CENTER for COMPETITIVE POLITICS
Congress shall make no law...

April 21, 2015

Via U.S. Mail

Hon. John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Standards for tax exemption for social welfare organizations

Dear Commissioner Koskinen:

In a letter dated April 3, three organizations—Public Citizen, Campaign Legal Center, and Democracy 21—expressed their disagreement with certain public statements you have made concerning groups organized under Internal Revenue Code ("IRC") Section 501(c)(4). Specifically, you were quoted as noting that "the framework Congress has set up" permits such groups to "spend a significant amount on politics." The Letter's arguments to the contrary, this was a correct statement of the law that should not, as these groups suggest, be retracted.

The Letter contains three substantial errors. First, it falsely imputes a ban on political spending to IRC § 501(c)(4) itself. Second, it ignores that provision's context in the overall structure of the IRC. Third, it misleadingly cites irrelevant case law, much of it more than a quarter century old, in an attempt to avoid the near-universal and decades-old understanding of Section 501(c).

1. Section 501(c)(4)

IRC § 501(c)(4) states that "organizations not organized for profit but operated exclusively for the promotion of social welfare" are exempt from taxation. In this the Letter's authors are correct. But the core of their argument is that because "promotion of social welfare does not include direct or indirect participation or intervention in political campaigns," social welfare organizations may not engage—even indirectly—in politics. Ltr. at 2 (citing Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii)).

This argument is strange on its face. After all, Section 501(c)(4) makes no mention of political activity whatsoever. And Congress knows how to prohibit political

intervention when it wishes to do so, as it did explicitly for § 501(c)(3) groups.[1] Similarly, IRC § 527 is directed precisely to those tax-exempt organizations that principally involve themselves in electoral politics.[2] Given those subsections clear language, it is unlikely that Congress meant to prohibit political activity by (c)(4) groups, as it did with (c)(3) organizations, and simply failed to say so.

Consequently, the Letter relies not on the statute, but on an out-of-context IRS regulation. In essence, the Letter argues that the Service cannot simultaneously (1) declare political activity outside the scope of social welfare, and (2) then permit any such political activity (or at least any spending beyond *de minimis* amounts).

But, to the extent there is tension here, it is of the Service's making. Or, put differently, the Letter's authors cannot take issue with only one isolated portion of the Service's regulations while ignoring the whole, especially where the language of section 501(c)(4) itself provides no basis for claiming that Congress intended to exclude political spending—however defined—from its view of social welfare.

Logic is to the contrary. The better reading is that Congress *did* intend to allow Section 501(c)(4) organizations to engage in at least some political activity. These groups advocate concerning issues of public policy.[3] These activities do not cease to serve social welfare merely because an election—an intentionally frequent event in our democracy—is taking place. Indeed, citizens are more likely to consider these issues as public interest soars during the period surrounding elections.

The artificial separation of political advocacy and advocacy in favor of social welfare, suggested by the Letter, posits a cynical view of representative democracy that finds no support in our laws or traditions. The very preamble to the Constitution states, in part, that "We the People of the United States, in Order to ... promote the general Welfare... do ordain and establish this Constitution for the United States of America." U.S. CONST. preamble. Congress has provided a range of organizational means for citizens to organize, lobby, and advocate for candidates who take positions supported by organizations. *All* of these activities improve the general welfare of the nation. Section 501(c) reflects this belief.

In short, the IRC itself suggests that Section 501(c)(4) groups may "spend a significant amount on politics."

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[1] 26 U.S.C. § 501(c)(3) (covering organizations that "do[] 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").

[2] 26 U.S.C. § 527(e).

[3] INTERNAL REVENUE SERVICE, *Social Welfare Organizations*, http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Social-Welfare-Organizations (last accessed Apr. 15) ("Seeking legislation germane to the organization's programs is a permissible means of attaining social welfare purposes.").

2. Structure of the Internal Revenue Code

While the language of the IRC itself suggests that Section 501(c)(4) groups may "spend a significant amount on politics," the larger problem with the Letter is that it completely ignores the overall structure of the tax code.

In general terms, Congress has created three relevant groups: those that cannot participate in politics at all (§ 501(c)(3) organizations, contributions to which are consequently tax-deductible), those that can engage in some political activity, provided it does not become their major purpose (other § 501(c) groups, including (c)(4)s, contributions to which are *not* tax-deductible), and organizations that *do* engage principally in politics (§ 527 organizations, which are treated in the same manner as § 501(c)(4) groups from a taxation standpoint).

The Service has previously recognized the strict (and appropriate) limits on political activity carried on by (tax-deductible) funds given to § 501(c)(3) organizations, and noted Congress's intention to allow some such activity by § 501(c)(4) groups. This judgment takes the form of an operating assumption that the political activity that cannot be the *primary* activity of a § 501(c)(4) organization is substantively similar to the activity that § 501(c)(3) organizations cannot engage in at all.[4]

By contrast, IRC § 527 governs the taxation of "political" organizations "organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function." 26 U.S.C. § 527(e)(1). Counterintuitively, and perhaps an appropriate example of the complex statutes the Service is asked to interpret, "exempt function" for a § 501(c) organization does not mean a function that is "tax exempt." Rather it signifies actions that may not comprise the organization's primary activity, and which may be taxed because it does not qualify as activity under the IRC § 501(c) tax exemptions. In other words, "exempt" is double negation. 26 U.S.C. §527(f).[5] Under IRC § 527, an "exempt function" is:

> [T]he 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.

26 U.S.C. §527(e)(2).

While a § 527 organization may engage in activity that is not "political activity," such as hosting educational workshops, lobbying, or social activities, these activities must be an insubstantial portion of its program activities. 26 C.F.R. 1.527-2(a)(3).

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[4] *See, e.g.*, I.R.S. Priv. Ltr. Rul. 1996-9652026 22 (Oct. 1, 1996) ("[i]t follows that any activities constituting prohibited political intervention by a section 501(c)(3) organization are activities that must be less than the primary activities of a section 501(c)(4) organization…").

[5] By contrast, "exempt functions" *are* tax-exempt for § 527 organizations. 26 U.S.C. §527(c)(3).

Thus, the IRC already conceptualizes three "buckets" of activity, imposing differing tax treatment on organizations based upon which category they fall into. Section 501(c)(3) organizations work to educate and engage in other charitable work, with limited lobbying and no political activity. Advocacy nonprofits work on behalf of a variety of interests, and include groups promoting the common good, such as labor organizations, farm groups, and trade associations—as well as social welfare organizations. These may engage in a blend of activities encompassing education, lobbying, and politics, as long as political activity does not become their primary activity. And § 527 organizations advocate for or against *political candidates*[6] based upon the candidates' views on public policy or other criteria developed by the organization. Taken together, these provisions allow nonprofit groups to tailor their organizational form to their missions.

The Letter's authors conflate the permissible political activities of § 501(c)(3) and (c)(4) groups. Given that § 527 organizations must be *primarily* engaged in politics, this creates an illogical gap in the tax code. If a nonprofit group spends no money on politics, it may be tax exempt as a § 501(c)(3) group. If it spends a majority of its money on politics, it is tax exempt as a § 527 group. If it spends a minority of its money on politics… the Letter's logic would require it to be treated as a taxable corporation. This is illogical, unnecessary, and explains why the Service has reasonably chosen a different approach.

3. The Letter's legal authority is badly mischaracterized.

The Letter's citations to case law are grossly outdated and, generally, mischaracterized. Its sole Supreme Court citation is to a decision handed down in 1945, prior to the adoption of any portion of the tax code under discussion. The Letter's authors suggest that case, *Better Business Bureau v. United States*,[7] addressed "identical language in a previous version of the IRC." This is incorrect. The Bureau claimed exception from taxation under a provision governing groups organized for "scientific or educational purposes."[8] Such activity now belongs to § 501(c)(3) organizations, not (c)(4) groups. 26 U.S.C. § 501(c)(3) (governing groups "organized and operated exclusively for religious, charitable, *scientific,* testing for public safety, literary, or *educational* purposes") (emphasis added).

While the citation to *Better Business Bureau* continues, this time explicitly, the Letter's conflation of sections 501(c)(3) and (c)(4), its remaining cases are equally irrelevant. The Letter cites three decisions of the Courts of Appeals—each at least a quarter century old—for the proposition that "any substantial non-exempt purpose is

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[6] I.R.S. Priv. Ltr. Rul. 1999-25051 (June 25, 1999) (noting that, generally, expenditures to support or oppose state ballot initiatives are not for an exempt function activity); *see also* I.R.S. Tech. Adv. Mem. 92-49-002 (June 30, 1992) (§527 organization seeking an IRS ruling that its ballot measure advocacy and lobbying would constitute electioneering for §527 purposes based on its particular facts).

[7] 326 U.S. 279 (1945).

[8] *Id.* at 280.

sufficient to disqualify an organization from exempt status under section 501(c)(4)." While this is true, so far as it goes, none of the cases deals with political activity by a § 501(c)(4) organization. Rather, they *all* concern organizations whose "non-exempt purpose" was the private financial benefit of their members.[9] Such activity is indeed disqualifying, but it is governed by IRC § 501(c)(4)(B), a separate subsection from the portion discussing "social welfare."[10]

The Letter's approach to case law would not stand up in court, and should not sway your reading of the IRC.

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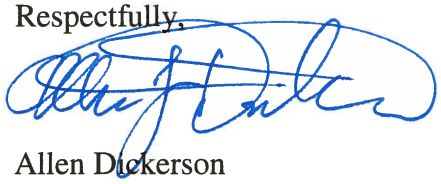
The heart of the Letter's plea is found on the last page:

> Unless the "49 percent" approach is eliminated, and IRS regulation and practice is conformed to the IRC statutory standard forbidding any spending for non-exempt purposes above a de minimis or insubstantial amount, section 501(c)(4) organizations will continue to spend hundreds of millions of dollars in secret contributions on campaign activities in contravention of the IRC.

But of course, such activity is only "in contravention of the IRC" if Congress intended "social welfare" to entirely exclude "politics." That assertion begs the question, and finds no support whatsoever in the statute.

However badly the Letter's authors may wish the IRC were amended to further their policy goals, such arguments should be addressed to Congress, not the Service. Moreover, they should be honestly presented as a serious departure from longstanding policy, and supported by more than selective quotations and off-point cases.

Respectfully,



Allen Dickerson
Legal Director

cc: Robert Weissman, Public Citizen
J. Gerald Herbert, Campaign Legal Center
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[9] *Contracting Plumbers Coop. Restor. Cor. v. United States*, 488 F.2d 684, 687 (2d Cir. 1973) ("private benefit to each member"); *Am. Ass'n of Christian Sch. Vol. Emp. v. United States*, 850 F.2d 1510, 1516("substantial private purpose to provide insurance in return for premiums"); *Mutual Aid Ass'n of Church of the Brethren v. United States*, 759 F.2d 792, 796 (10th Cir. 1985) (describing non-exempt purpose as "providing property insurance for its members on the basis of assessed premiums").

[10] 26 U.S.C. § 501(c)(4)(B) ([§ 501(c)(4) status] shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual").