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

DEPUTY COMMISSIONER

March 15, 2013

The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security
and Government Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I am responding to your letter dated January 4, 2013, requesting additional information about § 501(c)(4) organizations. This response supplements the previous responses dated June 4, 2012, July 13, 2012, August 24, 2012, September 14, 2012, October 17, 2012, and November 23, 2012, and addresses the additional questions raised in your recent letter.

Question 1. In the IRS response of September 14, 2012, you write that "during the past six months, no notices of proposed or final revocation were issued to section 501(c)(4) organizations." In the November 23, 2012 IRS response, you write that "we have issued 42 revocation notices to section 501(c)(4) organizations since January of 2007." Also in the November 23, 2012, response you write "since January 1, 2007, we have issued ten adverse determinations to section 501(c)(4) applicants." Please respond to the following:

a. Please explain the difference between a "revocation notice" and an "adverse determination."

An adverse determination is a written ruling denying tax-exempt status to an organization that has applied for tax exemption, but has failed to meet the applicable requirements. A revocation notice is a written notice that tax exempt status is being revoked, as the result of an examination.[1]

[1] Revocation notices also may be issued to organizations that are automatically revoked for failing to file a Form 990 series return for three consecutive years. The revocation notices noted in Question1 above resulted from examinations.

b. Please explain whether or not a total of 52 organizations have now been deemed by the IRS as having not met their obligations as a § 501(c)(4) social welfare organization, and if so, please describe the consequences for those organizations in terms of whether or not they were subject to tax or penalties under § 527(i) and (j) for failure to make proper disclosure, whether they were then required by the IRS to pay other taxes, including back taxes, and whether or not they did so.

See Question 1bi below for information regarding the number of organizations that have not met the requirements for 501(c)(4) social welfare status.

As discussed in the June 4, 2012 and September 14, 2012 responses, failure to qualify under § 501(c)(4) is not determinative of whether an organization qualifies as tax-exempt under § 527. Sections 501(c)(4) and 527 both provide avenues for tax exemption under the Code, but for different types and levels of activity. To be tax-exempt under § 527, an organization must be operated primarily for the purpose of accepting contributions or making expenditures for an exempt function (i.e., influencing or attempting to influence the selection, nomination, election, or appointment of any federal, state, or local public office or office in a political organization). To be tax-exempt under § 501(c)(4) an organization must be primarily engaged in social welfare activity, but may conduct some amount of non-social welfare activity. If a § 501(c)(4) organization is determined not to be primarily engaged in social welfare by virtue of conducting high levels of non-social welfare activity, which could include political campaign intervention activity, that does not automatically mean the organization qualifies to be a § 527 political organization. To be tax-exempt under § 527, an organization must meet the requirements for that section, including taking action to be so treated by filing Form 8871, unless it meets one of the statutory exceptions. If it fails to timely file Form 8871, the organization will not be treated as a tax-exempt political organization for any period before the date the Form is filed, and its income will be subject to tax.

i. If you have not already done so, please provide the notices or letters that the IRS sent to the groups which the IRS determined did not meet their obligations as § 501(c)(4) charitable organizations.

Under the disclosure restrictions of §§ 6103 and 6110, we can only provide adverse determination letters and revocation notices in which taxpayer identifying and certain other information have been redacted.

Once we redact identifying information from an adverse determination letter or a revocation notice, copies of the original and redacted versions are sent to the organization, along with Notice 437, *Notice of Intention to Disclose*. Notice 437 provides the organization with an opportunity to request additional deletions or a delay in public disclosure. If the organization does not take any further action within a specified period, generally 60 days

after the mailing date of the notice, the redacted documents can then be made public. If, however, the organization disagrees with the redactions or requests a delay in publication, the process can take longer.

With regard to your request, we provided the ten redacted adverse determination letters with the November 23, 2012 response to your October 23, 2012 letter. The 42 instances of revocation notices identified in our earlier response resulted from queries to our automated systems, which have some limitations. In searching for the revocation notices, we noted some discrepancies between system-generated information and the actual revocation notices. To ensure that we provide responsive information to your request, we are manually reviewing case files for some of these matters. We will provide an update as we complete our review. We have enclosed nine revocation notices that have completed the redaction and taxpayer review process. Others are at various stages in that process and we will provide them as the process is completed.

Question 2. In the IRS response of November 23, 2012, you write that from January 1, 2007 to September 2012, the IRS has examined 643 § 501(c)(4) organizations to determine whether or not they were primarily engaged in social welfare activities but that the IRS "cannot definitively conclude whether we examined an organization to determine the level of political activity" without conducting a manual review of these cases. Please respond to the following:

a. **Please conduct this manual review and provide the number of these 643 examinations which involved political activity;**
b. **Please provide the number and names of the organizations that were determined to not be valid § 501(c)(4) organizations from this review.**

As stated in the November 23, 2012, response, our system reflects that 22 of the 643 examined § 501(c)(4) organizations had political campaign activity as one of the issues explored during examination. We derived this information from the selected Principal Issue Codes (PIC codes), which identify issues during an examination. Although there are some limitations to PIC codes, we do not believe a manual review of the files would significantly change the number of examinations in which political campaign activity was an issue considered. We would like to discuss with your staff any remaining concerns with this methodology.

Please note that the law would not allow us to provide the names of the organizations. As previously noted, § 6103 of the Internal Revenue Code prohibits the disclosure of information about specific taxpayers, including whether they are under investigation or examination, unless the disclosure is authorized by some provision of the Internal Revenue Code.[2]

[2] IRC § 6103(f) of the Code sets forth the means by which congressional committees may obtain access to return and return information (that is not otherwise made publicly available under

c. Please provide an explanation as to how the IRS determined whether or not the § 501(c)(4) organization was primarily engaged in political activity including any guidance, memorandum, criteria used by the IRS to determine whether or not a § 501(c)(4) organization was primarily engaged in political activity during these examinations.

To maintain tax exemption as described in § 501(c)(4), the organization must meet the statutory requirements in the Internal Revenue Code and accompanying regulations. Whether an organization maintains the statutory and regulatory requirements of § 501(c)(4) depends upon all of the facts and circumstances, and no one factor is determinative. Thus, in making a determination, we must take into account all facts and circumstances in evaluating whether legal requirements are satisfied. A variety of legal and procedural guidance is relevant in making such determination.

Legal guidance used to determine whether a § 501(c)(4) organization primarily engages in exempt activities include the following:

- IRC § 501(c)(4)
- Treas. Reg. § 1.501(a)-1[3]
- Treas. Reg. § 1.501(c)(4)-1; i.e., Treas. Reg. § 1.501(c)(4)-1(a)(2)(i)-(ii)[4]
- Rev. Rul. 2007-41, 2007-1 C.B. 1421

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§§ 6104 and 6110). We are available to discuss these rules in more detail with your staff.

[3] Treas. Reg. § 1.501(a)-1(a)(3). In general; proof of exemption. An organization claiming exemption under § 501(a) and described in any paragraph of § 501(c) (other than § 501(c)(1)) shall file the form of application prescribed by the IRS and shall include thereon such information as required by such form and the instructions issued with respect thereto. For rules relating to the obtaining of a determination of exempt status by an employees' trust described in § 401(a), see the regulations under § 401. Treas. Reg. § 1.501(a)-1(b)(2). In addition to the information specifically called for by this section, the IRS may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under § 501(a), and when deemed advisable in the interest of an efficient administration of the internal revenue laws, the IRS may in the cases of particular types of organizations prescribe the form in which the proof of exemption shall be furnished.

[4] 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 civic betterments and social improvements. A social welfare organization will qualify for exemption as a charitable organization if it falls within the definition of charitable set forth in paragraph (d)(2) of Reg. § 1.501(c)(3)–1 and is not an action organization as set forth in paragraph (c)(3) of Reg. § 1.501(c)(3)–1. 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. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

- Rev. Rul. 2004-6, 2004-1 C.B. 328
- Rev. Rul. 81-95, 1981-1 C.B. 332[5]
- Rev. Rul. 67-368, 1967-2 C.B. 194[6]
- Rev. Rul. 60-193, 1960-1 C.B. 195[7]

A revenue agent working a case uses sound reasoning based on tax law training and his or her experience in examining an organization. Because of the facts and circumstances nature and the need for professional judgment on the part of the revenue agent doing the review, procedural guidance is necessary to minimize variances in how cases are developed. As such, the IRS utilizes procedural guidance to promote quality and consistency in similar cases, such as the following:

- Rev. Proc. 2013-9[8]
- Form 1024[9]
- IRM 4.75[10]
- IRM 4.76.13[11]

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[5] Rev. Rul. 81-95 provides that "an organization may carry on lawful political activities and remain exempt under § 501(c)(4) as long as it is primarily engaged in activities that promote social welfare."
[6] In Rev. Rul. 67-368, an organization formed for the purpose of promoting an enlightened electorate, whose primary activity was rating candidates for public office, was not exempt under § 501(c)(4) because such activity was not "the promotion of social welfare." The ruling stated that comparative rating of candidates, even though on a non-partisan basis, constitutes participation or intervention in a political campaign on behalf of candidates favorably rated and in opposition to those less favorably rated.
[7] Rev. Rul. 60-193 concludes that an organization whose purpose was to encourage greater participation in governmental and political affairs promoted social welfare and therefore qualified for recognition of exemption under § 501(c)(4). Activities of the organization included conducting nonpartisan seminars and workshops relating to the American political system. All lecturers were required to maintain certain technical standards and were not allowed to advocate for any particular political group. Seminars and workshops were moderated by permanent staff personnel of the organization in order to prevent the program from becoming partisan in character.
[8] Rev. Proc. 2013-9 sets forth IRS procedures for issuing, as well as for revoking and modifying, determination letters and rulings on the exempt status of organizations under § 501 of the Internal Revenue Code.
[9] IRS application form for organizations seeking IRS recognition of exemption under § 501, including § 501(c)(4).
[10] IRM 4.75 provides general examination procedures.
[11] IRM 4.76.13 provides examination guidelines on social welfare organizations.

Question 3. In the IRS response of November 23, 2012, you write "Section 6104(a) of the Code permits public disclosure of an application for recognition of tax exempt status and supporting materials only after the organization has been recognized as exempt." On December 14, 2012, Propublica released the 1024 application for tax exempt status filed by Crossroads Grassroots Policy Strategies with the IRS. Please respond to the following:

a. **Did the IRS release the 1024 application filed by Crossroads Grassroots Policy Strategies to Propublica or any other entity?**
b. **If the IRS released the 1024 application filed by Crossroads Grassroots Policy Strategies, why did it do so since the IRS has yet to approve Crossroads' application?**

Section 6103 of the Internal Revenue Code prohibits the disclosure of information about specific taxpayers unless the disclosure is authorized. The protection and confidentiality of tax information is one of our top priorities. When questions arise about the release of tax information, our normal procedure is to refer the matter to the Treasury Inspector General for Tax Administration. We are unable to comment further.

c. **Please also provide an update as to the status of the application for tax exempt status filed by Crossroads Grassroots Policy Strategies.**

Section 6104(a) of the Code does permit public disclosure of an application for recognition of tax-exempt status and supporting materials only after the application has been approved for the organization to be recognized as exempt. The IRS has no record of an approved application for Crossroads GPS.

Question 4. With regard to your June 4, 2012 response:

a. **When describing the § 501(c)(4) application process, you write that "...in situations where there are a number of cases involving similar issues (such as credit counseling organizations, down payment assistance organizations, organizations that were automatically revoked and are seeking retroactive reinstatement, and most recently, advocacy organizations), the IRS will assign cases to designated employees to promote consistency." Please explain the term "advocacy organization" and provide any guidelines, memorandum, or procedures used by the IRS to evaluate § 501(c)(4) advocacy organizations including whether or not the IRS considers an "advocacy organization" to be an organization that is engaged in political activity.**

As the chart below illustrates, the Code distinguishes between advocacy activities that influence legislation, those that influence candidate elections, and those that do neither. Depending on the subsection under which an organization is exempt, there are differing rules regarding the nature and amount of advocacy an organization can conduct and still retain its exemption. As used in the prior response, "advocacy organizations" was a short hand way of describing cases that raise questions whether the type and amount of advocacy an organization undertakes is consistent with the code section under which it seeks exemption.

	501(c)(3)	501(c)(4)	501(c)(5)	501(c)(6)	527
Receive tax-deductible charitable contributions	YES	NO	NO	NO	NO
Receive contributions or fees deductible as a business expense	YES	YES	YES	YES	NO
Substantially related income exempt from federal income tax	YES	YES	YES	YES	YES
Investment income exempt from federal income tax	LTD*	YES	YES	YES	NO
Engage in legislative advocacy	LTD	YES	YES	YES	LTD
Engage in candidate election advocacy	NO	LTD	LTD	LTD	YES
Engage in public advocacy not related to legislation or election of candidates	YES	YES	YES	YES	LTD

*Private foundations are subject to tax on their net investment income.

See also response to question 2(c) above for guidance and procedures used to determine whether a § 501(c)(4) organization primarily engages in exempt activities.

b. Please provide the "draft educational guide sheet on the issue of political activity for section 501(c)(4) applications that was shared for comment with some employees in EO Determinations" that you reference on page 13 of the letter.

We would like to provide some additional details regarding this document. The guide sheet draft referenced in this question was an initial staff draft, which was never approved nor finalized. It was distributed for comment only. We are able to discuss with your staff in more detail.

Question 5. Please explain the difference between Rev. Ruling 2007-41, 2007-1 C.B. 1421, which is generally used by the IRS to determine whether issue advocacy crosses the line into campaign intervention and Rev. Ruling 2004-6, 2004-1 C.B. 328, which generally addresses whether an expenditure for an issue advocacy expenditure is subject to the § 527(f) tax. Please also explain which of these is used by the IRS to determine whether a § 501(c)(4) organization is primarily engaged in political activity.

As you note in your question, Rev. Rul. 2004-6 and Rev. Rul. 2007-41 provide guidance under two different statutory provisions. Rev. Rul. 2004-6 provides guidance on the circumstances in which a public policy advocacy communication may constitute an exempt function within the meaning of § 527(e)(2), which would be subject to tax under § 527(f).[12] The ruling describes six factual situations involving organizations that are exempt from federal income tax under § 501(a) as organizations described in § 501(c)(4), § 501(c)(5) or § 501(c)(6). Each of the situations assumes that the organization would continue to be exempt under § 501(a), even if the described activity is not a § 501(c) exempt activity. The ruling provides nonexclusive lists of factors that tend to show that an advocacy communication on a public policy issue is (or is not) for an exempt function under § 527(e)(2), but also states that all facts and circumstances must be considered.

Rev. Rul. 2007-41 provides guidance on when an organization exempt from federal income tax under § 501(a) as an organization described in § 501(c)(3) has participated or intervened in a political campaign on behalf of (or in opposition to) any candidate for public office in violation of § 501(c)(3).[13] The ruling describes 21 factual situations. In each factual situation, all the facts and circumstances are considered in determining whether the organization's activities result in political campaign intervention for purposes of § 501(c)(3).

Neither Rev. Rul. 2004-6 nor Rev. Rul. 2007-41 specifically addresses whether a § 501(c)(4) organization is engaged in political campaign activity within the meaning of Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).[14] Nevertheless, consistent with both of these revenue rulings, the Service analyzes all the facts and circumstances to determine whether a § 501(c)(4) organization participated or intervened in a political campaign.

Question 6. It has been reported in the press that some § 501(c)(4) organizations report to the IRS that they do not engage in political activity but then report either they do engage in political activity to the Federal Election Commission (FEC) or report widely varying amounts of political activity to the FEC and the IRS. Please respond to the following:

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[12] Section 527(e)(2) provides: "The term "exempt function" means the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed. Such term includes the making of expenditures relating to an office described in the preceding sentence which, if incurred by the individual, would be allowable as a deduction under section 162(a)."

[13] To qualify under § 501(c)(3) an organization must "not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

[14] Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) provides: "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."

a. Does the IRS track a § 501(c)(4) organization's filings with the FEC?
b. What actions does the IRS take when there are differences in what a § 501(c)(4) organization reports to the IRS versus what it reports to the FEC?
c. How does the IRS coordinate with the FEC with regard to § 501(c)(4) organizations?

We use all publicly-available information, including FEC filings, when considering an application or conducting an examination. However, we do not have a system that formally tracks FEC filings of § 501(c)(4) organizations. We also do not formally coordinate with the FEC on matters related to § 501(c)(4) organizations as § 6103 of the Internal Revenue Code prohibits the disclosure of information about specific taxpayers unless the disclosure is authorized by some provision of the Internal Revenue Code. Therefore, exchange of confidential taxpayer information with the FEC generally is barred.

Further, differences in reporting requirements such as the following make coordination between the agencies difficult. These include, for example, differences in who is responsible for filing the reports, what constitutes reportable political campaign activity, and the timing of reports.

The party responsible for filing with the FEC depends upon the nature of the political campaign expenditure. So, for example, if a § 501(c)(4) organization makes any contributions, including in-kind contributions and coordinated expenditures, to an FEC political organization (campaign committee, party committee or PAC), it is our understanding that the § 501(c)(4) organization is not required to file anything with the FEC. Instead, it is our understanding that the recipient political organization is required to include the contribution on its report to the FEC. On the other hand, if a § 501(c)(4) organization makes independent expenditures or electioneering communications, it is required to file a report with the FEC.

The definition of what constitutes reportable political campaign expenditures under the two filing regimes also differs. Although most political campaign expenditures required to be reported to the FEC may constitute political campaign intervention under the Internal Revenue Code, some might not.

In addition, we are not limited by the express advocacy standard or FEC case law in determining whether an activity is political campaign intervention for § 501(c)(4) purposes. The regulations under § 501(c)(4) provide that directly or indirectly participating or intervening in a political campaign on behalf of or in opposition to a candidate for public office is not in furtherance of § 501(c)(4) exempt purposes. This determination is based upon all of the facts and circumstances.

Another factor that can lead to differences in reporting is timing of the reports. Organizations report to the FEC based upon the election cycle; while organizations report to the IRS based upon their fiscal tax year, which differs among organizations. Forms 990

filed with the IRS are due 5 months and 15 days after the end of the organization's fiscal tax year. So, for example, an organization with a June fiscal tax year might make independent expenditures in October that are reported to the FEC prior to the November election. However, because the Form 990 is not due until the 15th day of the fifth month after the end of the fiscal tax year, those same expenses would be reported on the Form 990 that is due on November 15th of the following year (and, because of extensions, may not actually be filed for another six months after that).

All of these factors can contribute to perceived inconsistencies between FEC and IRS records of political campaign activity by § 501(c)(4) organizations.

I hope this information is helpful. If you have questions, please contact me or have your staff contact Catherine Barré, Director, Legislative Affairs, at (202) 622-3720.

Sincerely,

Steven T. Miller
Deputy Commissioner for
Services and Enforcement

Enclosures (9)

Exhibit B

Letter from Senator Dick Durbin to IRS Commissioner Douglas H. Shulman and Press Release

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October 12, 2010

DURBIN URGES IRS TO INVESTIGATE SPENDING BY CROSSROADS GPS

[WASHINGTON, D.C.] – Assistant Senate Majority Leader Dick Durbin (D-IL) urged the Internal Revenue Service (IRS) to quickly investigate the tax status of Crossroads GPS and other organizations that are directing millions of dollars into political advertising without disclosing their funding sources. U.S. tax law requires that the primary purpose of 501(c)(4) organizations, like Crossroads GPS, cannot be political, including the "participation or intervention in political campaigns."

"I write to urge the Internal Revenue Service to examine the purpose and primary activities of several 501 (c) (4) organizations that appear to be in violation of the law," wrote Durbin. "[Crossroads GPS] has spent nearly $20 million on television advertising specific to Senate campaigns this year. If this political activity is indeed the primary activity of the organization, it raises serious questions about the organization's compliance with the Internal Revenue Code."

Crossroads GPS was created in June 2010 as a non-profit "social welfare" organization under section 501(c) (4) of the federal tax code, which means, in addition to tax-exempt status, the group can raise and spend freely without being required to disclose to the public the sources of its funding. Crossroads GPS is affiliated with American Crossroads, a Section 527 group that can raise and spend freely on direct advocacy but must reveal its source of funding. Together these organizations have already spent a total of $20 million on political campaigns nationwide.

Text of the letter appears below:

October 11, 2010

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

Dear Commissioner Shulman:

I write to urge the Internal Revenue Service to examine the purpose and primary activities of several 501 (c) (4) organizations that appear to be in violation of the law.

One organization whose activities appear to be inconsistent with its tax status is Crossroads GPS, organized as a (c)(4) entity in June. The group has spent nearly $20 million on television advertising specific to Senate campaigns this year. If this political activity is indeed the primary activity of the organization, it raises serious questions about the organization's compliance with the Internal Revenue Code.

In addition to its tax-exempt status, an entity organized as a 501(c)(4) is not required to disclose to the public the sources of its funding. Given the millions of dollars these groups are pouring into Senate campaigns across the country, it is imperative that the organizations spending such sums on political advertising are appropriately disclosing relevant information about contributors. The current spending patterns without disclosing the sources of the funding create a deeply troubling lack of transparency that threaten to undermine the ability of the electorate to make informed choices on Election Day.

I ask that the IRS quickly examine the tax status of Crossroads GPS and other (c)(4) organizations that are directing millions of dollars into political advertising, and respond with your findings as soon as possible.

Sincerely,

Richard J. Durbin
United States Senator

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WASHINGTON, D.C.
711 Hart Senate Bldg.
Washington, DC 20510
9 am to 6 pm ET
(202) 224-2152 – phone
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230 S Dearborn St.
Suite 3892
Chicago, IL 60604
8:30 am to 5 pm
(312) 353-4952 – phone
(312) 353-0150 – fax

SPRINGFIELD
525 South 8th St.
Springfield, IL 62703
8:30 am to 5 pm
(217) 492-4062 – phone
(217) 492-4382 – fax

CARBONDALE
250 W. Cherry Street
Suite 115-D
Carbondale, IL 62901
8:30 am to 5 pm
(618) 351-1122 – phone
(618) 351-1124 – fax

ROCK ISLAND
1504 Third Avenue
Suite 227
Rock Island, IL 61201
8:30 am to 4:30 pm
(309) 786-5173 – phone
(309) 786-5404 – fax

Exhibit C

Letters From Senator Bennet, Senator Franken, Senator Merkley, Senator Schumer, Senator Shaheen, Senator Udall and Senator Whitehouse and Press Release

United States Senate
WASHINGTON, DC 20510

February 16, 2012

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

Dear Commissioner Shulman:

We write to inquire if the Internal Revenue Service ("IRS") is investigating or intends to investigate whether groups designated as "social welfare" organizations, and thus receiving tax and other advantages under section 501(c)(4) of the Internal Revenue Code (IRC), 26 U.S.C. § 501(c)(4), are improperly engaged in a substantial or even a predominant amount of campaign activity. In section 501(c)(4), Congress created a tax preference for social welfare organizations because the nation benefits greatly from their social welfare activities. It is contrary to the letter and the spirit of the statute for political organizations formed primarily to advocate for a political candidate or to run attack ads against other candidates to take advantage of section 501(c)(4).

Under the IRC and IRS regulations, section 501(c)(4) organizations are required to primarily engage in the promotion of social welfare to obtain tax exempt status. Section 501(c)(4) establishes tax-exempt status for nonprofits "operated exclusively for the promotion of social welfare . . . ." 26 U.S.C. § 501(c)(4). IRS regulations state that a nonprofit operates "exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare for the people of the community." 26 U.S.C. § 501 (c)(4), 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) (emphasis added). The regulations require that a social welfare organization "is one which is operated primarily for the purpose of bringing about civic betterments and social improvements." *Id.*

Even more to the point is what the regulations say about campaign activities: "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." *Id.* § 1.501(c)(4)-1(a)(2)(ii). This standard is clear, and it appears to preclude the formation of 501(c)(4) organizations for campaign-related purposes.

Courts have interpreted section 501(c)(4) to prohibit a group organized under that section from engaging in more than an insubstantial amount of campaign activity. Courts have consistently found that the presence of a single substantial non-exempt purpose precludes exempt status, regardless of the number or importance of the exempt purposes. *See Contracting Plumbers Coop. Restor. Corp. v. U.S.*, 488 F.2d 684, 686 (2d. Cir. 1973); *see also American*

Ass'n of Christian Sch. Vol. Emp. v. U.S., 850 F.2d 1510, 1516 (11th Cir. 1988). The IRS is tasked with applying this strict statutory interpretation of 501(c)(4) by the courts.

IRS regulations, however, appear more permissive than the statute as interpreted by the courts. For example, the IRS authorizes section 501(c)(4) social welfare organizations to engage in federal election activities, including electioneering communications, as long as such activities do not constitute the "primary" activity of the organization. 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i). Some political organizations argue that section 501(c)(4) organizations can spend up to forty-nine percent of their total expenditures on campaign activities without such activities constituting the "primary" activity of the organization. While this forty-nine percent threshold appears to violate the language of the statute and the subsequent interpretation of several courts, we are concerned that some political organizations may still be violating this exceptionally high threshold.

We are aware that non-profit organizations have filed a petition for rulemaking with the IRS to revise existing regulations governing whether an organization that intervenes or participates in elections is entitled to obtain or maintain an exemption from taxation under section 501(c)(4). We urge you to investigate these allegations and to seriously consider launching a rulemaking to prevent this type of abuse of the tax code.

We urge you to protect legitimate section 501(c)(4) entities by preventing non-conforming organizations that are focused on federal election activities from abusing the tax code. We thank you for your prompt attention to this matter and look forward to your response.

Sincerely,

Michael F. Bennet
U.S. Senator

Al Franken
U.S. Senator

Jeff Merkley
U.S. Senator

Charles E. Schumer
U.S. Senator

Jeanne Shaheen
U.S. Senator

Tom Udall
U.S. Senator

Sheldon Whitehouse
U.S. Senator

Michael F. Bennet

United States Senator for Colorado

Senators Call for IRS Investigations into Potential Abuse of Tax-Exempt Status by Groups Engaged in Campaign Activity

February 16, 2012

Colorado U.S. Senator Michael Bennet, along with Senators Al Franken (D-MN), Chuck Schumer (D-NY), Sheldon Whitehouse (D-RI), Jeff Merkley (D-OR), Jeanne Shaheen (D-NH) and Tom Udall (D-NM), today called on the Internal Revenue Service (IRS) to investigate whether organizations claiming tax-exempt status are engaging in a substantial amount of campaign activity.

In a letter to Douglas Shulman, commissioner of the IRS, the Senators requested the IRS enforce the law and prevent abuse of the tax code by organizations receiving tax-exempt status under section 501(c)(4) of the Internal Revenue Code (IRC), which is designated for "social welfare" organizations not engaged in election activity.

"It is contrary to the letter and the spirit of the statute for political organizations formed primarily to advocate for a political candidate or to run attack ads against other candidates to take advantage of section 501(c)(4)," the Senators wrote in the letter. "We urge you to protect legitimate section 501(c)(4) entities by preventing non-conforming organizations that are focused on federal election activities from abusing the tax code."

The senators expressed concerns that the IRS regulations were more permissive than federal court interpretation of the code and that some 501(c)(4) organizations were engaged in a degree of election activities that precludes them from claiming tax-exempt status.

In section 501(c)(4), Congress created a tax preference for social welfare organizations because the nation benefits greatly from their social welfare activities. Under the IRC and IRS regulations, section 501(c)(4) organizations are required to primarily engage in the promotion of social welfare to obtain tax exempt status.

For instance, long-time partisan operative Karl Rove is a senior official behind a 501(c)(4) "social welfare" charity, yet it's common knowledge that his organization exists to elect and defeat specific political candidates. Elections operations such as Mr. Rove's should not be allowed to masquerade as charities to take advantage of their tax exempt status and hide their donors from the public. It's the IRS's job to enforce the tax code and make sure that "social welfare" organizations are what they say they are.

The IRC regulations state that "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."

Full text of the letter is included below.

Dear Commissioner Shulman:

We write to inquire if the Internal Revenue Service ("IRS") is investigating or intends to investigate whether groups designated as "social welfare" organizations, and thus receiving tax and other advantages under section 501(c)(4) of the Internal Revenue Code (IRC), 26 U.S.C. § 501(c)(4), are improperly engaged in a substantial or even a predominant amount of campaign activity. In section 501(c)(4), Congress created a tax preference for social welfare organizations because the nation benefits greatly from their social welfare activities. It is contrary to the letter and the spirit of the statute for political

organizations formed primarily to advocate for a political candidate or to run attack ads against other candidates to take advantage of section 501(c)(4).

Under the IRC and IRS regulations, section 501(c)(4) organizations are required to primarily engage in the promotion of social welfare to obtain tax exempt status. Section 501(c)(4) establishes tax-exempt status for nonprofits "operated exclusively for the promotion of social welfare . . . ." 26 U.S.C. § 501(c)(4). IRS regulations state that a nonprofit operates "exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare for the people of the community." 26 U.S.C. § 501 (c)(4), 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) (emphasis added). The regulations require that a social welfare organization "is one which is operated primarily for the purpose of bringing about civic betterments and social improvements." Id.

Even more to the point is what the regulations say about campaign activities: "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." Id. § 1.501(c)(4)-1(a)(2)(ii). This standard is clear, and it appears to preclude the formation of 501(c)(4) organizations for campaign-related purposes.

Courts have interpreted section 501(c)(4) to prohibit a group organized under that section from engaging in more than an insubstantial amount of campaign activity. Courts have consistently found that the presence of a single substantial non-exempt purpose precludes exempt status, regardless of the number or importance of the exempt purposes. See Contracting Plumbers Coop. Restor. Corp. v. U.S., 488 F.2d 684, 686 (2d. Cir. 1973); see also American Ass'n of Christian Sch. Vol. Emp. v. U.S., 850 F.2d 1510, 1516 (11th Cir. 1988). The IRS is tasked with applying this strict statutory interpretation of 501(c)(4) by the courts.

IRS regulations, however, appear more permissive than the statute as interpreted by the courts. For example, the IRS authorizes section 501(c)(4) social welfare organizations to engage in federal election activities, including electioneering communications, as long as such activities do not constitute the "primary" activity of the organization. 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i). Some political organizations argue that section 501(c)(4) organizations can spend up to forty-nine percent of their total expenditures on campaign activities without such activities constituting the "primary" activity of the organization. While this forty-nine percent threshold appears to violate the language of the statute and the subsequent interpretation of several courts, we are concerned that some political organizations may still be violating this exceptionally high threshold.

We are aware that non-profit organizations have filed a petition for rulemaking with the IRS to revise existing regulations governing whether an organization that intervenes or participates in elections is entitled to obtain or maintain an exemption from taxation under section 501(c)(4). We urge you to investigate these allegations and to seriously consider launching a rulemaking to prevent this type of abuse of the tax code.

We urge you to protect legitimate section 501(c)(4) entities by preventing non-conforming organizations that are focused on federal election activities from abusing the tax code. We thank you for your prompt attention to this matter and look forward to your response.

FOR IMMEDIATE RELEASE: March 12, 2012

SENATE DEMOCRATS URGE IRS TO IMPOSE STRICT CAP ON POLITICAL SPENDING BY NONPROFIT GROUPS—VOW LEGISLATION IF AGENCY DOESN'T ACT

Senators Seek To End Tax Code Abuse By Political Groups Masquerading As 'Social Welfare Organizations'

In Letter to IRS, Lawmakers Say Firm Limit Should Be Set on Percentage of Nonprofits' Spending That Can Be Devoted To Political Activities

Reforms Also Urged To Prevent Political Donors From Claiming Tax Deduction For Their Contributions

WASHINGTON, D.C. – A group of seven Senate Democrats urged the Internal Revenue Service on Monday to impose a strict cap on the amount of political spending by tax-exempt, nonprofit groups.

The senators said the lack of clarity in the IRS rules has allowed political groups to improperly claim 501(c)4 status and may even be allowing donors to these groups to wrongly claim tax deductions for their contributions. The senators promised legislation if the IRS failed to act to fix these problems.

"We urge the IRS to take these steps immediately to prevent abuse of the tax code by political groups focused on federal election activities. But if the IRS is unable to issue administrative guidance in this area then we plan to introduce legislation to accomplish these important changes," the senators wrote.

The letter was signed by Senators Charles E. Schumer, Michael

Bennet, Sheldon Whitehouse, Jeff Merkley, Tom Udall, Jeanne Shaheen and Al Franken. It follows an earlier letter, sent to the IRS by the same of group of senators last month, that also urged the IRS to better enforce rules pertaining to 501(c)4 organizations.

Federal law defines 501(c)4 groups as groups engaged exclusively in "social welfare" activities. The IRS, however, has allowed these 501(c)4 groups to venture into political activities as long as civic and charitable work remains their "primary purpose." This loophole has caused a number of organizations heavily engaged in political work to organize themselves as 501(c)4 groups in order to gain tax-exempt status and shield their donors from the disclosure requirements that apply to more traditional political organizations.

The senators said the IRS should close this loophole by imposing a strict, percentage-based cap on the amount of a nonprofit group's spending that can go towards political activities. Legal experts have proposed a cutoff of 49 percent to ensure that political activities never command more than half of a group's total spending. But the senators said even this threshold would be too high and would permit more political work than any nonprofit group should be able to perform.

The senators also said that 501(c)4 groups should have to disclose upfront—on all written and online solicitations that get sent to potential donors—how much of their activities are political. The senators said this would make it clear to potential donors how much of a tax deduction, if any, they could claim on their tax returns. Currently, no such information is required to be disclosed and tax experts have expressed concern that many corporations contributing funds to these political groups may be counting those donations as a business expenses eligible for a full tax deduction.

A copy of the senators' letter to IRS Commissioner Douglas H. Shulman appears below.

Hon. Douglas H. Shulman

Commissioner

Internal Revenue Service

Room 3000 IR

1111 Constitution Avenue, N.W.

Dear Commissioner Shulman:

We write to ask the Internal Revenue Service ("IRS") to immediately change the administrative framework for enforcement of the tax code as it applies to groups designated as "social welfare" organizations. These groups receive tax and other advantages under section 501(c)(4) of the Internal Revenue Code (hereinafter, "IRC" or the "Code"), but some of them also are engaged in a substantial amount of political campaign activity. As you know, we sent a letter last month expressing concerns about the 501(c)(4) issue; an investigation this week by the New York Times has uncovered new, specific problems on how c)4)s conduct business. We wanted to address those new concerns in this letter.

IRS regulations have long maintained that political campaign activity by a 501(c)(4) entity must not be the "primary purpose" of the organization. These regulations are intended to implement the statute, which requires that such organizations be operated exclusively for the public welfare. But we think the existing IRS regulations run afoul of the law since they only require social welfare activities to be the 'primary purpose' of a nonprofit when the Code says this must be its 'exclusive' purpose. In recent years, this daylight between the law and the IRS regulations has been exploited by groups devoted chiefly to political election activities who operate behind a facade of charity work.

A related concern, raised in a March 7th *New York*

Times article, concerns whether certain nonprofits may be soliciting corporate contributions that are then treated by the company as a business expense eligible for a tax deduction. The *Times* wrote: "Under current law, there is little to no way to tell whether contributions are being deducted, especially because many of the most political companies are privately held." This potential abuse distorts the objectives of vital revenue mechanisms and undermines the faith that we ask citizens to place in their electoral system.

We propose that the IRS make three administrative changes to curtail these questionable practices and bring IRS tax regulations back into alignment with the letter and spirit intended by those who crafted the Code:

- First, we urge the IRS to adopt a bright line test in applying its "primary purpose" regulation that is consistent with the Code's 501(c)(4) exclusivity language. The IRS currently only requires that the purpose of these non-profits be "primarily" related to social welfare activities, without defining what "primarily" means. This standard should be spelled out more fully by the IRS. Some have suggested 51 percent as an appropriate threshold for establishing that a nonprofit is adhering to its mission, but even this number would seem to allow for more political election activity than should be permitted under the law. In the absence of clarity in the administration of section 501(c)(4), organizations are tempted to abuse its vagueness, or worse, to organize under section 501(c)(4) so that they may avail themselves of its advantages even though they are not legitimate social welfare organizations. If the IRS does not adopt a bright line test, or if it adopts one that is inconsistent with the Code's exclusivity language, then we plan to pursue legislation codifying such a test.

- Second, such organizations should be further obligated to document in their 990 IRS form the exact percentage of their undertakings dedicated to "social welfare." Organizations should be required to "show their math" to demonstrate that political election activities

and other statutorily limited or prohibited activities do not violate the "primary purpose" regulation.

· Third, 501(c)(4) organizations should be required to state forthrightly to potential donors what percentage of a donation, if any, may be taken as a business expense deduction. As the New York Times reported in its March 7th article, some of these organizations do not currently inform donors whether a contribution is tax deductible as a business expense at all.

The IRS should already possess the authority to issue immediate guidance on this matter. We urge the IRS to take these steps immediately to prevent abuse of the tax code by political groups focused on federal election activities. But if the IRS is unable to issue administrative guidance in this area then we plan to introduce legislation to accomplish these important changes.

Sincerely,

Senators Charles E. Schumer, Michael Bennet, Sheldon Whitehouse, Jeff Merkley, Tom Udall, Jeanne Shaheen and Al Franken

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Exhibit D

Letter from Senator Max Baucus to IRS Commissioner Douglas H. Shulman and Press Release

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, DC 20510–6200

September 28, 2010

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

Via Electronic Transmission

Dear Commissioner Shulman:

The Senate Finance Committee has jurisdiction over revenue matters, and the Committee is responsible for conducting oversight of the administration of the federal tax system, including matters involving tax-exempt organizations. The Committee has focused extensively over the past decade on whether tax–exempt groups have been used for lobbying or other financial or political gain.

The central question examined by the Committee has been whether certain charitable or social welfare organizations qualify for the tax-exempt status provided under the Internal Revenue Code.

Recent media reports on various 501(c)(4) organizations engaged in political activity have raised serious questions about whether such organizations are operating in compliance with the Internal Revenue Code.

The law requires that political campaign activity by a 501(c)(4), (c)(5) or (c)(6) entity must not be the primary purpose of the organization.

If it is determined the primary purpose of the 501(c)(4), (c)(5) and (c)(6) organization is political campaign activity the tax exemption for that nonprofit can be terminated.

Even if political campaign activity is not the primary purpose of a 501(c)(4), (c)(5), and (c)(6) organization, it must notify its members of the portion of dues paid due to political activity or pay a proxy tax under Section 6033(e).

Also, tax-exempt organizations and their donors must not engage in private inurement or excess benefit transactions. These rules prevent private individuals or groups from using tax-exempt organizations to benefit their private interests or to profit from the tax-exempt organization's activities.

A September 23 *New York Times* article entitled "Hidden Under a Tax-Exempt Cloak, Private Dollars Flow" described the activities of the organization Americans for Job Security. An Alaska Public Office Commission investigation revealed that AJS, organized as an entity to promote social welfare under 501(c)(6), fought development in Alaska at the behest of a "local financier who paid for most of the referendum campaign." The Commission report said that "Americans for Job Security has no other purpose other than to cover money trails all over the country." The article also noted that "membership dues and assessments ... plunged to zero before rising to $12.2 million for the presidential race."

A September 16 *Time Magazine* article examined the activities of Washington D.C. based 501(c)(4) groups planning a "$300 million … spending blitz" in the 2010 elections. The article describes a group transforming itself into a nonprofit under 501(c)(4) of the tax code, ensuring that they would not have to "publically disclose any information about its donors."

These media reports raise a basic question: Is the tax code being used to eliminate transparency in the funding of our elections – elections that are the constitutional bedrock of our democracy? They also raise concerns about whether the tax benefits of nonprofits are being used to advance private interests.

With hundreds of millions of dollars being spent in election contests by tax-exempt entities, it is time to take a fresh look at current practices and how they comport with the Internal Revenue Code's rules for nonprofits.

I request that you and your agency survey major 501(c)(4), (c)(5) and (c)(6) organizations involved in political campaign activity to examine whether they are operated for the organization's intended tax exempt purpose and to ensure that political campaign activity is not the organization's primary activity. Specifically you should examine if these political activities reach a primary purpose level – the standard imposed by the federal tax code – and if they do not, whether the organization is complying with the notice or proxy tax requirements of Section 6033(e). I also request that you or your agency survey major 501(c)(4), (c)(5), and (c)(6) organizations to determine whether they are acting as conduits for major donors advancing their own private interests regarding legislation or political campaigns, or are providing major donors with excess benefits.

Possible violation of tax laws should be identified as you conduct this study.

Please report back to the Finance Committee as soon as possible with your findings and recommended actions regarding this matter.

Based on your report I plan to ask the Committee to open its own investigation and/or to take appropriate legislative action.

Sincerely,

Max Baucus
Chairman

The United States Senate Committee on Finance

For Immediate Release
September 29, 2010
Contact:
Contact: Scott Mulhauser/Erin Shields
(202) 224-4515

Baucus Calls On IRS to Investigate Use of Tax-Exempt Groups for Political Activity

Finance Chairman works to ensure special interests don't use tax-exempt groups to influence communities, spend secret donations

Washington, DC – Senate Finance Committee Chairman Max Baucus (D-Mont.) today sent a letter to IRS Commissioner Doug Shulman requesting an investigation into the use of tax-exempt groups for political advocacy. Baucus asked for the investigation after recent media reports uncovered instances of political activity by non-profit organizations secretly backed by individuals advancing personal interests and organizations supporting political campaigns. Under the tax code, political campaign activity cannot be the main purpose of a tax-exempt organization and limits exist on political campaign activities in which these organizations can participate. Tax-exempt organizations also cannot serve private interests. Baucus expressed serious concern that if political groups are able to take advantage of tax-exempt organizations, these groups could curtail transparency in America's elections because non-profit organizations do not have to disclose any information regarding their donors.

"Political campaigns and powerful individuals should not be able to use tax-exempt organizations as political pawns to serve their own special interests. The tax exemption given to non-profit organizations comes with a responsibility to serve the public interest and Congress has an obligation to exercise the vigorous oversight necessary to ensure they do," Baucus said. "**When political campaigns and individuals manipulate tax-exempt organizations to advance their own political agenda, they are able to raise and spend money without disclosing a dime, deceive the public and manipulate the entire political system. Special interests hiding behind the cloak of independent non-profits threatens the transparency our democracy deserves and does a disservice to fair, honest and open elections.**"

Baucus asked Shulman to review major 501(c)(4), (c)(5) and (c)(6) organizations involved in political campaign activity. He asked the Commissioner to determine if these organizations are operating for the organization's intended tax exempt purpose, to ensure that political activity is not the organization's primary activity and to determine if they are acting as conduits for major donors

advancing their own private interests regarding legislation or political campaigns, or are providing major donors with excess benefits. Baucus instructed Shulman to produce a report for the Committee on the agency's findings as quickly as possible. Baucus' full letter to Commissioner Shulman follows here.

September 28, 2010
The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Via Electronic Transmission

Dear Commissioner Shulman:

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Also, tax-exempt organizations and their donors must not engage in private inurement or excess benefit transactions. These rules prevent private individuals or groups from using tax-exempt organizations to benefit their private interests or to profit from the tax-exempt organization's activities.

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Office Commission investigation revealed that AJS, organized as an entity to promote social welfare under 501(c)(6), fought development in Alaska at the behest of a "local financier who paid for most of the referendum campaign." The Commission report said that "Americans for Job Security has no other purpose other than to cover money trails all over the country." The article also noted that "membership dues and assessments ... plunged to zero before rising to $12.2 million for the presidential race."

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Possible violation of tax laws should be identified as you conduct this study.

Please report back to the Finance Committee as soon as possible with your findings and recommended actions regarding this matter.

Based on your report I plan to ask the Committee to open its own investigation and/or to take appropriate legislative action.

Sincerely,

Max Baucus

Chairman

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Senate Committee on Finance | 219 Dirksen Senate Office Building | Washington, DC 20510-6200