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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

July 27, 2012

VIA U.S. MAIL & EMAIL (Catherine.M.Barre@irs.gov)

The Honorable Douglas H. Shulman Commissioner Internal Revenue Service 10th Street and Pennsylvania Avenue, NW Washington, D.C. 20004

Dear Commissioner Shulman:

I am writing to express my concern about how the IRS interprets the law regarding the extent to which 501(c)(4) "social welfare" organizations can engage in partisan political activity. The July 13, 2012 response by Lois G. Lerner, Director of Exempt Organizations, to my June 13, 2012 letter was unsatisfactory.

In the response, Ms. Lerner stated that "The IRS takes steps to **continually inform** organizations of their responsibilities as social welfare organization to help them avoid jeopardizing their tax-exempt status," and "**actively educates** section 501(c)(4) organizations at multiple states in their development about their responsibilities under the tax law." [*Emphasis added*.]

Her discussion does not describe an IRS initiative to "continually inform" or "actively educate." Rather, it shows the IRS is <u>passively</u> making some information available once a 501(c)(4) entity is already in existence. Further, her discussion of the explanatory materials available to the public, and the materials themselves, are confusing. This leads to a predictable result: organizations are using Internal Revenue Code Section 501(c)(4) to gain tax exempt status while engaging in partisan political campaigns. There is an absurd tangle of vague and contradictory materials that the IRS provides. Making the problem worse is that the IRS knows there is a problem because of the public nature of the activity, but has failed to address it.

First, the law.

26 U.S.C. §501(c)(4) states that "Civic leagues or organizations not organized for profit but operated **exclusively for the promotion of social welfare**, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes" are exempt from taxation. [Emphasis added.] Merriam-Webster defines "exclusively" as "single, sole; whole; undivided." Therefore, it would appear that the law prevents entities that organize under Section 501(c)(4) from any activity that is not operated exclusively for the promotion of social welfare or an association of employees.

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¹ 26 U.S.C. §501(c)(4).

Consistent with the law is a 1997 letter from the IRS denying tax-exempt status to a group called the National Policy Forum. The letter indicates that the IRS based its denial on the fact that the organization was engaged in partisan political activity, stating that "partisan political activity does not promote social welfare as defined in section 501(c)(4)," and that the applicant "benefit[s] select individuals or groups, instead of the community as a whole.²

One part of Internal Revenue Service Publication 557 in its guidance states, consistent with the law, that:

"If your organization is not organized for profit and will be operated **only** to promote social welfare to benefit the community, you should file Form 1024 to apply for recognition of exemption from federal income tax under section 501(c)(4)." [Emphasis added.]

Another part of Internal Revenue Service Publication 557 starts off by agreeing with the law and states, "Promoting 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." The IRS is accurately and clearly stating, in some places at least, that "social welfare" advocacy does <u>not</u> include campaigning for or against a candidate or candidates.

So far, so good - - until that same Publication 557 states: "However, if you submit proof that your organization is organized exclusively to promote social welfare, it can obtain an exemption [from taxes] even if it participates legally in some political activity on behalf of or in opposition to candidates for public office."⁵

That language seems inconsistent with the other referenced parts of Publication 557 (as well as being inconsistent with law and precedent), unless it means that the exemption isn't available for the political activity portion funded by 501(c)(4) receipts.

Further, an IRS regulation that interprets Section 501(c)(4) states that, "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." [Emphasis added.]

So the IRS regulation says the law's requirement of "exclusively" really means "primarily," something very different from "exclusively."

The IRS webpage cites an internal training article which states:

"[S]ocial welfare' is inherently an abstruse concept that continues to defy precise definition. Careful case-by-case analyses and close judgments are still required." [Emphasis added.]

Fair enough.

² Internal Revenue Service letter to the National Policy Forum, February 21, 1997.

³ Publication 557 (Rev. October 2011), pg. 51.

^{*} Id.

⁵ Id.

⁶ Treasury Regulations, Subchapter A, Sec. 1.501(c)(4)-1.

http://www.irs.gov/charities/nonprofits/article/0, id=156372,00.html.

In its Compliance Guide for Tax-Exempt Organizations, the IRS gives direction regarding how to make a case-by-case evaluation whether a communication is political. That Guide says that the following factors indicate that an advocacy communication is political campaign activity:

- The communication identifies a candidate for public office;
- The timing of the communication coincides with an electoral campaign;
- The communication targets voters in a particular election;
- The communication identifies the candidate's position on the public policy issue that is the subject of the communication;
- The position of the candidate on the public policy issue has been raised as distinguishing the candidate from others in the campaign, either in the communication itself or in other public communications; and
- The communication is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.

The guide further lays out the factors that indicate when an advocacy communication **is not** political campaign activity:

- The absence of any one or more of the factors listed above;
- The communication identifies specific legislation, or a specific event outside the control of the organization, that the organization hopes to influence;
- The timing of the communication coincides with a specific event outside the control of the organization that the organization hopes to influence, such as a legislative vote or other major legislative action (for example, a hearing before a legislative committee on the issue that is the subject of the communication);
- The communication identifies the candidate solely as a government official who is in a position to act on the public policy issue in connection with the specific event (such as a legislator who is eligible to vote on the legislation); and
- The communication identifies the candidate solely in the list of key or principal sponsors of the legislation that is the subject of the communication.

It is clear from the application of those factors that what is going on in the U.S. with certain 501(c)(4) organizations in their television advertisements are political campaign activities.

Below are two transcripts of advertisements that were put on television by 501(c)(4) organizations. As you can see, the subject of Advertisement #1 is a Democratic Senator, and the subject of Advertisement #2 is a Republican Senator. This is not a partisan issue.

Television Advertisement #1:

"It's time to play: Who is the biggest supporter of the Obama agenda in Ohio. It's Sherrod Brown. Brown backed Obama's agenda a whopping 95 percent of the time. He voted for budget busting ObamaCare that adds \$700 billion to the deficit. For Obama's \$453 billion tax increase. And even supported cap-and-trade which could have cost Ohio over 100,000 jobs. Tell Sherrod Brown, for real job growth, stop spending and cut the debt. Support the new majority agenda at newmajorityagenda.org."

⁸ Compliance Guide for Tax-Exempt Organizations, pgs. 4-5.

Television Advertisement #2:

"Before Wall Street gave him \$200,000 in campaign cash. ... Before he voted to let bank CEOs take millions in taxpayer funded bonuses. ... Dean Heller was a stockbroker. No wonder he voted against Wall Street reform; against holding the big banks accountable. Heller even voted to risk your Social Security here, in the stock market. Dean Heller: he votes like he still works for Wall Street, and that's bad for you."

Those ads, and so many like them, clearly fit the factors the IRS has laid out in its guide for what constitutes a political campaign activity. The advertisements make no pretense at nonpartisanship; they are blatantly and aggressively partisan communications.

Entities that file under Section 501(c)(4) of the Internal Revenue Code and take advantage of its tax exemption benefits should have to make a choice: either lose their exempt status (and pay taxes) or eliminate the partisan political activity.

The IRS needs to immediately review the activities of 501(c)(4) entities engaging in running partisan political ads or giving funds to Section 527 organizations that run such ads. The IRS needs to advise 501(c)(4) entities of the law in this area and the factors it will look at in reviewing 501(c)(4) status and tax exemption issues.

Please provide me with the following information no later than August 10, 2012:

- 1. How can the IRS interpret the explicit language in 26 U.S.C. §501(c)(4), which provides that 510(c)(4) entities must operate "exclusively" for the promotion of social welfare, to allow any tax exempt partisan political activity by 501(c)(4) organizations?
- 2. Since partisan political activity does not meet the IRS definition of "promoting social welfare," how can an organization that participates in any partisan political activity be "organized exclusively to promote social welfare?"
- 3. The Exempt Organizations 2011 Annual Report and 2012 Work Plan states: "As in any election year, EO will continue its work to enforce the rules relating to political campaigns and campaign expenditures. In FY 2012, EO will combine what it has learned from past projects on political activities with new information gleaned from the redesigned Form 990 to focus its examination resources on serious allegations of impermissible political intervention."
 - a. Typically, how long after a complaint to the IRS does a compliance review begin?
 - b. What approximate time does it take to review the complaint?
 - c. How many persons are involved in the enforcement of the 501(c)(4) rules?
- 4. The Exempt Organizations 2011 Annual Report and 2012 Work Plan states that 501(c)(4) organizations "can declare themselves tax-exempt without seeking a determination from the

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⁹ Exempt Organizations 2011 Annual Report and 2012 Work Plan, pg. 8.

IRS. EO will review organizations to ensure that they have classified themselves correctly and that they are complying with applicable rules."¹⁰

- a. Why does the IRS allow 501(c)(4) organizations to self-declare?
- b. When an organization "self declares" as a 501(c)(4) organization, how does the IRS get notice and how long does it take the IRS to conduct the review to ensure that that organization has classified itself correctly?
- 5. The IRS Compliance Guide for Tax-Exempt Organizations states:

"When a 501(c)(4), (5) or (6) organization's communication explicitly advocates the election or defeat of an individual to public office, the communication is considered political campaign activity. A tax-exempt organization that makes expenditures for political campaign activities shall be subject to tax in an amount equal to it its net investment income for the year or the aggregate amount expended on political campaign activities during the year, whichever is less."

- a. How does the IRS keep track of these explicit communications and ensure that the organization pays this tax?
- b. What is the reason for the requirement that the tax will be based on "whichever is less" between its net investment income for the year or the aggregate amount expended on political campaign activities?
- c. What tax would an organization have to pay if it spends *all* of its income on political advertising (therefore it has NO net investment income)?
- 6. Ms. Lerner's letter quotes the IRS webpage on Social Welfare Organizations:

"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. However, a section 501(c)(4) social welfare organization may engage in some political activities, so long as that is not its primary activity. However, any expenditure it makes for political activities may be subject to tax under section 527(f)." [Emphasis added.]

- a. What is the statutory basis of the language that allows 501(c)(4) organizations to engage in *some* political activities?
- b. How does the IRS keep track of these political activities and ensure that the organization pays the tax under section 527(f)?
- 7. In her July 13 letter, Ms. Lerner states that the IRS also addresses the issue of political activities in the Forms 990 and 990-EZ.

Are Forms 990 and 990-EZ made public? If so, where can they be accessed?

8. Internal Revenue Service Publication 557 states that, if a 501(c)(4) entity can "submit proof that [the] organization is organized exclusively to promote social welfare, it can obtain an

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Compliance Guide for Tax-Exempt Organizations, pgs. 3-4.

exemption even if it participates legally in some political activity on behalf of or in opposition to candidates for public office."¹²

Have the following 501(c)(4) organizations a) applied for; and if so, b) received the described exemption for political activity from the IRS?

- a. Crossroads Grassroots Policy Strategies
- b. Priorities U.S.A.
- c. Americans Elect
- d. American Action Network
- e. Americans for Prosperity
- f. American Future Fund
- g. Americans for Tax Reform
- h. 60 Plus Association
- i. Patriot Majority USA
- j. Club for Growth
- k. Citizens for a Working America Inc.
- 1. Susan B. Anthony List
- 9. Have you reminded 501(c)(4)s which publicly seem to be operating in the partisan political arena as to the factors you will consider in determining whether they are engaging in partisan political activity? If not, why not?

I have enclosed a copy of Ms. Lerner's letter. If you have any questions, please contact me, or have your staff contact Kaye Meier of my staff at kaye_meier@levin.senate.gov or 202/224-9110. Again, it is urgent that I receive your answers by August 10, 2012.

Sincerely.

Carl Levin

Chairman

Permanent Subcommittee on Investigations

cc: Dr. Tom Coburn Ms. Lois G. Lerner

Publication 557 (Rev. October 2011), pg. 51.