COMMON CAUSE
Holding Power Accountable

United States Senate
Committee on Finance

Statement for the Record

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For the Hearing
"The Internal Revenue Service's Response to Committee Recommendations Contained in Its August 5, 2015 Report"

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Chairman Hatch and Ranking Member Wyden, thank you for the opportunity to submit this statement for the record.

Last week, the Department of Justice concluded its investigation in connection with the handling of tax-exempt applications filed by new social welfare organizations and "found no evidence that any IRS official acted based on political, discriminatory, corrupt, or other inappropriate motives."[1]

Instead, as this testimony explains, we believe much of this controversy erupted because of vague IRS rules governing political activities of tax exempt entities under Section 501(c) of the Internal Revenue Code – and in particular, social welfare organizations. Their lack of clarity, coupled with a substantial increase in tax-exempt organization applications post-*Citizens United*, hobbled compliance and enforcement.

To be clear: it was wrong for the IRS to subject some "social welfare" nonprofit applications to extra scrutiny based solely on their names and identified interests. In keeping with the findings of this Committee's bipartisan report, the agency should take action to ensure these mistakes are not repeated.

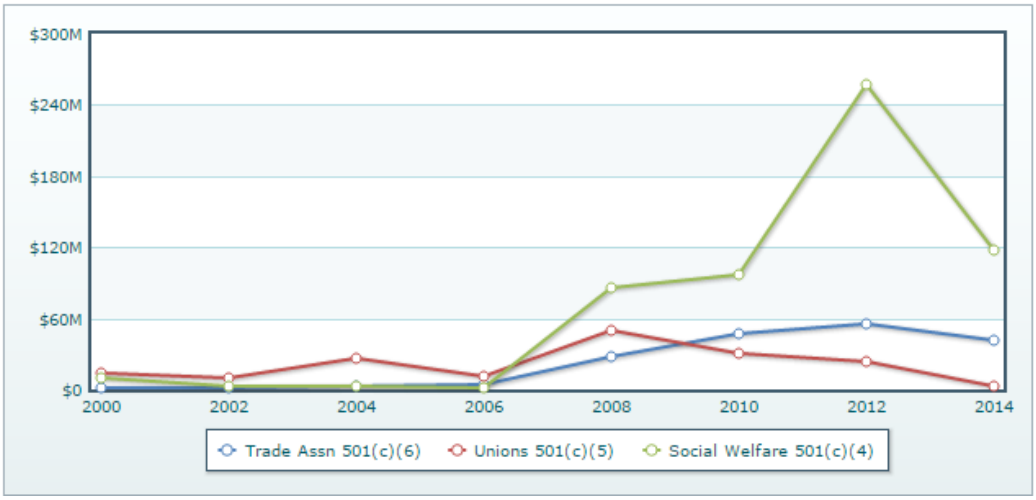
Specifically, the IRS and Treasury Department should write new rules that are consistent with the Internal Revenue Code, clarify what constitutes political activity under the tax laws, and clearly state that social welfare organizations can spend no more than an insubstantial amount of their resources on political activity.

The real scandal – hundreds of millions of secret dollars in our elections funneled through a handful of social welfare organizations – stems from a powerful combination of at least four factors: 1) a lack of bright line standards about what constitutes partisan political activity, including how much political activity social welfare organizations may engage in, and how to measure it; 2) the brazen willingness of political consultants to exploit and manipulate the rules governing social welfare organizations by operating them as *de facto* political committees; 3) an under-resourced agency that has thus far failed to do its job to hold the largest offenders accountable; and 4) champions of gridlock who have blocked Congress from considering comprehensive disclosure legislation in the wake of *Citizens United*.

If the IRS fails to move forward in its rulemaking as discussed above, major political groups will continue to masquerade improperly as social welfare nonprofits under Section 501(c)(4) – solely to keep political spenders anonymous. This deprives the American people of the information they need about who is trying to influence their votes, and to whom their elected officials may owe a debt of gratitude after Election Day.

Up to and including the 2006 election cycle, social welfare groups spent little on partisan political activity. Then, a series of court decisions dramatically changed the status quo. First, the Supreme Court's 2007 decision in *FEC v. Wisconsin Right to Life* lifted prohibitions on corporate spending for election-related communications except for express advocacy and its functional equivalent.[2] That led to a sharp increase in spending on electioneering communications by nonprofit groups that do not disclose their donors. A far larger increase came after the Supreme Court's 2010 decision in *Citizens United* struck down all prohibitions on corporate election-related independent, outside spending.[3] Combined with the D.C. Circuit's opinion in *SpeechNow.org v. FEC*, these decisions led to an explosion in outside election spending.[4] It topped $1 billion in the 2012 elections and over $500 million in the 2014 midterms.[5]

With this increased spending came increased secrecy about who is financing these political expenditures and, consequently, a less-informed electorate. Approximately one-third of the outside money in the 2012 and 2014 federal elections came from secret sources, to the tune of $481 million, of which spending by social welfare nonprofits accounted for approximately $375 million.[6] These numbers, though staggering, underestimate the total spent by these organizations to influence campaigns, because they only include the money spent on federal, and not state, elections. The amounts also exclude money that funds communications that fall short of express advocacy outside of the electioneering communications windows but are clearly intended to influence elections.



Source: Center for Responsive Politics, http://www.opensecrets.org/outsidespending/nonprof_summ.php (last accessed Oct. 26, 2015).

As election-related spending by social welfare organizations soared after *Citizens United* and *SpeechNow.org*, so did the number of applications from groups seeking 501(c)(4) tax-exempt status. They nearly doubled between 2010 and 2012, from 1,735 in 2010 to 3,357 in 2012.[7] Although social welfare organizations may self-declare without submitting a formal application to the IRS, the optional approval process provides them with more certainty that their operations will not jeopardize their tax-exempt status.

Congress never intended for social welfare organizations to exist as conduits for secret political spending. In exchange for their tax exemption, the law requires these nonprofits to engage "exclusively" in the promotion of social welfare.[8] The IRS has said social welfare activities do not include political campaign intervention.[9] IRS regulations muddied the waters with a primary purpose analysis that is inconsistent with the exclusivity requirement of the Internal Revenue Code.[10]

Today, no bright line IRS standard exists as to how much and by what measure the IRS should evaluate a social welfare organization's furtherance of its primary purpose. As the IRS has explained, "no precise definition exists in relevant revenue rulings, cases or regulations" to decide if an organization is "'primarily' engaged in social welfare activities."[11] This may "often requir[e] a sophisticated legal and complex factual review to evaluate the application."[12] We are left with a vague "facts and circumstances" test that invites inconsistent enforcement of the law. Even when applied properly, some political groups are out of compliance with the existing flawed regulations.

In the wake of *Citizens United*, this discrepancy – coupled with a lack of enforcement – has paved the way for several high-profile partisan political organizations on the right and left to pose as social welfare organizations and spend tens of millions of dollars from undisclosed sources on elections. Ultimately, it is the secrecy that social welfare nonprofits provide to donors that makes them attractive vehicles for political spending, and all the more reason why Americans expect the IRS to do its job and enforce the law.

Citing their campaign spending and public reports about their operations, some campaign finance reform advocates have urged the IRS to investigate groups on the left like Priorities USA and on the right like Crossroads GPS to gauge whether they are in fact organizations that exist primarily to influence candidate election outcomes.[13]

Just last week, the Center for Responsive Politics released a report showing how one purported social welfare organization – "Carolina Rising" – spent 97 percent of the almost $5 million it raised in 2014 in support of a single victorious Senate candidate.[14]

As of today, the IRS has done little to hold the most flagrant violators accountable, despite reams of evidence that their overriding purpose appears to be to provide anonymity for donors eager to spend unlimited amounts of money supporting and attacking candidates for public office.[15]

This troubling trend shows no sign of stopping in 2016. According to the *New York Times*, supporters of former Secretary of State Hillary Rodham Clinton are considering activating a 501(c)(4) to support her run for the White House.[16] On the Republican side, most of the candidates "have aligned with nonprofit groups to raise hundreds of millions of dollars," including at least one that has already planned a $1 million advertising campaign in support of one of the individuals running for the nomination.[17]

Voters deserve to know who is attempting to influence their votes and who is speaking to them. Disclosure allows them to evaluate the strength, content and agenda of political messages, and is an important tool to hold representatives accountable to their interests instead of those of financial backers. That is why courts have repeatedly upheld disclosure requirements.[18]

Specifically, the Supreme Court ruled 8-1 in *Citizens United* that disclosure by outside spending groups "permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency [in political spending] enables the electorate to make informed decisions and give proper weight to different speakers and messages."[19] *Citizens United* reaffirmed prior campaign finance cases that upheld disclosure requirements, citing "evidence in the record that independent groups were running election-related advertisements 'while hiding behind dubious and misleading names.'"[20]

Consistent with this important First Amendment value – an informed electorate – the law requires Super PACs and other Section 527 organizations to disclose their donors when they spend money to influence elections. **Political operatives should not circumvent the constitutionally sound bedrock policy of disclosure by exploiting inconsistent enforcement and vague regulations governing organizations that Congress never anticipated would engage in election-related spending.**

Impartial and consistent enforcement of the law governing nonprofit political spending is squarely within the IRS's mandate and authority. The IRS and Treasury Department took the important step in 2013 of issuing a notice of proposed rulemaking, recognizing that both the public and the government "would benefit from clearer definitions" of campaign-related political activity.[21] This action was in keeping with one of the recommendations in the Treasury Inspector

General for Tax Administration's (TIGTA) report on the IRS's use of inappropriate criteria to select social welfare applications for review.[22] Importantly, TIGTA recommended that "guidance on how to measure the 'primary activity' of … 501(c)(4) social welfare organizations be included for consideration in the Department of the Treasury Priority Guidance Plan."[23]

The IRS and Treasury Department's notice of proposed rulemaking was a critical first step to solve the problem and protect the integrity of our tax laws. Still, the proposal had significant flaws. Common Cause – along with over 27,000 of our members who have signed our petition – continue to urge the IRS to release a second proposed rule for comment. We are filing over 5,000 more comments from Common Cause members this week, urging a new rule consistent with the policy outlined in this statement for the record.

It is essential that the next proposed rule establish a low limit on the amount of campaign activity a group can engage in consistent with the Internal Revenue Code. In keeping with court precedent, new commonsense regulations should allow an insubstantial amount of activity that is unrelated to a 501(c)(4)'s social welfare purpose without jeopardizing the organization's tax-exempt status. Such a rule would permit a small amount of candidate-related political activity, so long as it is not more than an insubstantial part of its activities.

To influence elections, an organization could establish a Section 527 organization, which requires disclosure, for all other election-related expenditures. This appears to be what the Senate expected when it enacted Section 527 in the first place.[24]

We recognize that the IRS funding levels have fallen steadily from $13.4 billion in 2010 to $10.9 billion in 2015 – a one-fifth reduction in funding, adjusting for inflation.[25] This hobbles meaningful action and forces the IRS to rethink its priorities. Senate appropriators proposed another cut in the FY16 Financial Services appropriations bill, reducing the IRS's funding another $470 million, to $10.4 billion.[26] The IRS should not use these budgetary constraints to justify a green light for continued misuse of social welfare organizations.

Of course, Congress could enact a more robust disclosure regime to respond to the new landscape post-*Citizens United*. Senators, including the ranking member of this Committee, have introduced bills that would stem the tide, including the DISCLOSE Act (S. 229) and the Follow the Money Act (S. 791 (113th Cong.)). The DISCLOSE Act has been subjected to repeated filibusters in past years and has not had as much as a hearing during this Congress, unfortunately. Still, as discussed above, the IRS should enforce the law as written and enact regulations consistent with the exclusivity requirements of the Internal Revenue Code and later case law.

The use of inappropriate criteria to single out some social welfare applicants for scrutiny does not justify an abrogation of the agency's duty to enforce the law fairly and impartially in the first place. The IRS should hold political groups on the right *and* the left accountable if they misappropriate the privileges of the social welfare organization's structure. The IRS should bring its regulations in line with the Internal Revenue Code, while watchdogging blatant efforts to violate even the flawed rules.

Thank you, Mr. Chairman, for the opportunity to submit this statement.

[1] Letter from Peter J. Kadzik (Assistant Attorney General) to Rep. Bob Goodlatte and Rep. John Conyers (Oct. 23, 2015), *available at* http://online.wsj.com/public/resources/documents/IRS1023.pdf.
[2] 551 U.S. 449 (2007).
[3] 558 U.S. 310 (2010).
[4] 599 F.3d 686 (2010); Richard L. Hasen, *The Numbers Don't Lie*, SLATE, Mar. 9, 2012, http://www.slate.com/articles/news_and_politics/politics/2012/03/the_supreme_court_s_citizens_united_decision_has_led_to_an_explosion_of_campaign_spending_.html (last accessed Oct. 26, 2015).
[5] Center for Responsive Politics, Outside Spending by Cycle, http://www.opensecrets.org/outsidespending/index.php (last accessed Oct. 26, 2015).
[6] Center for Responsive Politics, Outside Spending by Disclosure, Excluding Party Committees http://www.opensecrets.org/outsidespending/disclosure.php (last accessed Oct. 26, 2015); Center for Responsive Politics, 501(c) Spending, Cycle Totals, by Type http://www.opensecrets.org/outsidespending/nonprof_summ.php (last accessed Oct. 26, 2015).
[7] TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW 3 (2013).
[8] 26 U.S.C. § 501(c)(4).
[9] Treas. Reg. § 1.501(c)(4)-(1)(a)(2)(ii).
[10] Treas. Reg. § 1.501(c)(4)-(1)(a)(2)(i).
[11] IRS, CHARTING A PATH FORWARD AT THE IRS: INITIAL ASSESSMENT AND PLAN OF ACTION 25 (2013).
[12] *Id.* at 22.
[13] *See* Letter from J. Gerald Hebert, Executive Director, Campaign Legal Center and Fred Wertheimer, President, Democracy 21 to the IRS, September 28, 2011, *available at* http://www.democracy21.org/wp-content/uploads/2014/05/9-28-2011-Letter_to_the_IRS_from_Democracy_21_and_Campaign_Legal_Center.pdf.
[14] Robert Maguire, "Political Nonprofit Spent Nearly 100 Percent of Funds to Elect Tillis in '14," CENTER FOR RESPONSIVE POLITICS, https://www.opensecrets.org/news/2015/10/political-nonprofit-spent-nearly-100-percent-of-funds-to-elect-tillis-in-14/ (last accessed Oct. 24, 2015).
[15] Democracy 21 and the Campaign Legal Center have sent at least 11 letters to the IRS, thoroughly documenting the extent of Crossroads GPS' campaign activity and its legal argument for why the IRS should deny Crossroads GPS' social welfare status and assess penalties for any violations of the law. They sent letters on May 6, 2014; January 2, 2013; September 27, 2012; July 23, 2012; May 24, 2012; April 17, 2012; March 22, 2012; March 9, 2012; December 14, 2011; September 28, 2011; and October 5, 2010 and will provided to the Committee as an appendix.
[16] Eric Lichtblau, "IRS Expected to Stand Aside as Nonprofits Increase Role in 2-16 Race," N.Y. TIMES, July 5, 2015, *available at* http://www.nytimes.com/2015/07/06/us/politics/irs-expected-to-stand-aside-as-nonprofits-increase-role-in-2016-race.html.
[17] *See id*.
[18] *See* Letter from Fred Wertheimer, President, Democracy 21 & Trevor Potter, President, Campaign Legal Center to Senators, Nov. 14, 2013, *available at* http://www.democracy21.org/wp-content/uploads/2013/11/LETTER-TO-HSE-AND-SENATE-ON-COURTS-REJECTING-CHALLENGES-TO-DISCLOSURE-FINAL-11-1-3-13.pdf.
[19] *Citizens United*, 558 U.S. at 371.
[20] *Id*. at 367.
[21] Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).
[22] TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW 17 (2013).
[23] *Id.*
[24] Senate Rep. No 93-1357, 93rd Cong. 2d Sess. (Dec. 16, 1974), reprinted in 1974-1 Cum. Bull. 517, 534; Miriam Galston, Vision Service Plan v. U.S.: *Implications for Campaign Activities of 501(c)(4)s*, 53 EXEMPT ORGANIZATION TAX REVIEW 165 (2006).
[25] Brandon DeBot and Chuck Marr, *Poor IRS Service Reflects Congress's Deep Funding Cuts* (June 1, 2015), Center for Budget and Policy Priorities, *available at* http://www.cbpp.org/sites/default/files/atoms/files/6-1-15tax.pdf.

[26] Press release, Senate Committee Agrees to FY2016 Financial Services Appropriations Bill, July 23, 2015, *available at* http://www.appropriations.senate.gov/news/majority/senate-committee-agrees-to-fy2016-financial-services-appropriations-bill.