to you,<sup>2</sup> a number of groups claiming tax exempt status under section 501(c)(4) are engaging in substantial candidate election activities this election cycle – spending tens of millions of dollars to directly influence the 2012 candidate elections, much as such groups also did to influence the 2010 elections. This candidate campaign activity is bound to increase as the 2012 general election draws closer.

For instance, as we discussed in our letter to you of December 14, 2011, one section 501(c)(4) group, American Action Network, reportedly spent \$26 million on candidate campaign-related activities in 2010, which was approximately *87 percent* of the organization's total spending that year. Another supposed "social welfare" organization, Americans Elect, is seeking ballot access as a political party in all 50 states for the purpose of nominating and running its own presidential candidate. The group has already obtained this status as a political party in a number of states. A group cannot be a "political party" and a "social welfare" organization at the same time.

The extent of the candidate election activities by these and other groups appears on its face to violate even the current ineffectual regulatory standard that limits participation in candidate campaign-related activities by section 501(c)(4) "social welfare" organizations. The activities certainly violate both the statutory language of section 501(c)(4) and the court interpretations of that provision.

The IRS must act expeditiously to revise and clarify the "primarily engaged" standard and to conform its regulations to the statute as construed by the courts. Absent action by the IRS, it is a virtual certainty that candidate election activities by groups improperly claiming tax-exempt status under section 501(c)(4) will escalate.

The stakes here are very high for the country and for the integrity of our elections. Organizations are improperly claiming tax-exempt status under section 501(c)(4) in order to keep secret the donors financing their candidate campaign-related expenditures. Citizens have a basic right to know who is giving and spending money to influence their votes.

Since section 501(c)(4) groups (unlike section 527 "political organizations") are not required to publicly disclose their donors, the sources of the money such groups spend for candidate election activities are hidden from public scrutiny.

Recent press reports have taken note of the increased candidate campaign spending by section 501(c)(4) groups, and the use of such "social welfare" groups specifically for the purpose of keeping secret the donors financing their candidate election activities.

One report in *Politico* noted that corporations have generally not contributed to so-called "Super PACs," which are federally registered political committees that are required to report their donors to the FEC. The report explained:

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<sup>2</sup> See Letters of October 5, 2010, September 28, 2011, December 14, 2011 and March 9, 2012.

Instead, corporate lobbyists and others say companies have preferred to give to politically active nonprofits that allow their donations to stay anonymous. . . .

Millionaires and others might see an advantage to giving to super PACs, but one in-house corporate lobbyist told POLITICO that “nondisclosure is always preferred” when it comes to any contribution to mitigate any public perception issues and shareholder controversy.

It’s unclear how much money is being directed to nonprofit advocacy organizations – 501(c)(4)s – which do not have to disclose their donors to the Federal Election Commission but are in many cases associated with Super PACs.<sup>3</sup>

By allowing groups to claim tax exempt status under section 501(c)(4) while also engaging in substantial candidate election activity, the IRS is serving to deny citizens essential campaign finance information about the money being spent to influence federal elections.

This is 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.” *Citizens United v. FEC*, 130 S. Ct. 876, 916 (2010).

The widespread abuse of the tax laws by groups improperly claiming section 501(c)(4) tax-exempt status will continue and grow until the IRS revises its regulations to conform with the statutory provision in the Internal Revenue Code and with court interpretations holding that tax-exempt groups may not engage in more than an insubstantial amount of non-exempt activity.

The IRS must move promptly to set a new clear, bright-line and administrable standard for determining eligibility for 501(c)(4) tax status, and ensure that such standard complies with the statute. Absent such action by the IRS, the agency will bear direct responsibility for the misuse and abuse of the tax laws by groups that are flooding our elections with secret money.

We strongly urge the IRS to promptly institute a rulemaking proceeding to address this matter. We would appreciate receiving a response from the IRS to our letter regarding what action the agency is prepared to take.

Sincerely,

/s/ Gerald Hebert

/s/ Fred Wertheimer

J. Gerald Hebert  
Executive Director  
Campaign Legal Center

Fred Wertheimer  
President  
Democracy 21

---

<sup>3</sup> A. Palmer and A. Phillip, “Corporations not funding super PACs,” *Politico* (March 8, 2012).





DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

JUL 17 2012

Fred Wertheimer, President  
Democracy 21  
2000 Massachusetts Ave., NW  
Washington, DC 20036

J. Gerald Hebert, Executive Director  
Campaign Legal Center  
c/o Democracy 21  
2000 Massachusetts Ave., NW  
Washington, DC 20036

Dear Messrs. Wertheimer and Hebert:

I am responding to your letter dated March 22, 2012, which supplemented your letter dated July 27, 2011, urging the IRS to institute a rulemaking proceeding to address the rules related to political activity by organizations exempt under section 501(c)(4) of the Internal Revenue Code.

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.

I hope this information is helpful. If you have any questions, please contact Andrew F. Megosh, Jr. (Identification Number 1000221546) at (202) 283-8942.

Sincerely,

A handwritten signature in cursive script, reading "Lois G. Lerner".

Lois G. Lerner  
Director, Exempt Organizations

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.”<sup>1</sup>

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.”<sup>2</sup> 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.”<sup>3</sup>

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,

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

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

<sup>3</sup> 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.”<sup>4</sup> 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.<sup>5</sup>

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).

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

<sup>5</sup> 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

August 9, 2012

Hon. Douglas H. Shulman  
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Lois Lerner  
Director of the Exempt Organizations Division  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
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Re: Petition for rulemaking on candidate election activities by Section 501(c)(4) groups

Dear Commissioner Shulman and Director Lerner:

According to news reports, Senator Orin Hatch (R-UT) and other Republican Senators have sent a letter to the IRS urging the agency to delay undertaking any effort to revise IRS regulations that govern the extent to which a group eligible for tax-exempt status as a section 501(c)(4) “social welfare” organization can engage in candidate campaign activity.

The letter from the Republican Senators is apparently in response to the letter you sent to our organizations dated July 17, 2012 in which you said you would consider changes in this area.

In your July 17 letter, you acknowledged receipt of our earlier letters to the IRS in which we submitted and then supplemented a petition for rulemaking that challenges as inadequate and contrary to law the existing IRS regulations which set eligibility criteria for section 501(c)(4) tax-exempt status.

As we have noted in a series of letters to the IRS, groups that clearly have an overriding purpose to influence elections are claiming status as “social welfare” organizations in order to keep secret the donors whose funds they are spending to influence the 2012 presidential and congressional elections.

Your July 17 letter to us recognized that the existing regulations in this area were put in place more than a half century ago, that you “are aware of the current public interest” in this matter and that you “will consider proposed changes in this area.”

We consider the letter you recently received from the Republican Senators to be a partisan effort to pressure the IRS to back away from the position you correctly took in your July 17 letter to look at new regulations to govern eligibility for section 501(c)(4) tax-exempt status.

We believe the Republican Senators' letter is intended to preserve the ability of groups with an overriding purpose to support Republican candidates to continue to improperly claim tax-exempt status as "social welfare" organizations in order to keep secret the donors financing their campaign expenditures.

We urge you in the strongest possible terms to ignore this partisan pressure or any other partisan attempts to dissuade the IRS from carrying out its responsibilities to properly interpret the tax laws and protect the interests of American taxpayers and voters.

As you know, in addition to the petition we submitted to the IRS we have also filed complaints with the IRS to challenge improper claims of eligibility for section 501(c)(4) tax-exempt status by pro-Republican, pro-Democratic and independent groups. We have called on the IRS to investigate and take appropriate enforcement action against these groups.

These groups include Crossroads GPS, the brainchild of Republican Party operative Karl Rove, whose purpose is to support Republican candidates, and Priorities USA, formed by two former Obama White House officials, whose purpose is to support President Obama's reelection.

These groups are campaign operations, not "social welfare" organizations, and they are not entitled to section 501(c)(4) tax-exempt status.

Recent published reports, for example, overwhelmingly document what is obvious – Crossroads GPS is all about electing Republican candidates and defeating Democratic candidates for federal office.

According to a May 22, 2012 *New York Times* article,<sup>1</sup> a \$25 million advertising campaign by Crossroads GPS in 10 swing states, "is expected to become one of the most heavily broadcast political commercials of this phase of the general election." 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."

We do not believe that "social welfare" organizations conduct 18 focus groups over nearly a year to determine a clear rationale for defeating a presidential candidate. That is what campaign operations do.

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<sup>1</sup> Peters, Jeremy W. "Masters of Attack Ads Take Subtle Shot at Obama." *The New York Times*. 22 May 2012. <<http://www.nytimes.com/2012/05/22/us/politics/new-crossroads-gps-ad-takes-a-soft-shot-at-obama.html?pagewanted=all>>.



Last week, Karl Rove proudly wrote in *The Wall Street Journal*<sup>2</sup> that in response to the Obama campaign's recent ads, outside groups had spent \$107.4 million on "ads attacking Mr. Obama's policies or boosting Mr. Romney," with "Crossroads GPS, a group I helped found, providing over half" of that total.

With this statement, Rove has confirmed that more than \$50 million in ads run by Crossroads GPS are campaign ads intended to damage President Obama and boost Mitt Romney in the 2012 presidential campaign. Again, this is not what "social welfare" organizations do. It is what campaign operations do.

The letter from the Republican Senators to the IRS seeking to delay and discourage any action by the agency to correct flawed regulations is not about determining the proper interpretation and enforcement of the tax laws. The letter instead is a partisan effort to allow pro-Republican campaign groups like Crossroads GPS to continue hiding their donors from the American people by posing as section 501(c)(4) "social welfare" organizations.

As we have discussed at length in our previous submissions, the existing IRS regulations do not properly define and limit the amount of candidate campaign activity that a section 501(c)(4) "social welfare" organization may permissibly conduct. As we have also documented, the regulations do not comply with court decisions on the eligibility requirements for section 501(c)(4) tax-exempt status.

It is a matter of urgent public importance for the IRS to undertake all appropriate efforts to fix its rules. Because of the existing flawed regulations, massive amounts of secret contributions are being spent in federal elections by groups that are improperly claiming status as "social welfare" organizations. This abuse of the tax laws to hide political donors is contrary to the Internal Revenue Code, to court interpretations of that Code and to the longstanding national policy of providing citizens with transparency for campaign finance contributions and expenditures.

It is vitally important for the IRS not to be swayed or deterred on this matter by partisan pressure. The IRS must carry out its statutory responsibilities to oversee and enforce the tax laws.

The IRS needs to conform its regulations with the requirements of the tax laws and court decisions which hold that in order to be eligible for tax-exempt status as a section 501(c)(4) "social welfare" organization, an organization may not engage in more than an "insubstantial amount" of non-social welfare activity, such as candidate campaign activity.

We appreciate your July 17 letter stating that you will consider changes in this area. We strongly urge you to continue these efforts without delay.

Sincerely,

/s/ Gerald Hebert

/s/ Fred Wertheimer

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<sup>2</sup> Rove, Karl. "Rove: The Obama Ad Blitz Isn't Working." *The Wall Street Journal*, 1 Aug. 2012. <[http://online.wsj.com/article/SB10000872396390443687504577563002812933574.html?mod=WSJ\\_Opinion\\_LEADTop](http://online.wsj.com/article/SB10000872396390443687504577563002812933574.html?mod=WSJ_Opinion_LEADTop)>.

J. Gerald Hebert  
Executive Director  
Campaign Legal Center

Fred Wertheimer  
President  
Democracy 21

August 21, 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 eligibility requirements for Section 501(c)(4) status and requests submitted to IRS calling for investigations of certain groups.

Dear Commissioner Shulman and Director Lerner:

Enclosed is a report published by *ProPublica* on August 19, 2012, entitled, "How Nonprofits Spend Millions on Elections and Call it Public Welfare." According to the report:

An investigation by ProPublica, drawing on documents filed with the Internal Revenue Service and the Federal Election Commission, offers the most detailed picture to date of how 501(c)(4) groups have used their tax status for purposes likely never intended.

Our examination shows that dozens of these groups do little or nothing to justify the subsidies they receive from taxpayers. Instead, they are pouring much of their resources, directly or indirectly, into political races at the local, state and federal level.

We believe the report further documents the case we have made in a series of letters to the IRS that certain groups are improperly claiming Section 501(c)(4) status and that new regulations are needed to properly define the eligibility requirements for Section 501(c)(4) status.

Sincerely,

/s/ *Gerald Hebert*

/s/ *Fred Wertheimer*

J. Gerald Hebert  
Executive Director

Fred Wertheimer  
President

## *ProPublica*

# How Nonprofits Spend Millions on Elections and Call it Public Welfare

By [Kim Barker](#)

August 19, 2012

Matt Brooks describes the mission of the Republican Jewish Coalition as educating the Jewish community about critical domestic and foreign policy issues.

But the well-dressed crowd that gathered in May for a luncheon on the 24th floor of a New York law firm easily could have figured that the group had a different purpose: Helping Mitt Romney win the presidency.

Brooks, the group's executive director, showed the 100 or so attendees two coalition-funded [ads taking aim](#) at President Barack Obama. Then Brooks made a pitch for a \$6.5 million plan to help Romney in battleground states, reminding guests that their donations would not be publicly disclosed by the tax-exempt group.

"Contributions to the RJC are not reported," Brooks told the people sitting around a horseshoe-shaped table. "We don't make our donors' names available. We can take corporate money, personal money, cash, shekels, whatever you got."

The Republican Jewish Coalition and similar organizations enjoy tax-exempt status in exchange for promoting social welfare. In this election, the most expensive in U.S. history, they also have emerged as the primary conduit for anonymous big-money contributions.

Forget super PACs, their much-hyped cousins, which can take unlimited contributions but must name their donors. [More money](#) is being spent on TV advertising in the presidential race by social welfare nonprofits, known as 501(c)(4)s for their section of the tax code, than by any other type of independent group.

As of Aug. 8, they had spent more than \$71 million on ads mentioning a candidate for president, according to estimates by Kantar Media's Campaign Media Analysis Group, or [CMAG](#). Super PACs have spent an estimated \$56 million.

Congress created the legal framework for 501(c)(4) nonprofits nearly a century ago. To receive the tax exemption, groups were supposed to be "operated exclusively for the promotion of social welfare." The IRS later opened the door to some forms of political activity by interpreting the

statute to mean groups had to be ["primarily"](#) engaged in enhancing social welfare. But neither the tax code nor regulators set out how this would be measured.

In recent years, Democrats and Republicans alike have seized on that seemingly innocuous wording to create the darkest corner of American political fundraising.

An investigation by ProPublica, drawing on documents filed with the Internal Revenue Service and the Federal Election Commission, offers the most detailed picture to date of how 501(c)(4) groups have used their tax status for purposes likely never intended.

Our examination shows that dozens of these groups do little or nothing to justify the subsidies they receive from taxpayers. Instead, they are pouring much of their resources, directly or indirectly, into political races at the local, state and federal level.

The 2010 election functioned, effectively, as a dry run, providing a blueprint for what social welfare groups are doing on a larger scale today. Records on what is happening in the 2012 campaign will not be available until well after the election.

For this story, ProPublica reviewed thousands of pages of filings for 106 nonprofits active during the 2010 election cycle, tracking what portion of their funds went into politics. We watched TV ads bought by these groups, looked at documents from other nonprofits that gave them money, and interviewed dozens of campaign finance experts and political strategists.

We found that some groups said they would not engage in politics when they applied for IRS recognition of their tax-exempt status. But later filings showed they spent millions on just such activities.

On the [very day](#) in 2008 that the [American Future Fund](#) mailed its application to the IRS, checking the box for "no" on whether it planned to participate in politics, it [uploaded an ad](#) to YouTube praising a Republican senator. The group reported more than [\\$8 million](#) in political spending in 2010.

We also found that social welfare groups used a range of tactics to underreport their political activities to the IRS, a critical measure in determining whether they are entitled to remain tax-exempt.

Many groups told the IRS they spent far less on politics than they reported to federal election officials. Some classified expenditures that clearly praised or criticized candidates for office as "lobbying," "education" or "issue advocacy" on their tax returns.

One group, the [Center for Individual Freedom](#), told election officials that it spent \$2.5 million on ads in 2010, when it paid for commercials criticizing [Democrats in 10 districts](#). But it reported to the IRS that it spent [nothing](#) to directly or indirectly influence elections, calling those same ads "education" or "legislative activities."

In several instances, nonprofits funneled much of their money to other 501(c)(4)s, which experts say is a way to meet, or appear to meet, IRS requirements for promoting social welfare. Yet records show the recipients of those grants spent much of their money on political activities, whether ads or voter-registration drives.

For example, almost 70 percent of [America's Families First's](#) 2010 expenditures went to grants to [five social welfare nonprofits](#). Four spent money on ads supporting Democrats or criticizing Republicans, including one group that put [almost half](#) of its expenditures into political ads.

No one from the Center for Individual Freedom or the American Future Fund responded to phone calls and emails from ProPublica asking for comment. In a written statement, America's Families First said its primary purpose was "issue advocacy" but did not answer specific questions about grants.

Campaign-finance watchdogs say the IRS has not clarified rules for social welfare groups or enforced them vigorously.

"The tax laws are being ripped off and the public is being denied information to which they are entitled — namely, who is financing ads that are being run to influence their votes," said Fred Wertheimer, the president of [Democracy 21](#), a watchdog group that has filed repeated complaints about 501(c)(4)s to regulators.

The IRS declined to answer questions from ProPublica for this story. The agency said in its [annual work plan](#) that it would look at "serious allegations of impermissible political intervention" by social welfare groups.

Marcus Owens, who was the director of the IRS' exempt organizations division for 10 years, pointed out that chasing political nonprofits isn't the agency's primary function, nor one for which it is staffed. One measure of this: Between 2001 and 2011, the IRS recognized more than 14,000 501(c)(4)s and turned down 56 applications.

One reason the IRS struggles is that it can't match the speed of politics. By the time some groups submitted tax returns spelling out the millions they put into the 2010 election, they had stopped operating, or disbanded and reformed under new names, ProPublica found.

The most politically active social welfare groups — former Minnesota Republican Sen. Norm Coleman's American Action Network and GOP strategist Karl Rove's Crossroads GPS — only filed tax returns covering fall 2010 in the spring of this year.

The [Republican Jewish Coalition](#), though formed in 1985, in many ways epitomizes the new breed of political-minded social welfare nonprofits.

The group's [initial IRS application](#) said it would not engage in politics, yet its 2010 tax return says it gave [almost \\$3.8 million](#) to other groups for political activities.

Separately, the Republican Jewish Coalition told the FEC it spent more than \$1.1 million on political ads, money that wasn't reported to the IRS. Together, the grants and the political advertising made up almost 40 percent of the total expenditures of the group, which is chaired by GOP super donor and casino magnate [Sheldon Adelson](#).

"Our efforts and our expenditures are well within our primary purpose test requirements," Brooks said in an interview. "Everything we do is strictly within the legal guidelines."

### **Recent Rulings Embolden Nonprofits**

Social welfare nonprofits have emerged as a prime vehicle for political money for several reasons.

Like super PACs, they can rake in unlimited contributions, support and oppose candidates, and buy ads right up until Election Day. But unlike super PACs, they don't have to disclose their donors.

Although individuals cannot deduct contributions to social welfare nonprofits on their taxes, companies may be able to write off donations as business expenses as long as they aren't earmarked for lobbying or political ads.

Many social welfare nonprofits became more active in politics after a series of recent court rulings, including the Supreme Court's Citizens United decision in January 2010, reshaped the rules of campaign finance.

Previously, laws had barred nonprofits from accepting donations from corporations or unions for political purposes and had mostly restricted 501(c)(4)s to generic "issue" ads that stopped short of calling on people to vote for or against candidates.

Citizens United dismantled this system. In a 5-4 decision, the high court said corporations and unions enjoyed the free speech rights of any individual. They could spend directly on political ads or give unlimited amounts of money to nonprofits for political activities. Over the next two years, contributions to existing social welfare nonprofits skyrocketed and new ones geared specifically toward elections were formed.

"It really sounded the starting gun for the creation of nonprofits that were strictly political in nature," said Sheila Krumholz, executive director of the Center for Responsive Politics, a nonpartisan research group that tracks money in politics.

Some new-style social welfare nonprofits share staff members and offices with super PACs. Their goals are intertwined: [Crossroads GPS](#), or Crossroads Grassroots Policy Strategies, and its sister super PAC, American Crossroads, for example, announced that together they hoped to spend \$200 million on the presidential election. Political operatives often hold key positions: The vice president of policy at Crossroads GPS oversaw the development and passage of the Republican platform in 2008.

Political expenditures by groups that do not disclose their donors — a category that includes trade associations like the U.S. Chamber of Commerce as well as social welfare nonprofits — have jumped dramatically in recent years. In 2006, groups that didn't report their donors made up less than 2 percent of outside spending, excluding party committees, [research by the Center for Responsive Politics](#) shows. By 2010, that had grown to more than 40 percent.

Most of the money spent by social welfare groups in 2010 came from conservative groups, a pattern holding true so far this year. As of Aug. 8, CMAG estimates show, liberal groups accounted for only \$1.6 million of the total spent by such organizations on TV ads for the presidential race. By contrast, the two leading conservative 501(c)(4)s, Crossroads GPS and [Americans for Prosperity](#), founded by conservative billionaire brothers David and Charles Koch, had spent about \$60 million.

Even as the role of social welfare nonprofits in politics has expanded, the IRS has not clarified how much time and resources they can legally devote to political activities — or what it means to be "primarily" engaged in promoting what the agency terms the "common good and general welfare of the people of the community."

Some groups have interpreted the rules to mean they can spend up to 49 percent of their money on political ads. The IRS has never set a hard limit. The agency has struggled to revoke or deny tax exemptions to groups because of political activity, sometimes having its decisions reversed by courts.

Many established social welfare nonprofits, such as the Sierra Club or the National Right to Life Committee, spend only a fraction of their money on political ads. But a few groups have devoted most of their expenditures to ads that have an undeniable political component, ProPublica found.

A group called [Economy Forward](#) spent \$173,470 on ads in March 2010 praising Senate Majority Leader Harry Reid, the Nevada Democrat, according to a transcript of the [ad](#) and public filings with eight TV stations in Nevada. That's almost [99 percent](#) of the total the group told the IRS it spent that year. The group did not respond to repeated requests for comment.

More than three-quarters of the money the American Action Network — former Republican Sen. Coleman's group — told the IRS it spent in its 2010 tax year was for political ads. In an email, American Action Network spokesman Dan Conston said the group complied with all laws and government regulations.

"The IRS seems to blink if you push them on this, which is what groups like the American Action Network and Crossroads GPS are probably betting on," said Lloyd Hitoshi Mayer, an associate dean and law professor at Notre Dame University who specializes in the intersection of tax and political law.

### **Groups Say "No" to Politics; Tax Returns Say Otherwise**

When groups apply to the IRS for recognition as tax-exempt, they must spell out their plans. They also must swear under penalty of perjury that they believe what they say is true.



Politics is one litmus test the agency uses to determine whether a group has a legitimate social welfare purpose and warrants a tax exemption, experts say. Question 15 on the application asks, "Has the organization spent or does it plan to spend any money attempting to influence the selection, nomination, election, or appointment of any person to any Federal, state, or local public office or to an office in a political organization?"

ProPublica compared applications from 58 501(c)(4)s with tax returns they filed later. We found 24 groups that initially said "no" to politics then filed tax returns showing they had done the opposite.

Even before mailing its application to the IRS saying it would not spend money on elections, the [Alliance for America's Future](#) was [running TV ads](#) supporting Republican candidates for governor in [Nevada](#) and [Florida](#). It also had given \$133,000 to two political committees directed by [Mary Cheney](#), the daughter of the former vice president. No one from the Alliance for America's Future returned calls for comment.

Another group, the [Revere America Association](#), launched with the help of former Republican New York [Gov. George Pataki](#), told the IRS in May 2010 that it [wouldn't spend money](#) to influence elections. But in its 2010 tax return, Revere America said it spent [about \\$2.5 million](#) on political ads.

Marianne Zuk, the group's president, did not return calls or emails about the discrepancy. In a brief interview in December, she said the group was "in the process of winding down." Zuk said a new social welfare nonprofit, [Partnership for America](#), had taken over Revere America's activities.

Some nonprofits provided other information in their applications that didn't line up with what they said in later filings.

America's Families First told the IRS in late 2009 that it would spend [50 percent](#) of its time on its website and emails, [30 percent](#) on conferences and [20 percent](#) on grants.

There's no sign America's Families First sponsored any conferences, however. The group's [website](#) consists of a photograph of a family holding hands and a single paragraph of text. Its tax return does not specify how much time the group spent on grants, but most of its expenditures were grants to other liberal groups.

Although America's Families First's IRS application said the group would "be funded by contributions from [individuals only](#)," tax records show much of its money came from other sources.

The group received [\\$2 million](#) from the Pharmaceutical Research and Manufacturers of America, or PhRMA, the pharmaceutical industry's main trade group, and an additional \$3.15 million from the [National Education Association](#) teachers union weeks before the election. The contributions became public in late 2011, when [PhRMA](#) and the [NEA](#) disclosed them.

America's Families First's leadership includes Greg Speed, now the treasurer for [Priorities USA Action](#), the super PAC devoted to re-electing Obama.

In a written statement, a spokeswoman for America's Families First said the group's application for IRS recognition broadly sketched out its planned activities. "As with all plans, they evolve, we adjusted our execution of activities and fundraising to reflect the changing environment and landscape," she wrote in an email.

Social welfare nonprofits can operate without IRS recognition, although most seek it. Having the agency's approval helps with fundraising and can help insulate groups against sanctions or back taxes later, experts say.

Three groups that spent money on politics in 2010 — Crossroads GPS, [Arkansans for Common Sense](#) and the CVFC 501c4, which appears to be related to Combat Veterans for Congress — have applied for IRS recognition but have yet to receive it.

In some cases, however, the IRS first learns about social welfare nonprofits when they file tax returns — by which time they may be inactive or defunct.

Five nonprofits that spent money on politics in 2010 confirmed they never applied for IRS recognition. Another seven groups said on tax returns that they had no application pending; the IRS had no record of recognizing them.

One of the groups never even filed the required tax return. [America's Future Fund](#), a Louisiana 501(c)(4) incorporated in June 2009 by lawyer Bryan Jeansonne, spent more than \$100,000 in October 2010 sending political mailers to Nevada voters. The following [February](#), it dissolved.

In an email, Jeansonne acknowledged the group had not submitted the tax filing, saying its accountant had said it was unnecessary. He did not respond to follow-up questions.

### **Spending Reported to IRS, FEC Often Doesn't Match**

Under state and federal laws, social welfare nonprofits must tell election authorities when they pay for independent expenditures, which are ads, mailings and phone calls that directly ask for people to vote for or against a candidate.

They also must report spending on electioneering communications — ads that mention candidates and run just before elections but are less explicit, using language like, "Call Candidate X. Tell him to stop killing jobs."

ProPublica identified 103 groups that reported such spending to state and federal election officials in 2010. But in tax filings covering the same period, at least 30 of these groups told the IRS they spent no money to influence elections, either directly or indirectly.

The [Women's Voices Women Vote Action Fund](#), for example, told the FEC it spent \$250,000 on [ads calling for people to vote](#) for a Democrat for Senate in Maine, but it told the IRS it [spent](#)

[nothing](#) on politics. Asked about the disparity, an official with the nonprofit said it was an inadvertent error and the group would amend its tax return.

Other groups reported less spending to the IRS than they acknowledged to election officials. [Americans for Tax Reform](#) told the IRS it spent about \$1.86 million on campaign activity, less than half of the \$4.2 million it told the FEC it spent on ads supporting Republicans and opposing Democrats. The group did not respond to calls or emails asking for comment.

One possible reason for such differences is that the FEC has specific guidelines for what constitutes a political ad, while the IRS goes case by case, looking at the content of ads, when they ran, and how they relate to groups' other spending. In tax filings, groups are asked to report both direct and indirect political spending.

Yet many social welfare groups have interpreted the IRS guidelines to mean they can report what the FEC considers to be electioneering communications as "education," "lobbying" or "issue advocacy" on tax filings.

Consider the [American Action Network](#), which reported spending [\\$25.7 million](#) on its 2010 tax return.

The group told the IRS the bulk of that money, [\\$17 million](#), went for lobbying and only [\\$5 million](#) went to political activity. But that same year, it told the FEC it spent more than \$19 million on ads.

Conston, the American Action Network's spokesman, declined to explain the discrepancy, saying that the group had complied with all applicable laws.

Details in FEC filings offer some additional clues. The American Action Network reported \$4 million in independent expenditures for 2010. Those ads clearly should be reported to the IRS as political spending, experts say. The group also reported \$15.4 million in electioneering communications to the FEC — the only category on its 2010 tax form large enough to cover this amount is lobbying.

Many of the electioneering communication ads are no longer accessible online. ProPublica found nine that remain public. These cost more than \$4.4 million, FEC records show.

Most criticized Democrats in vulnerable districts for supporting then-House Majority Leader Nancy Pelosi or health care reform. One focused on Nevada Rep. Dina Titus, showing a woman talking to a friend on Skype about the Democratic congresswoman.

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"Apparently, convicted rapists can get Viagra paid for by the new health bill," the woman said. Later, she added, "I mean, Viagra for rapists? With my tax dollars? And Congresswoman Titus voted for it."

At ProPublica's request, Ellen Aprill, a law professor and the John E. Anderson chair in tax law at Loyola Law School in Los Angeles, reviewed the ads to assess whether they fit the IRS definition of political spending.

Criticizing particular lawmakers or candidates makes it likely that the IRS would see such ads as attempts to influence elections, rather than as issue advocacy or lobbying, Aprill said.

"Not simply saying this is bad legislation, but these people hurt you — with the implication, 'Don't send them back to Congress,'" she said.

Even in cases in which it seems clear that nonprofits have not met reporting requirements for political spending, groups sometimes stop operating before regulators can take action.

The [Commission on Hope, Growth and Opportunity](#) paid for a series of ads in 2010 that cost an estimated \$2.3 million, according to CMAG.

One portrayed a cartoon dance line featuring Obama, Pelosi and an interchangeable Democrat, depending on where the ad ran. "Folks in Washington are living it up," it said. The ad urged viewers to "join" the Republican challenger.

Still, the group reported no spending to the FEC. In its 2010 tax return, it said it put at least [\\$4.6 million](#) — 96 percent of its total expenditures — into advertising, yet insisted it spent [nothing](#) to influence elections.

The [Commission on Hope, Growth and Opportunity](#) now appears dormant. Calls and emails to the group went unanswered.

"They are, of course, the best example of one of the problems with this: You can go into business and violate the law and then go out of business," said Melanie Sloan, the executive director of the [Citizens for Responsibility and Ethics in Washington](#), which filed complaints against the group with the IRS and FEC. "And what's ever going to happen about that? There's no consequence."

## Grants to Other Nonprofits Flow Into Politics

One way 501(c)(4) groups appear to fulfill their social welfare obligation is by making grants to other groups that share their tax status. Yet since the recipients also funnel money into politics, it's possible the grant money is ultimately spent on ads or other election-related activities.

According to its tax return, the nonprofit [CitizenLink](#) gave a grant of [\\$120,000](#) to the [Susan B. Anthony List](#) to "assist with purchase of TV promotional spots & election help." CitizenLink did not count this money as [political spending](#), the return said. The Susan B. Anthony List then used the money to help buy ads criticizing [two Democrats](#) for betraying voters by supporting health care reform, according to FEC reports. (The ads credited CitizenLink for helping pay for them.)

Another group, [CSS Action Fund](#), [gave a grant](#) of \$175,865 to Economy Forward for "promoting health care reform." Economy Forward spent almost all of this on ads promoting Sen. Harry Reid's help for the economy; health care reform wasn't mentioned.

Sometimes, ProPublica found, money passed back and forth between pairs or clusters of nonprofits with similar political agendas. It's not clear if the IRS compares tax filings and observes these patterns.

According to tax returns for 2010, the WMC Issues Mobilization Council gave [\\$865,000](#) to the American Justice Partnership, which in turn gave [\\$205,000](#) to the WMC Issues Mobilization Council. Both groups backed conservative causes and candidates.

The Republican Jewish Coalition reported making [grants](#) to Crossroads GPS and the American Action Network in 2010, giving each group \$4 million. Both groups returned the favor, reporting grants to the Republican Jewish Coalition in their 2010 tax years. Crossroads GPS gave the coalition [\\$250,000](#), while the American Action Network chipped in [\\$200,000](#).

Some nonprofits claim to stay out of politics but funnel money to other nonprofits that spend heavily on elections.

The Center to Protect Patient Rights, a group led by GOP strategist Sean Noble, reported on its 2010 tax return that it spent [no money](#) on politics.

As the [Center for Responsive Politics first reported](#), however, almost three-quarters of the group's income — a total of more than [\\$44 million](#) — went to other [social welfare groups](#) that were politically active, such as the American Future Fund and the [60 Plus Association](#).

Brooks, the Republican Jewish Coalition's executive director, said grants to other groups should "absolutely count" toward meeting a group's primary social welfare purpose. "It's not obscuring the source of the money because it's fully reported and disclosed," he said. "We happily support other organizations that share our goals and our work."

Jonathan Collegio, a spokesman for Crossroads GPS, said forming a network of like-minded groups was the only way to change policy. He said Crossroads GPS sent the Republican Jewish Coalition a contribution because it "had a great program of work."

Some experts, however, compared the transactions to Russian nesting dolls, with each layer opening to reveal another, equally inscrutable one underneath. Even if a social welfare nonprofit had to reveal the donors behind an ad, it would be another nonprofit. There would be no way to trace the money to the original source.

For instance, the Independent Women's Voice and Citizens for the Republic, two nonprofits that made disclosures to the FEC about political ads purchased in 2010, identified a new social welfare group, The Annual Fund, as a major contributor.

And where did [The Annual Fund](#) get its money? Mostly from yet another social welfare nonprofit, the [Wellspring Committee](#), run by the wife of The Annual Fund's founder.

### **Efforts for More Transparency Fall Short**

The new breed of political nonprofits may operate differently from traditional social welfare organizations, but some say they serve a vital purpose in an era of increasingly bitter political partisanship.

Dan Backer, a lawyer who represents several conservative nonprofits, pointed to the [Obama team's decision](#) to single out donors like the Koch brothers.

"You have the president of the United States attacking donors," Backer said. "A lot of them have been named in person by the president as bad people. That's horrifying."

Openly taking controversial political positions can be bad for business. Some Democrats and gay-rights groups called for a boycott of [Target](#) in 2010 after the company donated \$150,000 to a fund supporting a Republican candidate for governor in Minnesota who opposed gay marriage. Company officials swiftly apologized.

So far, efforts to impose limits on social welfare groups or demand more transparency from them have mostly failed.

Last summer, after coming under criticism, the [IRS abandoned efforts](#) to force five major donors to pay gift tax on contributions to social welfare nonprofits heavily involved in politics. This essentially gave the green light to donors worried about whether their donations could be taxed.

Bills to strengthen [disclosure requirements](#) have failed in the House and the Senate. The [Supreme Court](#) opted against reconsidering Citizens United in June.

In July, responding to a court ruling, the FEC said social welfare groups would have to identify [major donors](#) to electioneering communications. But groups are already finding work-arounds,

coming up with [different types of ads](#) or making sure the only donors they have to disclose are other nonprofits.

Watchdogs say they are frustrated that neither the IRS nor the FEC has been willing to enforce or even clarify the rules that exist to force transparency.

"I'm relatively pessimistic right now," said Karl Sandstrom, a former FEC vice chairman who's now with the Perkins Coie law firm. "We have agencies that are in some cases silent, in some cases divided and in some cases as slow as they can possibly be."

The IRS appears to be shifting its attention toward whether 501(c)(4)s benefit a segment of society, not the public as a whole, another requirement for such groups. In the past 18 months, the IRS rejected the applications of at least [four groups](#) and revoked the tax-exempt status of one small [Democratic nonprofit](#) and its affiliates for this reason. In most of these cases, the agency concluded the groups were run "primarily for the benefit of a political party and a private group of individuals."

Owens, the former head of the IRS nonprofit division who is now a lawyer at Caplin & Drysdale, said agents are probably examining other social welfare nonprofits using that framework, asking whether a group like Crossroads GPS benefits the community at large or a subset of politicians.

"Crossroads says its issue is free enterprise," he said. "That's their argument: They're really not carrying water for the Republicans. They're carrying water for free enterprise. It will be interesting to see if they make that argument stick. I think it'll be tough."

The IRS also has yet to make a decision on Crossroads GPS' request for recognition of its tax-exempt status, which news reports say was filed in [September 2010](#). Owens and others speculate that the IRS may be looking hard at the group.

Collegio, the spokesman for Crossroads GPS, said in an email that "without an IRS statement on the matter it is wholly irresponsible and unproductive to speculate."

Most experts do not expect the campaign finance landscape to change much before November, leaving social welfare nonprofits and their anonymous backers ample opportunity to influence who wins.

"The candidates and office holders will know where this money came from," said Paul S. Ryan, senior counsel for the Campaign Legal Center. "The political players who are soliciting these funds and are benefiting from the expenditure of these funds will know where the money came from. The only ones in the dark will be American voters."