IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CHRIS VAN HOLLEN,
1707 Longworth Office Building
U.S. House of Representatives
Washington, DC 20515

DEMOCRACY 21,
2000 Massachusetts Ave. NW
Washington, DC 20036,

CAMPAIGN LEGAL CENTER,
215 E St. NE
Washington, DC 20002,

and

PUBLIC CITIZEN, INC.,
1600 20th St. NW
Washington, DC 20009,

Plaintiffs,

v.

INTERNAL REVENUE SERVICE,
1111 Constitution Ave. NW
Washington, DC 20224,

and

DEPARTMENT OF THE TREASURY,
1500 Pennsylvania Ave. NW
Washington, DC 20220,

Defendants.

No. _____

COMPLAINT FOR DECLARATORY, INJUNCTIVE, AND MANDAMUS RELIEF

Introduction

1. Plaintiffs Chris Van Hollen, Democracy 21, Campaign Legal Center, and Public Citizen bring this action under the Administrative Procedure Act (APA), 5 U.S.C. §§ 702, 703, 704, and 706(1) & (2)(A), to compel agency action unlawfully withheld and unreasonably delayed, and to set aside agency action that is contrary to law. Defendant Internal Revenue Service (IRS) has for many years violated the Internal Revenue Code (IRC) by allowing tax-exempt social welfare organizations to expend substantial sums on electoral activity. The IRC

provides that tax-exempt social welfare organizations must be "exclusively" engaged in "promotion of social welfare." IRC § 501(c)(4). The IRS's implementing regulation recognizes that electoral activity does not fall within the scope of activity promoting social welfare. Treasury Regulation (TR) § 1.501(c)(4)-1(a)(2)(ii). But the IRS's regulation also purports to provide that an organization operates "exclusively" to promote social welfare as long as it is operated "primarily" for social welfare purposes. *Id*. § 1.501(c)(4)-1(a)(2)(i). By redefining "exclusively" as "primarily" in violation of the clear terms of its governing statutes, the IRS permits tax-exempt social welfare organizations to engage in substantial electoral activities in contravention of the law and court decisions interpreting it.

2. The IRS has continued to adhere to this unlawful construction of the law in the face of a petition filed by plaintiffs Democracy 21 and Campaign Legal Center in July 2011 requesting that it revise its regulation to conform to the statute's requirements. The IRS has not commenced any rulemaking or even provided a substantive response to the petition.

3. The IRS's continued failure to amend its regulation to correspond with the clear and nondiscretionary requirements of the law harms the plaintiffs in this action in a number of ways. It denies them information about the funding of election expenditures by section 501(c)(4) groups, because it allows such groups to claim tax-exempt status while engaging in electoral campaign spending without disclosing the identities of their contributors—disclosures that political organizations that properly claim tax exemption under section 527 of the IRC are required to provide. IRC § 527(j)(3). The IRS's inaction also means that candidates, such as plaintiff Van Hollen, and section 527 political organizations, such as the political committees operated by plaintiff Van Hollen, must compete on unequal terms with tax-exempt groups that are permitted to raise funds for electoral purposes without complying with the disclosure

requirements imposed on section 527 political organizations. To redress these injuries, plaintiffs request that the Court declare unlawful the IRS's inaction with respect to the petition that it amend its rules, and that the Court compel the IRS to commence proceedings to amend its rules to implement the statutory requirement that social welfare organizations operate exclusively for the advancement of social welfare.

4. Instead of amending its rules to conform to the requirements of IRC section 501(c)(4), the IRS has recently taken action with precisely the opposite effect: It has issued a directive providing a "safe harbor" for certain organizations seeking exemption under section 501(c)(4) if they spend no more than 40% of their time and expenditures on electoral campaign activities and stating that even organizations that expend more than this percentage on electoral campaign intervention may qualify for tax–exempt status under section 501(c)(4) because the IRS may consider them to be "primarily" engaged in social welfare activities. The IRS's new directive confirms that the IRS interprets its regulation to allow substantial electoral campaign intervention by section 501(c)(4) organizations—intervention up to and in some circumstances exceeding 40% of their activity—despite the statutory requirement that they be exclusively engaged in social welfare activities. The IRS's action thus makes the extent of the conflict between its regulation and the statute even more explicit and will injure the plaintiffs by fostering increased electoral campaign spending without donor disclosure by ostensible section 501(c)(4) organizations. The plaintiffs therefore request that the Court declare the IRS's new "safe harbor" directive unlawful insofar as it permits section 501(c)(4) organizations to spend amounts up to and exceeding 40% of their time and money on electoral campaign intervention.

Jurisdiction and Venue

5. This Court has jurisdiction over this action under 28 U.S.C. §§ 1331, 1340 and 1361.

6. Venue is proper in this Court under 28 U.S.C. § 1391(e).

Parties

7. Plaintiff Chris Van Hollen is a Member of the United States House of Representatives representing the 8th Congressional District of the State of Maryland. Representative Van Hollen was first elected to the House of Representatives in 2002 and has been reelected in each succeeding Congressional election. He intends to run for reelection in 2014. In addition to his own campaign committee, Representative Van Hollen has a leadership PAC, the Victory Now PAC, that, subject to the contribution limits and disclosure requirements imposed on federal political committees by the Federal Election Campaign Act (FECA), 2 U.S.C. §§ 431*ff*., raises and expends money to support other candidates running for federal office. Both Representative Van Hollen's campaign committee and the Victory Now PAC are tax-exempt under IRC section 527 and must operate under its requirements.

8. Plaintiff Democracy 21 is a nonpartisan, nonprofit organization that works to strengthen our democracy, protect the integrity of our political system against corruption and provide for honest and accountable elected officeholders and public officials. The organization promotes campaign finance reform, lobbying and ethics reforms, transparency and other government integrity measures, conducts public education efforts to accomplish these goals, participates in litigation involving the constitutionality and interpretation of campaign finance laws and engages in efforts to help ensure that campaign finance laws are properly enforced and implemented.

9. Plaintiff Campaign Legal Center is a nonpartisan, nonprofit organization that works on issues involving campaign finance and electoral reform, political communication and government ethics. The Campaign Legal Center offers nonpartisan analyses of issues and represents the public interest in administrative, legislative and legal proceedings. The Campaign

Legal Center also participates in generating and shaping our nation's policy debate about money in politics, disclosure, political advertising, and enforcement issues before the Congress, the Federal Communications Commission, Federal Election Commission (FEC) and the IRS.

10. Plaintiff Public Citizen, Inc., is a nonpartisan, nonprofit membership organization headquartered in Washington, DC. Public Citizen advocates the interests of consumers and members of the public before Congress, administrative agencies and the courts on a wide range of issues. Prominent among Public Citizen's concerns has been combating the corruption of our political system, and as a result Public Citizen has long supported campaign finance legislation and advocated its enforcement. In connection with those activities, Public Citizen studies and reports on the role of money in elections and the influence of political spending on officeholders and the formation of public policy.

11. Defendant IRS, a bureau of defendant United States Department of the Treasury, is the federal agency charged with administration and enforcement of the tax laws of the United States. The IRS is responsible for enforcing the requirements imposed by the IRC on tax-exempt organizations and issues regulations implementing those requirements, including the regulation at issue in this case. The United States Department of the Treasury is ultimately responsible for the operation of the IRS and the issuance of regulations implementing the IRC.

Statutory Background

12. Section 501 of the IRC provides that organizations meeting specified criteria are exempt from federal income taxation. Section 501(c)(4) provides such tax exemption to "civic leagues or organizations not organized for profit but operated *exclusively* for the promotion of social welfare …." (Emphasis added.) Section 501(c)(4) organizations are often devoted to advocacy with respect to public policy issues, because they are not subject to the strict

limitations on lobbying that are applicable to charitable organizations that claim tax exemption under section 501(c)(3).

13. Organizations that qualify under section 501(c)(4) are exempt from income taxation, but contributions to them are not, for income-tax purposes, deductible from income for contributors, unlike contributions to section 501(c)(3) charitable organizations. However, while not allowing contributors to deduct contributions to 501(c)(4) organizations from income, the IRS does not currently attempt to collect gift tax from contributors on their contributions to section 501(c)(4) organizations.

14. Section 501(c)(4) organizations are not required by the IRC to disclose the identity of their contributors publicly, and they typically do not do so.

15. The social welfare activities to which the IRC requires section 501(c)(4) organizations to be "exclusively" devoted do not include intervention in election campaigns. IRS regulations provide that "[t]he promotion of social welfare does not include direct or indirect participation in political campaigns on behalf of or in opposition to an candidate for public office." TR § 1.501(c)(4)-1(a)(2)(ii).

16. Another IRC provision, section 527, provides tax exemption for organizations that engage primarily in electoral activity. Section 527 organizations, which are operated primarily to influence or attempt to influence elections for public office, IRC § 527(e)(1), are generally exempt from federal income taxation. As in the case of section 501(c)(4) organizations, contributions to section 527 organizations are not tax-deductible for contributors, but such contributions are expressly exempted from gift taxation by IRC section 2501(a)(5).

17. Section 527 organizations, unlike section 501(c)(4) organizations, must publicly disclose, on a quarterly basis, the identity of all contributors that contribute $200 or more

annually. IRC § 527(j)(3). Section 527 organizations such as Representative Van Hollen's committees that are also "political committees" under FECA, 2 U.S.C. § 431(4), must report their contributions under the terms of FECA—requirements comparable to those of section 527—and need not make separate reports under section 527. *Id.* § 527(j)(5).

The IRS's Failure to Enforce IRC Section 501(c)(4)'s Plain Language

18. The IRS has not enforced section 501(c)(4)'s requirement that a tax-exempt organization be operated "exclusively" to promote social welfare. Instead, contrary to the plain meaning of the statute, the IRS has permitted section 501(c)(4) organizations to engage in substantial activity that does not qualify as promotion of social welfare, including election campaign intervention. In 1959, the IRS promulgated TR § 1.501(c)(4)-1(a)(2)(i), which provides that "[a]n organization is operated exclusively for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community" (emphasis added). As the IRS explained in an August 24, 2012, letter to U.S. Senator Carl Levin, the IRS has "interpreted 'exclusively' as used in section 501(c)(4) to mean primarily."

19. The effect of the IRS's regulatory redefinition of section 501(c)(4)'s exclusivity requirement is to allow section 501(c)(4) organizations to engage in substantial amounts of activity that does not promote social welfare as long as they are "primarily" engaged in social welfare activities. Thus, although by the IRS's own definition social welfare activities do not include participation or intervention in election campaigns, the IRS takes the view that "an organization may carry on lawful political activities and remain exempt under section 501(c)(4) as long as it is primarily engaged in activities that promote social welfare." Rev. Ruling 81-95, 1981-1 C.B. 332.

20. The IRS has not specifically defined "primarily," but TR § 1.501(c)(4)-1(a)(2)(i) is generally understood to require that just over 50% of an organization's activity must qualify as promotion of social welfare. Thus, the regulation is generally understood to mean that as much as 49% of a 501(c)(4) organization's budget may be spent on election campaign intervention or other non-social-welfare activities. Although the IRS had not previously stated expressly what percentage of a section 501(c)(4) organization's activities may be directed to electoral campaign intervention, the IRS has now expressly stated, in a report dated June 24, 2013, that it regards it as consistent with the presumptive availability of section 501(c)(4) tax-exempt status for an organization to spend up to 40% of its time and money on election campaign intervention, and that an organization may be eligible for exemption under section 501(c)(4), depending on the "facts and circumstances" of its activities, even if it spends more than 40% of its budget on election campaign intervention. The IRS's June 24, 2013 report, entitled *Charting a Path Forward at the IRS: Initial Assessment and Plan of Action* ("*Charting a Path*"), is attached hereto as Exhibit A and is discussed further below.

21. The substantial spending on election campaign intervention in which the IRS permits a section 501(c)(4) organization to engage is contrary both to the statutory requirement that section 501(c)(4) organizations must be operated "exclusively" to promote social welfare and to court decisions interpreting that statutory requirement to prohibit "substantial" non-social welfare activity.

The Effects of the IRS's Disregard of Section 501(c)(4)'s Plain Meaning

22. The IRS's replacement of the statutory requirement that section 501(c)(4) organizations operate exclusively to promote social welfare with a regulatory standard that allows them to engage in substantial election campaign activity has resulted in a flood of electoral spending by ostensible section 501(c)(4) organizations. Because these organizations do

not report the sources of their contributions, as is required of political committees and other section 527 organizations, election-related spending by section 501(c)(4) organizations deprives other participants in the political process, including voters, candidates, and political organizations, as well as persons and organizations who desire to study the sources of influence on the political process, of critical information about the financial interests served by electoral campaign spending.

23. Electoral campaign spending by section 501(c)(4) organizations soared after the U.S. Supreme Court's decisions in *FEC v. Wisconsin Right to Life*, 551 U.S. 449 (2007) (*WRTL*), and *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010), which, respectively, narrowly construed and then invalidated federal laws prohibiting corporate electoral campaign expenditures. In the wake of those decisions, section 501(c)(4) organizations became the vehicles of choice for mobilizing anonymous contributions for political purposes.

24. In the 2008 presidential election cycle, following the decision in *WRTL*, section 501(c)(4) organizations reported to the FEC that they had engaged in election-related spending totaling over $82.7 million, after having reported only $7.6 million in the 2004 presidential election cycle, according to the Center for Responsive Politics. *See* http://www.opensecrets.org/outsidespending/nonprof_summ.php.

25. In the 2010 congressional elections, the first federal elections conducted after the *Citizens United* decision, section 501(c)(4) organizations reported more than $92 million in election-related spending to the FEC, according to the Center for Responsive Politics. *Id.* By contrast, in the 2006 congressional elections, section 501(c)(4) organizations had reported spending only $1.2 million. *See id.*

26. In the 2012 presidential election cycle, section 501(c)(4) organizations increased their reported election-related spending still further, to over $256 million, a threefold increase over the amount spent in the 2008 presidential elections. *See id*.

27. Individual section 501(c)(4) organizations spent very substantial amounts in these elections. In the 2008 election cycle, a dozen section 501(c)(4) groups reported election-related spending in excess of $1 million, with one group spending nearly $9 million. *See* http://www.opensecrets.org/outsidespending/summ.php?cycle=2008&chrt=V&disp=O&type=U. In the 2010 congressional elections, the number of 501(c)(4) organizations reporting election-related spending exceeding $1 million rose to 15. *See* http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=V&disp=O&type=U. One of those groups reported spending $18.9 million, and another spent $16.7 million.

28. In the 2012 presidential elections, the number of section 501(c)(4) organizations with at least $1 million in election-related spending had risen to 25, with seven spending more than $10 million. *See* http://www.opensecrets.org/outsidespending/summ.php?cycle=2012&chrt=V&disp=O&type=U. One group alone spent over $71 million; another spent $36.4 million; and another spent $25.4 million. *Id*.

29. The increase in election campaign activity by section 501(c)(4) organizations is primarily responsible for a corresponding increase in electoral spending that is not accompanied by donor disclosure. Because section 501(c)(4) organizations, unlike political parties, political candidate committees, other FECA-regulated political committees (including PACs and "Super PACs") and other section 527 tax-exempt political organizations, are not required to disclose their donors publicly, their electoral campaign expenditures are almost entirely unaccompanied by donor disclosure. Only when donors specifically earmark contributions for particular electoral

campaign expenditures, which is extremely rare, do existing campaign finance regulations result in disclosure by section 501(c)(4) organizations. As a result, only about 30% of election-related spending by groups other than the political parties and candidate committees (often referred to as "outside" spending) in the 2012 presidential election was accompanied by donor disclosure, and approximately $310 million in electoral campaign spending was by non-disclosing groups (including section 501(c)(4) organizations as well as section 501(c)(6) organizations). *See* http://www.opensecrets.org/outsidespending/disclosure.php.

30. The operators of politically active organizations have openly acknowledged that they make use of section 501(c)(4) precisely because IRS regulations allow section 501(c)(4) organizations to channel large amounts of money into elections while at the same time avoiding donor disclosure requirements applicable to other types of organizations. For example, Carl Forti, an official of the 501(c)(4) group Crossroads GPS and the affiliated Super PAC American Crossroads (which, unlike Crossroads GPS is a political committee subject to FECA disclosure requirements), has stated that "some donors didn't want to be disclosed, and, therefore, the (c)(4) was created." P. Overby, *Group Behind Election Ads Weighs In On Tax Deal*, National Public Radio (Dec. 14, 2010), http://m.npr.org/story/132060878. Similarly, the founders of a Super PAC supporting President Obama's reelection in 2012, Priorities USA Action, set up a parallel 501(c)(4) organization, Priorities USA, to allow donors who preferred that their identities not be disclosed to contribute to independent spending in support of President Obama.

31. The huge electoral campaign expenditures without donor disclosure by section 501(c)(4) organizations are directly attributable to the IRS's regulation permitting such organizations to engage in substantial electoral campaign activity as long as they are "primarily" engaged in promoting social welfare. Politically active section 501(c)(4) organizations operate

on the understanding that they will retain their tax exemption as long as they can plausibly maintain that more than 50% of their activity is aimed at promoting social welfare, even though they engage in substantial election campaign intervention that itself is outside the scope of social welfare activity under section 501(c)(4). If the IRS were instead to enforce the requirement that section 501(c)(4) organizations engage exclusively in activity to promote social welfare, and thus refrain from engaging in substantial amounts of election campaign activity and expenditures, much of the electoral campaign spending currently carried out by section 501(c)(4) organizations would shift to other types of organizations—specifically, political committees regulated by FECA and other section 527 tax-exempt organizations—that are subject to donor-disclosure requirements. The resulting disclosures would materially advance the public's "interest in knowing who is speaking about a candidate shortly before an election." *Citizens United*, 558 U.S. at 369.

The Rulemaking Petition and the IRS's Delay and Inaction

32. On July 27, 2011, plaintiffs Democracy 21 and Campaign Legal Center submitted a formal petition for rulemaking to the IRS requesting that it revise TR § 1.501(c)(4)–1(a)(2)(i) to prohibit substantial election campaign expenditures by section 501(c)(4) organizations. The petition is attached to this Complaint as Exhibit B.

33. Plaintiffs' rulemaking petition demonstrated that by purporting to interpret the statutory term "exclusively" to mean "primarily," TR § 1.501(c)(4)–1(a)(2)(i) conflicts with the plain meaning of section 501(c)(4) and with authoritative judicial precedents construing the term "exclusively" as used in section 501. *See* Exhibit B, at 2–3, 13–16.

34. The rulemaking petition explained how the IRS's regulation permits section 501(c)(4) organizations to engage in substantial electoral campaign expenditures without disclosing their donors, described how politically active section 501(c)(4) organizations had

engaged in tens of millions of dollars of electoral campaign spending without donor disclosure in the 2010 election cycle, and pointed to evidence that even more substantial spending by section 501(c)(4) organizations in the 2012 election cycle was likely. *See* Exhibit B, at 5–12.

35. The rulemaking petition requested that the IRS "promptly issue new regulations that properly define the statutory requirement for section 501(c)(4) organizations to be 'operated exclusively' for social welfare purposes to mean that campaign activity may not constitute more than an insubstantial amount of the activities of a group organized under section 501(c)(4)." Exhibit B, at 16. The petition explained that such action was necessary both to bring the IRS's rules into conformity with the IRC and also to prevent politically active organizations from improperly using section 501(c)(4) to reap the benefits of tax exemption while "keep[ing] secret from the American people the sources of tens of millions of dollars being spent by the section 501(c)(4) organizations to influence federal elections." *Id*. at 17-18. Because the "large scale spending of secret contributions in federal elections by section 501(c)(4) organizations is doing serious damage to the integrity and health of our democracy and political system," *id*. at 18 the petition requested that the IRS "act expeditiously to ensure that the new regulations are in effect in time for the 2012 elections." *Id*. at 19.

36. The IRS did not take prompt action in response to the petition.

37. On March 22, 2012, Democracy 21 and the Campaign Legal Center sent a letter to then-Commissioner of Internal Revenue Douglas Shulman and then-Director of the IRS's Exempt Organizations Division Lois Lerner. The letter is attached to this Complaint as Exhibit C.

38. Plaintiffs' March 22, 2012, letter apprised the IRS of "developments in the course of the 2012 national elections" that "have served to underscore the fact that inadequate and

flawed IRS regulations are facilitating widespread misuse of the tax laws by organizations claiming tax-exempt status under section 501(c)(4) in order to keep secret the donors financing their candidate campaign-related expenditures." Exhibit C, at 1. Referencing a series of letters that the two groups had sent to the IRS documenting ongoing electoral campaign intervention by section 501(c)(4) organizations, the letter pointed out that increasing electoral campaign expenditures by such organizations necessitated that the IRS "promptly institute a rulemaking proceedings to address this matter" and requested that the IRS respond "regarding what action the agency is prepared to take." *Id*. at 4.

39. Four months later, on July 20, 2012, Ms. Lerner sent Democracy 21 and the Campaign Legal Center a three-paragraph letter responding to their letter of March 22, 2012. The IRS's July 20, 2012, letter is attached to this Complaint as Exhibit D. The letter stated that the IRS was "aware of the current public interest in this issue." It observed that the challenged regulation has "been in place since 1959," and it stated that "[w]e will consider proposed changes in this area as we work … to identify tax issues that should be addressed through regulations and other public guidance."

40. Democracy 21 and the Campaign Legal Center immediately responded with a letter to Mr. Shulman and Ms. Lerner dated July 23, 2012. The letter is attached as Exhibit E to this Complaint. The letter stated that "we believe the 'proposed changes in this area' that Ms. Lerner says the IRS will now consider are crucially important and need to be made with urgency." Exhibit E, at 2. The letter pointed out that electoral campaign spending by section 501(c)(4) groups had "grown exponentially" since the rulemaking petition was filed a year earlier, *id.*, and it cited examples of plans by a number of such organizations to spend tens of

millions of dollars in the 2012 elections. The letter again urged the IRS to act promptly to institute a rulemaking proceeding. *Id*. at 5.

41. The IRS took no action before the 2012 elections, and, as a result, the large-scale electoral campaign intervention by section 501(c)(4) organizations in those elections predicted in the petition for rulemaking and the subsequent letters to the IRS from Democracy 21 and the Campaign Legal Center occurred. On January 4, 2013, representatives of Democracy 21 and the Campaign Legal Center met with Ms. Lerner and other IRS officials regarding the petition for rulemaking and to urge the IRS to move promptly on the request. The IRS officials present at the meeting provided no substantive information on whether or when they would respond to the petition for rulemaking.

42. The IRS has never granted, denied, or provided any substantive response to the rulemaking petition. The IRS has neither provided any explanation of how its regulation is consistent with the statutory requirement that section 501(c)(4) organizations operate exclusively to promote social welfare, nor taken any public action to initiate a rulemaking proceeding to conform its regulation to the statute.

43. The IRS's inaction permitted huge electoral campaign expenditures by section 501(c)(4) organizations without donor disclosure in the 2012 election cycle. The agency's continued inaction allows similar expenditures without donor disclosure to be made in the 2014 congressional elections and succeeding election cycles and makes such expenditures inevitable.

The IRS's "Safe Harbor" Directive

44. Instead of acting to bring its regulations permitting substantial election campaign intervention by section 501(c)(4) organizations into conformity with the statute's requirements, the IRS has taken action that ratifies the views of some politically active section 501(c)(4)

organizations that they may expend nearly half their resources on electoral campaign intervention and still qualify for tax exemption under section 501(c)(4).

45. In the June 24, 2013, *Charting a Path* report, the IRS revealed that it has directed its personnel to recognize tax exemption for certain putative section 501(c)(4) organizations that represent that they will expend (i) at least 60% of their time and money on social welfare activities and (ii) less than 40% of their time and money on election campaign intervention. Organizations that are part of the IRS's "priority backlog" of delayed applications for 501(c)(4) tax-exempt status and that meet these criteria are entitled to a "safe harbor" and will be "presumed" eligible for tax exemption under section 501(c)(4). Exhibit A, at 24-25 and Appendix E to Exhibit A, at 4.

46. The IRS has further directed its personnel that even those "priority backlog" organizations that do not qualify for the "safe harbor" because they expend more than 40% of their resources on electoral campaign intervention may be eligible for tax exemption under section 501(c)(4), depending on the "facts and circumstances" of their activities. Exhibit A, at 25 & Appendix E to Exhibit A, at 3.

47. The IRS's new directive thus makes clear the quantity of electoral activity that the IRS's "primarily engaged" standard permits section 501(c)(4) organizations to conduct : If those activities do not exceed 40% of an organization's time and money, the IRS will consider it presumptively eligible for tax exemption under § 501(c)(4), but the IRS will, depending on circumstances, permit even greater amounts of election campaign intervention.

Injuries Attributable to the IRS's Unlawful Construction of Section 501(c)(4)

48. The IRS's ongoing failure to revise its regulations to prohibit substantial electoral campaign expenditures by groups claiming tax exemption under Section 501(c)(4), and its recent directive allowing such organizations to expend substantial percentages of their resources on

electoral campaign activity, have resulted and will continue to result in large amounts of electoral campaign spending by such groups without donor disclosure. The lack of disclosure directly injures plaintiffs Democracy 21, Campaign Legal Center, and Public Citizen. Each of these organizations engages in studies and/or publishes information concerning the sources of funding of politically active groups and the resulting influence that is brought to bear on the formation of public policy. Concealment of the sources of funding of politically active section 501(c)(4) interferes with the ability of these plaintiffs to carry out these activities by denying them information essential to their efforts.

49. Plaintiff Public Citizen is a membership organization with members who are voters in all fifty states and the District of Columbia. These voters are injured when they are denied information about the sources of funding of organizations that make political expenditures supporting or opposing candidates who seek their votes, as information concerning who is behind such expenditures would help them evaluate the arguments presented in the election campaigns as well as the candidates who benefit from or are the targets of those arguments. The IRS's facilitation of electoral campaign spending by section 501(c)(4) organizations without donor disclosure interferes with the important interests of Public Citizen's members in knowing who is speaking about candidates shortly before elections and limits their ability "to make informed decisions and give proper weight to different speakers and messages," which disclosure would foster. *Citizens United*, 558 U.S. at 371.

50. Revision of the IRS's regulations to prevent substantial electoral campaign expenditures by section 501(c)(4) organizations, and revocation of its recent directive providing a "safe harbor" for electoral campaign activities amounting to up to 40% of certain section 501(c)(4) organizations' resources and permitting even greater expenditures in some cases,

would result in increased availability of public information about the donors behind electoral campaign expenditures by shifting expenditures currently made by section 501(c)(4) organizations to political committees and other groups claiming tax exemption under section 527, which are required to report the identity of donors.

51. Plaintiff Van Hollen is injured by the IRS's ongoing failure to comply with the requirements of section 501(c)(4) because the IRS's action and inaction permits organizations that are his political competitors and potential political competitors to obtain an improper benefit—the advantage of tax exemption without the requirement of donor disclosure. Representative Van Hollen is injured by the resulting illegal structuring of a competitive environment, which directly affects his interests. Representative Van Hollen's campaign committee must disclose its donors under FECA, but any section 501(c)(4) organization spending money to oppose Representative Van Hollen's reelection can, notwithstanding substantial electoral campaign expenditures, receive both a tax exemption and an exemption from disclosure obligations as a result of the IRS's unlawful regulation and its recent directive interpreting the regulation to allow substantial electoral campaign spending by section 501(c)(4) organizations.

52. Similarly, Representative Van Hollen's leadership PAC, the Victory Now PAC, is tax-exempt under section 527 but must disclose its donors. Candidates that Representative Van Hollen supports through the efforts of the Victory Now PAC, however, face opposition from organizations that, as a result of the IRS's unlawful regulation, receive both tax exemption and exemption from disclosure obligations. For example, in the 2012 election cycle, Representative Van Hollen's Victory Now PAC supported Representative Leonard Boswell for reelection in the election in Iowa's Third Congressional District. Crossroads GPS, a section 501(c)(4)

organization, spent over $1 million against Rep. Boswell, who was defeated. The ability of section 501(c)(4) organizations to make expenditures that are improper under the IRC in elections in which Representative Van Hollen's political committee is also participating injures Representative Van Hollen. Representative Van Hollen intends to continue to support candidates through his leadership PAC in races in which, absent action by the IRS to revise its regulation, he will face unlawful political competition from section 501(c)(4) organizations.

53. As a national leader of his political party and, in particular, its efforts to campaign for seats in the United States House of Representatives, Representative Van Hollen is also injured by the denial of information about the donors to section 501(c)(4) organizations that oppose the candidates of his party. Information about the donors behind the electoral campaign expenditures made by such organizations would be of strategic importance to Representative Van Hollen and would assist him and his party in creating messages to respond to those expenditures and appeal to potential voters.

54. Action by the IRS to conform its regulations and practices to the requirements of the IRC would correct the illegal structuring of the competitive political environment in which Representative Van Hollen participates, and would also provide him with increased access to information about the donors behind electoral campaign expenditures as political spending shifted to organizations required to report their donors.

First Claim for Relief
Agency Action Unlawfully Withheld and Unreasonably Delayed
(5 U.S.C. § 706(1))

55. The APA provides a right of action for persons aggrieved by agency inaction to compel agency action unlawfully withheld or unreasonably delayed and to set aside agency action (including an agency's failure to act) that is arbitrary, capricious, and abuse of discretion, or not in accordance with law. 5 U.S.C. §§ 702, 703, 704, 706(1) & 706(2).

56. The defendants' failure to initiate a rulemaking to amend TR § 1.501(c)(4)-1(a)(2)(i) is unlawful because, by requiring only that section 501(c)(4) organizations be engaged "primarily" in activities to promote the social welfare and permitting them to engage in substantial activities, including election campaign intervention, that do not promote social welfare within the meaning of section 501(c)(4), the regulation is contrary to the plain meaning of IRC section 501(c)(4)'s requirement that tax-exempt social welfare organizations be "exclusively" engaged in activities promoting social welfare.

57. The defendants' failure to initiate a rulemaking to amend TR § 1.501(c)(4)-1(a)(2)(i) is also arbitrary and capricious, as the agency has provided no reasoned explanation for its failure to conform its regulation to the requirements of IRC § 501(c)(4).

58. Despite their duty under the APA to take action on matters before them in a reasonable time, 5 U.S.C. § 555(b), the defendants have delayed unreasonably in acting on the petition to initiate a rulemaking to amend TR § 1.501(c)(4)-1(a)(2)(i). In light of the clear incompatibility of the existing regulation with the governing statute, as well as the need to act promptly to prevent another election cycle from being adversely affected by immense electoral campaign expenditures without disclosure of donors, the two years that have passed without action on the petition constitute an excessive and unreasonable delay.

59. Plaintiffs Van Hollen, Democracy 21, Campaign Legal Center, and Public Citizen are persons aggrieved by the defendants' failure to take action to conform TR § 1.501(c)(4)-1(a)(2)(i) to the requirements of section 501(c)(4).

Second Claim for Relief
Agency Action That Is Arbitrary, Capricious,
an Abuse of Discretion, or Not in Accordance with Law
(5 U.S.C. § 706(2)(A))

60. The APA provides a right of action for persons aggrieved by final agency action to set aside such action if it is arbitrary, capricious, and abuse of discretion, or not in accordance with law. 5 U.S.C. §§ 702, 703, 704, & 706(2).

61. The IRS's recent directive indicating that it will presumptively permit election campaign activities by a section 501(c)(4) organization that constitute less than 40% of its time and expenditures, and will also allow tax exemption under section 501(c)(4) even where electoral campaign activities exceed the 40% threshold depending on the "facts and circumstances," constitutes final agency action.

62. The IRS's directive is arbitrary, capricious, an abuse of discretion, and not in accordance with law because it permits section 501(c)(4) organizations to engage in substantial election campaign intervention in violation of section 501(c)(4)'s requirement that such organizations devote themselves "exclusively" to social welfare activities, which do not include election campaign intervention.

63. Plaintiffs Van Hollen, Democracy 21, Campaign Legal Center, and Public Citizen are persons aggrieved by the defendants' directive permitting section 501(c)(4) organizations to engage in substantial election campaign expenditures.

Relief Requested

Wherefore, the plaintiffs pray for the following relief:

i. an order declaring that the defendants' failure to initiate a rulemaking to amend the IRS's regulations is contrary to law as well as arbitrary and capricious, and that the defendants have delayed unreasonably in initiating such a rulemaking;

ii. an injunction, or, in the alternative, a writ of mandamus, compelling the defendants to initiate a rulemaking to amend the IRS's regulations to prohibit electoral campaign expenditures that violate section 501(c)(4) within 30 days of the Court's order;

iii. a declaration that the IRS's directive allowing certain section 501(c)(4) applicants a "safe harbor" is arbitrary, capricious, an abuse of discretion, and contrary to law to the extent that it reflects the position that a 501(c)(4) organization may spend 40% or more of its resources on electoral campaign intervention; and

iv. any and all other proper relief.

Respectfully submitted,

s/Scott L. Nelson
Scott L. Nelson, DC Bar No. 413548
Allison M. Zieve, DC Bar No. 424786
PUBLIC CITIZEN LITIGATION GROUP
1600 20th Street, NW
Washington, DC 20009
(202) 588-1000
snelson@citizen.org

Fred Wertheimer, DC Bar No. 154211
DEMOCRACY 21
2000 Massachusetts Avenue, NW
Washington, DC 20036
(202) 429-2008

Donald J. Simon, DC Bar No. 256388
SONOSKY, CHAMBERS, SACHSE
ENDRESON & PERRY, LLP
1425 K Street, NW, Suite 600
Washington, DC 20005
(202) 682-0240

J. Gerald Hebert, VA Bar No. 38432
Paul S. Ryan, DC Bar No. 502514
THE CAMPAIGN LEGAL CENTER
215 E Street, NE
Washington, DC 20002
(202) 736-2200

Attorneys for Plaintiffs

August 21, 2013

EXHIBIT A

Charting a Path Forward at the IRS:
Initial Assessment and Plan of Action

Daniel Werfel, IRS

June 24, 2013

Table of Contents

Appendices

Charting a Path Forward at the IRS
Initial Assessment and Plan of Action

Introduction

> *The IRS used inappropriate criteria that identified for review Tea Party and other organizations applying for tax-exempt status based upon their names or policy positions instead of indications of potential political campaign intervention. Ineffective management: 1) allowed inappropriate criteria to be developed and stay in place for more than 18 months, 2) resulted in substantial delays in processing certain applications, and 3) allowed unnecessary information requests to be issued.*[1]

These findings by the Treasury Inspector General for Tax Administration (TIGTA) were the result of both organizational and individual failures within the Internal Revenue Service (IRS). In response, the President and the Secretary of the Treasury installed new leadership at the IRS in late May 2013, and directed that a thorough review of the matters identified in the TIGTA report occur, individuals responsible for mismanagement or wrongdoing be held to account, comprehensive corrective actions be taken to address the problems with IRS review of tax exempt applications, and a forward-looking assessment take place to identify ways to improve IRS operations broadly. This Report is the response to the request by the Secretary of the Treasury for a "30 day" update on our progress in carrying out the above directives.

The IRS Mission Statement states:

> To provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law *with integrity and fairness to all*.

The inappropriate criteria used to screen applications for tax exempt status within the Exempt Organizations (EO) unit of the IRS were inconsistent with the standards set out in this Mission Statement. Over the past 30 days, an ongoing review of these events has shed further light on the management failures that occurred within the IRS and the causes of those failures. Several key leaders, including some in the Commissioner's Office, failed in multiple capacities to meet their managerial responsibilities at various points during the course of these events. Most notably, there was insufficient action by these leaders to identify, prevent, address, and disclose the problematic situation that materialized with the review of applications for tax exempt status. The full extent of these management failures and any further inappropriate actions that may have taken place are the subject of various ongoing reviews and investigatory efforts that are being

[1] *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review*, Treasury Inspector General for Tax Administration. Reference Number 2013-10-053. May 14, 2013.

conducted by IRS, TIGTA, the Department of Justice, and the United States Congress, but that are not yet complete.

The IRS is actively pursuing and supporting these fact gathering efforts. Reinforcing the importance of such efforts, we have heard from concerned taxpayers and citizens around the country. Specifically, members of the public seek answers to the following questions:

- What caused the events described in the TIGTA report?
- How are IRS employees who failed in their responsibilities being held to account?
- What fixes are being put in place in the IRS's EO unit to permanently address the problems TIGTA identified with the application process for tax exempt status?
- Do the risks and failures identified by the TIGTA report extend to other areas within the IRS?
- Is the IRS properly positioned to effectively execute its broader operations?

While the IRS is committed to timely and comprehensively addressing each of these questions, this Report does not purport to provide a complete and final set of answers at this time. Instead, this Report provides an initial set of conclusions and action steps, along with an explanation of the additional review and investigatory activities underway. In developing the Report, we closely reviewed the TIGTA audit and underlying materials furnished by TIGTA, reviewed thousands of pages of materials relevant to both the review of applications for tax exempt status and broader IRS operations and risks, established an integrated leadership group from various business units around the IRS to assist in our evaluation, brought in new leadership with expertise in public sector management to provide perspectives from outside the IRS, and engaged in an ongoing dialogue with TIGTA and Congress to synthesize their ongoing review and investigation of these matters with our own. As specifically requested by TIGTA and the Department of Justice, and in order to avoid disruption with their ongoing investigations, we are relying on the professional investigators from these entities to interview employees regarding root causes of the identified problems in the review of the applications for tax exempt status.

This Report has three sections:

In Section 1, *Accountability*, we describe the process undertaken to determine the causes of the events described in the TIGTA report and the manner in which we are ensuring accountability for mismanagement or, to the extent identified, other forms of wrongdoing.

In Section 2, *Fixing the Problems with the Review of Applications for Tax Exempt Status*, we detail the numerous process improvements underway to meet and go beyond the recommendations from TIGTA, in order to ensure that appropriate screening criteria are in place and that taxpayers receive effective customer service in the review of applications for tax exempt status.

In Section 3, *Broad Review of IRS Operations and Risks,* we identify a series of actions that will improve performance and accountability in the leadership ranks of the IRS by ensuring that critical program or operational risks are identified early, raised to the right decision-makers in the organization, and are timely shared with external stakeholders, such as Congress, TIGTA, and the IRS Oversight Board.

Each section of the Report contains an upfront summary, highlighting both conclusions reached and discrete actions taken. By way of an overall summary, significant findings and actions in the Report are as follows:

Findings:

- Significant management and judgment failures occurred, as outlined in the TIGTA report, that contributed to the inappropriate treatment of certain taxpayers applying for tax exempt status.
- At this time, while fact gathering is still underway, we have not found evidence of intentional wrongdoing by IRS personnel, or involvement in these matters by anyone outside of the IRS.
- We concur with the nine TIGTA recommendations for improving the review of applications for tax exempt status. Further, we believe there are additional steps, beyond the TIGTA recommendations, that will help to ensure the problems identified by TIGTA are permanently corrected.
- The IRS Commissioner's Office and other leaders across the organization do not always have sufficient knowledge of emerging operational risks among the various IRS business units. This fact limits the ability of senior IRS leaders and managers to identify and help manage organizational risks, and stifles the timely flow of such information to external stakeholders.
- There is no current evidence of the use of inappropriate criteria in other IRS business unit operations. However, we recognize there is public concern in this regard, and therefore additional mechanisms to evaluate such criteria should be initiated.
- The IRS has mechanisms, such as the Taxpayer Advocate Service, to assist taxpayers who are having difficulty in resolving matters with the IRS. However these mechanisms are not well understood by taxpayers and therefore are not being sufficiently leveraged.

Actions:

- New leadership has been installed at all five levels of the senior executive managerial chain that had responsibility over the activities identified in the TIGTA report.
- We have empaneled an Accountability Review Board to provide recommendations within 60 days (and thereafter as needed) as to any additional personnel actions that should be taken to ensure there is appropriate accountability for the events described in the TIGTA report.

- We have suspended the use of "be-on-the-lookout," or BOLO, lists in the application process for tax exempt status.
- We have established a new voluntary process for certain taxpayers who have been in our priority backlog for more than 120 days to gain expedited approval to operate as a 501(c)(4) tax exempt entity through self-certifying to certain thresholds and limits to political and social welfare activities.
- We will establish a review process by which criteria and screening procedures across the IRS will be periodically assessed for any risks of criteria that would be inconsistent with our Mission Statement.
- We will establish an Enterprise Risk Management Program to provide a common framework for capturing, reporting, and addressing risk areas across IRS. This is intended to improve the timeliness by which such information is brought to the attention of the Commissioner and other IRS leaders, as well as external stakeholders.
- We will initiate additional internal and external education and outreach about the role of the National Taxpayer Advocate in assisting taxpayers in resolving problems with the IRS.

The actions described above, as well as many others detailed further in this Report, are guided by commitments to increased transparency of IRS operations, new checks and balances where objective assessments can ensure that appropriate screening criteria are in place and that taxpayers receive effective customer service, and an environment where IRS leaders, beginning with the Commissioner's Office, have active and timely knowledge of emerging operational risks and take responsibility for driving swift and effective solutions.

Our pursuit of broad-based reform in the IRS does not mean we believe that the specific challenges and concerns identified in the TIGTA report are present in other parts of the organization. In contrast to the management challenges raised by TIGTA, there are many instances across the IRS where effective management is leading to positive organizational performance. Section 3 of this Report elaborates on this issue, recognizing that both strengths and weaknesses should be considered when assessing management reforms. In this way, our agency-wide reforms build on a foundation of successful results within many of the IRS business units, while closing more significant performance and management gaps in others.

Lastly, although there is a desire for immediate answers regarding the circumstances that led to the inappropriate treatment of taxpayers identified in the TIGTA Report, such expediency must be carefully balanced with the need to engage in thorough and fair fact-finding. Working in concert with the leadership of the Department of the Treasury, Congress, TIGTA, the Department of Justice, and other key stakeholders, we have initiated both a candid vetting of issues that impact IRS effectiveness and a robust action plan to gather additional evidence and address needed improvements in a fair, yet expedient, manner. In this way, the process of restoring and sustaining the public's trust in the IRS is underway.

1. Accountability

Section Summary

In determining the proper level of accountability for those individuals responsible for the various failures identified in the TIGTA report, our approach is two-fold:

1. We are identifying the individuals within the IRS who are responsible for the mismanagement outlined in the TIGTA report, evaluating the extent to which their actions (or failure to act) contributed to the problems identified, and determining the appropriate consequences for each individual.

2. We are digging deeper into the evidence to determine if there are instances of wrongdoing or inappropriate conduct beyond the mismanagement identified in the original TIGTA report. By extending our review beyond the scope of the original audit, we are ensuring a more comprehensive understanding of the circumstances that led to these events.

The first component of our plan to ensure accountability relies principally on the employee interviews and underlying documents that supported the original TIGTA audit. In addition, investigatory materials beyond the original audit work are emerging through interviews of relevant IRS employees being conducted by TIGTA and Congress. We are also reviewing thousands of pages of materials compiled from various sources, including employee emails and other work papers and documents relevant to the application process for tax exempt status.

Although these additional efforts are not complete and will take some time in order to be conducted properly, we have already made a number of key personnel changes in the leadership ranks of the IRS based on available information. In several cases, there is already evidence of mismanagement that warrants the removal of personnel from the positions they held at the time the TIGTA report was issued. As a result, there is now new leadership in place at five different levels of the IRS senior executive and management chain involved in these matters.

As the investigation moves forward and we gather further evidence, new information will support our ongoing efforts to determine ultimate accountability for management failures. As of the publication of this Report, there is no evidence of intentional wrongdoing or misconduct on the part of IRS personnel beyond the conclusions reached in the TIGTA report. Moreover, we have found no evidence of involvement in these matters by any individuals outside of the IRS. However, investigatory efforts have yet to be completed, and we will make additional accountability determinations as appropriate.

Actions Taken to Date

Numerous reviews and investigations have been launched to examine the review of applications of certain groups for tax exempt status.[2] The TIGTA audit is just one of these reviews. Several Congressional committees and the Department of Justice are engaged in investigations, TIGTA has an additional investigation underway, and the IRS Commissioner's office is examining the specifics of the matter.

Though these investigations are still ongoing, enough evidence is available to enable us to draw conclusions about the significant breakdowns in management and process that led to the development and utilization of inappropriate criteria. Based on these conclusions, we have already begun the process of holding individuals accountable for their actions.

As a guiding principle in determining our actions, we recognize that our staff at the IRS, and particularly those in positions of leadership and decision-making, must be worthy of the public's trust and must behave consistent with our Mission Statement of operating with "integrity and fairness for all." The vast majority of IRS management and staff live up to this high standard. However, those who neglect this duty and cannot demonstrate the ability to hold the public's trust must be held accountable for their actions. Our other guiding principles include commitments to thoroughness, fairness, and expediency. Embedded in these principles is an inherent tension, but one that must be appropriately balanced. While we want to move quickly, we must be thorough in our fact finding and fair in our decisions.

For this initial review, we have relied extensively on the data in the TIGTA audit report, additional underlying data supporting the audit, further fact gathering and analysis by IRS management through review of e-mails and other documents gathered to date, and evidence uncovered through the ongoing employee interviews conducted by TIGTA and Congress. Based on the information we have reviewed to date, we can draw the following conclusions within the two broad categories depicted below:

- Process and execution failures affected a particular subset of applicants for tax exempt status beginning in 2010:
    - Personnel in the Exempt Organizations (EO) unit applied inappropriate screening criteria to applicants for tax exempt status, creating BOLO listings that resulted in the improper targeting of a number of applicants for additional scrutiny.
    - Even after management in the EO unit identified this activity and put in place steps to correct the behavior, the inappropriate scrutiny was allowed to return.

[2] Documents produced by the IRS during our 30-day review (and provided to Congress in response to their requests) revealed the use of political and other inappropriate labels in BOLO lists used by the EO unit, beyond those inappropriate labels identified in the TIGTA report. The Principal Deputy Commissioner directed the suspension of the use of all BOLO lists in the EO unit effective June 12, 2013.

- Some applicants were subjected to overly burdensome and intrusive questionnaires and data requests that went beyond an acceptable level of fact finding.
- Applications for tax exempt status remained unresolved well beyond the 120 days that the IRS has set as the standard for making determinations due, at least in part, to internal misunderstandings, poor communication, ineffective collaboration, and a lack of clarity on the proper standards for adjudicating the applications.

- IRS management failures:

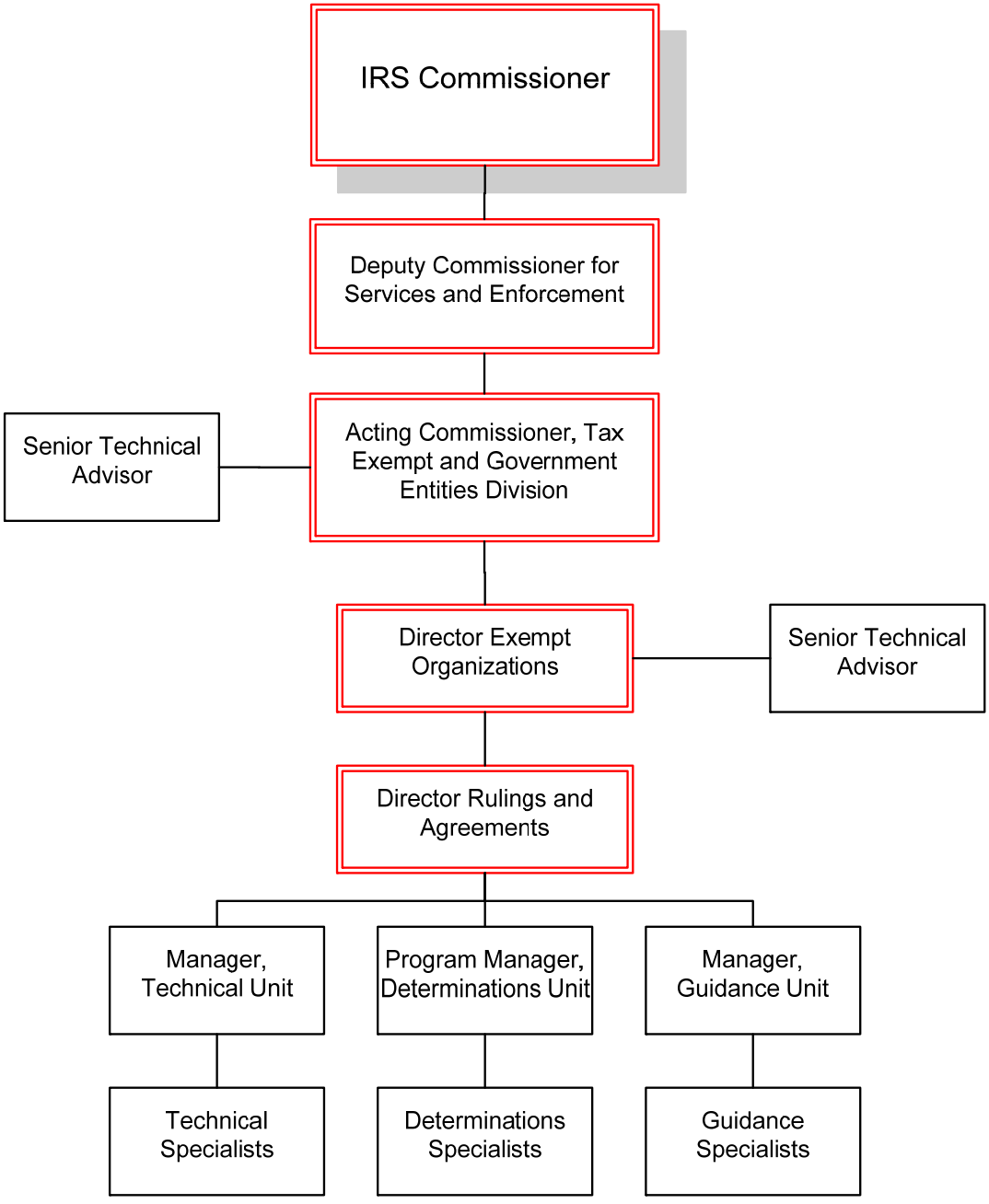
  - EO Management failed to identify the inappropriate activities in a timely fashion (it took 16 months from the time this activity began before the first briefing was provided to the EO Director on the topic, according to the timeline in the TIGTA report).
  - EO management failed to properly and expediently escalate these issues to the highest levels of senior leadership in the IRS.
  - Senior IRS leadership did not effectively oversee activities within EO, failing to take appropriate, proactive steps to identify and help address significant emerging operational risks.
  - Even after senior IRS leadership was informed of the inappropriate activities in question, it failed both to effectively put an end to the activity and to inform the proper committees in Congress in a timely fashion, despite requests from Congress on this topic.

This summary, based largely on the findings and supporting evidence associated with the TIGTA report, represents a list of significant failures by the IRS, including failures of transaction processing, customer service, effective collaboration, management, and overall leadership. Moreover, our own review to date of the evidence and communications associated with these activities indicates significant miscommunication between and among the various parts of the EO unit, along with a lack of critical thinking and judgment on behalf of key executives within and beyond this unit. These leaders did not adequately identify emerging problems (such as a growing backlog of applications for tax exempt status), effectively manage their organizations while this backlog continued to grow unabated, or elevate risks and issues to higher levels of authority. As a result, we have taken actions to hold IRS personnel accountable, impacting multiple levels of the IRS organization.

The Privacy Act of 1974 limits our ability to identify individual names and individual disciplinary actions in this Report. However, we can state that, by way of various personnel actions as a result of the activities covered in TIGTA report, a total of five executives are no longer in the positions they held at the time that the TIGTA report was published. As can be seen in Figure 1, the entire leadership chain, from the top of the organization to the front-line executives in the mission area

where these activities occurred, has been replaced since the TIGTA report was published (these changes are highlighted in red double-lined boxes). (Figure 1 is an adaptation of the portion of the IRS organization chart that was depicted in Appendix V in the TIGTA report, focusing on the chain of command that was relevant for the topics covered in that report.)

Figure 1: High-Level Organizational Chart of Offices Referenced in the TIGTA Report



The management changes highlighted are consistent with our guiding principles of thorough, fair, and expedient action, and represent conclusions we have drawn to date. We also recognize that accountability determinations will continue to be evaluated until all investigatory activity is complete.

Additional Actions Still to be Determined

At this time, there are ongoing reviews and investigations being conducted by IRS leadership, TIGTA, the Department of Justice, and Congressional committees. As specifically requested by TIGTA and the Department of Justice, and in order to avoid disruption with their ongoing investigations, we are relying on the professional investigators from these entities to interview employees about root causes of the identified problems. Concurrent with TIGTA's work, IRS management is continuing to review relevant documentary evidence to ensure all aspects of the investigation are carefully considered. All of the various fact-finding efforts underway will have a direct bearing on decisions we will make about additional accountability measures. Consistent with our approach to date, if there is sufficient evidence to conclude that an individual can no longer hold a position of public trust within the IRS, we will take appropriate personnel action.

To support these accountability determinations, we have convened an Accountability Review Board to assist in sorting through the record and helping identify appropriate personnel actions. This Board, consisting of senior executives and human resource professionals from across the IRS and representation from the Office of Personnel Management, will initially assist in determining any appropriate disciplinary action for executives who thus far have been placed on administrative leave. It is important to reach closure on those personnel actions in a timely fashion. The Board will also assist in any further personnel actions that may be appropriate for other individuals who participated in these activities. A one-size-fits-all approach to accountability is too broad for actions that may contain greater nuances for each of the individuals involved. Accordingly, we expect this Board to help sort through the evidence and yield recommendations for action on a case-by-case basis. Among other criteria, we expect that the Board will take into consideration the so-called "Douglas Factors," which are based on a landmark decision by the Merit Systems Protection Board (MSPB) and establish criteria that supervisors must consider in determining an appropriate penalty to impose for an act of employee misconduct (see Appendix A for a listing of the 12 "Douglas Factors"[3]). The Board, which was officially formed on June 17, 2013, is expected to provide recommendations for any disciplinary action on an ongoing basis over the next 60 days (and thereafter as needed). Any further action will be taken at that time.[4]

[3] The MSPB case was Curtis Douglas v. Veterans Administration, 5 MSPB 313, 332 (1981).

[4] The IRS will ensure that any such action will be in compliance with all statutory and regulatory requirements governing personnel actions for Federal employees, including appropriate due process, consultation with employees' exclusive representatives, and other applicable requirements. In many cases, such compliance may require additional time and create constraints on the actions the IRS is able to take or publicly disclose.

It is important to note that, at this point in time, we have not uncovered any evidence that we believe changes the conclusions in the TIGTA report that this inappropriate behavior resulted from significant mismanagement and poor judgment. We have not found evidence of intentional wrongdoing on behalf of IRS personnel. Further, we have found no evidence to date that anyone outside the IRS had any role in initiating or encouraging this activity. However, we also recognize that TIGTA, the Department of Justice, and Congress, are gathering additional evidence, as are we, and we will evaluate all new information on an ongoing and frequent basis. We are committed to a full vetting of the evidence and will work with TIGTA, the Department of Justice, and Congress to make such evidence and conclusions public, to the extent allowable under the law.

2. Fixing the Problems with the Review of Applications for Tax Exempt Status

Section Summary

A critical component of our action plan is to implement necessary controls to permanently address the problems with the tax exempt application process, as identified in the TIGTA report. As noted in Section 1, installing new leadership is the first in a series of corrective actions. In this section, we will highlight the additional steps that we are taking to reform our business practices in the review of applications for tax exempt status, using the nine recommendations stated in the TIGTA report as the organizing framework for this discussion. We have accepted all nine recommendations in full, are making effective progress in implementing them, and have identified additional solutions beyond the TIGTA recommendations.

Specifically, the IRS has:

- Suspended the use of BOLO lists in the application process for tax exempt status;
- Initiated an end-to-end overhaul of the business processes by which applications for tax exempt status are fulfilled;
- Begun to develop new guidance materials to allow IRS staff to operate without BOLO lists and under the reformed, more efficient process flows;
- Added technical and programmatic experts to assist the EO staff with the review of applications for tax exempt status;
- Initiated a new process whereby certain taxpayers whose applications for 501(c)(4) tax exempt status had been identified for potentially inappropriate campaign intervention and have been in our backlog for more than 120 days have the option of obtaining an approval if they self-certify that no more than 40% of their expenditures and voluntary person-hours will go toward political campaign intervention activities and that at least 60% of their expenditures and voluntary person-hours will go toward promoting social welfare;
- Created a new "Advocacy Application Review Committee" to provide expertise from other parts of the IRS to review screening and determination decisions;
- Begun the process to create a new check and balance mechanism, where IRS criteria and screening procedures will be reviewed on a systemic basis and any material risks of the use of inappropriate criteria found will be

reported to the IRS Commissioner, the IRS Oversight Board, and the relevant tax committees of Congress;

- Engaged with the Department of the Treasury regarding the need for greater clarity for certain terms that are relevant for 501(c)(4) tax exempt organizations, with a commitment for inclusion in the next Treasury Priority Guidance Plan.

We expect these various improvements and mechanisms to result in a rapid elimination of the existing backlog of applications for tax exempt status, with an initial focus on the backlog of potential political applications for tax exemption under Internal Revenue Code Section 501(c)(4). The new procedures will also help to ensure that the high standards of the IRS Mission Statement for appropriate and effective customer service will be adhered to in the application process for tax exempt status going forward.

Management Changes

While many of the actions that will be discussed in this section revolve around the nine recommendations made in the TIGTA report, there are other important steps we are taking that go beyond those specific recommendations. For example, as discussed in the prior section, we have brought in new leadership for a number of critical positions, with clear direction on what is expected from these individuals in their roles as leaders and managers of our day-to-day operations. These new leaders span the entire IRS management chain and reach into the EO unit and the team responsible for determinations on applications for tax exempt status. In identifying the right individuals to install in new leadership positions, we have worked closely with the IRS senior executive team to identify individuals from across the organization who hold the highest levels of integrity and have demonstrated a strong track record of effective management. We have sought leaders who have the ability to get things done and to focus on the combination of proper adherence to our tax laws and regulations as well as in providing high levels of service to our taxpayers.

Specifically, in addition to the appointment of new leadership in the Commissioner's Office, the following new leaders are in place within the IRS:

- Office of the Deputy Commissioner, Services and Enforcement (Heather Maloy)
- Office of the Commissioner, Tax Exempt and Government Entities (Michael Julianelle)
- Director, Exempt Organizations (Ken Corbin)
- Director, Rulings and Agreements, Exempt Organizations (Karen Schiller)

These new leaders have already begun to not only execute on their new responsibilities, but also to collaborate with the many other experienced and high-caliber leaders already in place across the IRS. Collectively, we are moving forward with the necessary actions to address the

deficiencies highlighted in the TIGTA report. Specifically, we reaffirm IRS's full agreement with all nine of the recommendations made in the TIGTA report and our firm commitment to the implementation of each of those recommendations. In some cases, we are implementing solutions that go beyond what was in the TIGTA recommendations, but those recommendations are our starting point. TIGTA has provided a roadmap for how to correct the problems that TIGTA identified, and we will be following that roadmap, including expanding upon it where there is even greater opportunity for improvement.

It is also imperative that we implement our corrective steps in a rapid and transparent manner, with an immediate focus on resolving the applications that have been sitting in the backlog for an extended period of time, which we refer to as our "priority backlog" (see the response to Recommendation 7 for more information on our new processes associated with managing this backlog and where we are in that process). As announced in Congressional testimony earlier this month, we will be maintaining and updating the status of each of these recommendations on the IRS web site, www.irs.gov, until such time as all of them have been implemented. Michael Julianelle, our new Acting Commissioner of Tax Exempt and Government Entities (TE/GE), and Ken Corbin, our new Acting Director of EO, are responsible for overseeing the implementation of these recommendations and providing frequent updates as to their status on our web site.

The following provides the current status, actions taken to date, pending actions, and estimated completion date for each of the nine TIGTA recommendations.

Status of the TIGTA Recommendations

TIGTA Finding No. 1

The Determinations Unit Used Inappropriate Criteria to Identify Potential Political Cases

TIGTA Recommendation 1: Ensure that the memorandum requiring the Director, Rulings and Agreements, to approve all original entries and changes to criteria included on the BOLO listing prior to implementation be formalized in the appropriate Internal Revenue Manual.

a. **Status**: Complete (additional action beyond recommendation still ongoing)
b. **Actions Taken to Date**:
    i. The memorandum was put into effect on May 17, 2012 (see Appendix B). Because, as discussed below, the use of BOLO lists has been suspended, this memo regarding their use will not need to be incorporated into the IRM at this time.
    ii. The Principal Deputy Commissioner directed the suspension of the use of BOLO lists within the EO function on June 12, 2013. This action was

formalized via a memorandum from the Acting Director, Rulings and Agreements on June 20, 2013 (see memo in Appendix C). This memorandum will be further formalized in Interim Guidance issued by June 28, 2013.

1. In the absence of BOLO lists, the Determinations Unit will continue to screen for information affecting the determination of applications for tax exempt status, including activity tied to political campaign intervention, but it will be done without regard to specific labels of any kind.

c. **Pending Actions**:
   i. Provide training to staff on how to apply the appropriate screening criteria in the absence of BOLO lists (part of which will be based on actions outlined in Recommendations 2 and 3).
d. **Estimated Completion Date**: June 28, 2013 for the original TIGTA recommendation; September 30, 2013 for the follow-on activity

TIGTA Recommendation 2: Develop procedures to better document the reason(s) applications are chosen for review by the team of specialists (e.g., evidence of specific political campaign intervention in the application file or specific reasons the EO function may have for choosing to review the application further based on past experience).

a. **Status**: Ongoing
b. **Actions Taken to Date**:
   i. The Acting Director, EO is satisfying this recommendation in two steps.
      1. Improving the documentation of the reasons applications are chosen for review by the team of specialists.
         a. The Acting Director, EO has organized a team to review, update, and formalize the documentation. The team consists of representatives from various IRS divisions, including Small Business / Self-Employed, Wage and Investment, Chief Counsel, and Exempt Organizations.
         b. The team formed and began its work the week of June 17, 2013.
      2. Reviewing the process associated with the selection of applications for tax exempt status for further review.
         a. This same team will partner with members of an IRS internal team of highly trained process improvement experts, which will also include employees from the office of Privacy, Governmental Liaison, and Disclosure, to evaluate the business process associated with the initial evaluation of the application through the steps associated with the selection for review.

b. The expected outcome is a more efficient business process, to be coupled with enhanced documentation.
c. This process review began the week of June 17, 2013.

c. **Pending Actions**:
   i. Complete assessments of the documentation and the current business process.
   ii. Implement the use of the new documentation and updated business process.
d. **Estimated Completion Date**: September 30, 2013

TIGTA Recommendation 3: Develop training or workshops to be held before each election cycle including, but not limited to, the proper ways to identify applications that require review of political campaign intervention activities.

a. **Status**: Ongoing
b. **Actions Taken to Date**:
   i. Implementing this recommendation will be a four-step process, the first of which has already been completed:
   Step 1: Review current content of the training program and materials
      a. The Acting Director, EO established a team to review the training materials currently in use regarding proper identification of applications that require review of political campaign intervention activities.
      b. These materials had been initiated in previous workshops, but had not been aggregated and consolidated into formal training materials.
c. **Pending Actions**:
   i. Three steps remain in the implementation of the four-step process:
   Step 2: Update the content of training materials based on new information derived from Recommendation 2
      a. This same team will monitor the progress of the implementation of Recommendation 2, and update the training materials accordingly.
   Step 3: Migrate the training to IRS's Electronic Learning Management System, which is the Service's core repository for enterprise-wide training
   Step 4: Deliver the training
      b. As recommended by TIGTA, training related to political campaign intervention will be delivered close in time to election cycles. We estimate that this broad delivery of training will begin on or around January 2014, in order to train personnel in advance of the 2014 election cycle.

c. Training will be repeated for all relevant EO employees on an annual basis.

d. **Estimated Completion Date**: June 30, 2013 for initial training material to be reviewed; January 2014 for delivery of new training

TIGTA Finding No. 2

Potential Political Cases Experienced Significant Processing Delays

TIGTA Recommendation 4: Develop a process for the Determinations Unit to formally request assistance from the Technical Unit and the Guidance Unit. The process should include actions to initiate, track, and monitor requests for assistance to ensure that requests are responded to timely.

a. **Status**: Complete (with additional activity ongoing to enhance the technical solution that is supporting the new process)

b. **Actions Taken to Date**:

i. Implementing this recommendation will be a two-step process:

1. Define the process and implement with a short-term technology solution

a. Close and transparent coordination between the Determinations Unit and the Technical and Guidance Units is critical to effectively managing the applications that are in the process of being reviewed.

b. These organizations formalized the process of coordination on June 21, 2013, under the direction of the Acting Commissioner, TE/GE and the Acting Director, EO.

c. The new process is documented in written procedures, and was enabled using a spreadsheet-based tracking tool that monitors more than 20 different data elements associated with a particular case, including a number of dates associated with key steps in the processing of the case.

d. The spreadsheet model, which went into operation on June 21, 2013 and satisfies the TIGTA recommendation, was utilized because it could be deployed quickly and provides a basic structure for effective collaboration.

2. Evolve to a more robust technology solution that can ultimately supplant the spreadsheet model (see below for pending actions)

c. **Pending Actions**:

i. Evolve to a more robust technology solution

1. While the spreadsheet model is an acceptable short-term solution for this collaboration, we believe a more robust technology would be appropriate for a longer-term solution.
2. The Acting Commissioner, TE/GE and Acting Director, EO will review existing technical solutions that perform a similar coordination and tracking function within the IRS, and look to repurpose one or more of those solutions to fulfill this requirement.
3. The final step will be to convert the coordination process from the spreadsheet-based model to this more robust technology solution.

d. **Estimated Completion Date**: Step 1 (spreadsheet based solution) went into effect on June 21, 2013. Step 2 evaluation is underway, with an estimated implementation date of September 30, 2013.

TIGTA Recommendation 5: Develop guidance for specialists on how to process requests for tax exempt status involving potentially significant political campaign intervention. This guidance should also be posted to the Internet to provide transparency to organizations on the application process.

a. **Status**: Ongoing
b. **Actions Taken to Date**:
   i. One of the significant challenges with the 501(c)(4) review process has been the lack of a clear and concise definition of "political campaign intervention". For example, it is often difficult to determine whether or not a particular paid advertisement is taking a position on a public policy issue or constitutes an attempt to influence an election, and, in turn, how that decision might factor into the overall evaluation of whether an organization is primarily engaged in promoting social welfare. Such complicated determinations currently rely on lengthy revenue rulings and judicial opinions with examples that serve to assist an evaluation based on all facts and circumstances.
   ii. Given the complexity of the issues involved and the immediate need to alleviate the existing backlog of 501(c)(4) applications that have some indication of potential or actual political campaign intervention, IRS Chief Counsel has assigned six additional attorneys to support the specialists in the EO Technical team on the most complex cases related to political campaign intervention. The IRS Chief Counsel team began to provide this additional support and expertise on June 11, 2013. Also, an expedited process (explained in the response to Recommendation 7) relying on applicant certifications for cases in the backlog was developed and is being implemented.

iii. The applicable revenue rulings can be found in Appendix D of this Report, and are being posted to the Internet.

c. **Pending Actions**:
   i. In addition to the primary revenue rulings, the specialists, who reside in the EO Technical division, will receive further guidance in these areas from IRS Chief Counsel.
   ii. The IRS will determine how to process all other 501(c)(4) applications involving potentially significant political campaign intervention activity after reviewing the experience of the use of expedited procedures for the priority backlog (as described in the response to Recommendation 7) that is the initial focus for these efforts.
   iii. Any subsequently-created guidance or other materials affecting the determinations process, including the guidance discussed in the response to Recommendation 8, will be posted to the Internet.
d. **Estimated Completion Date**: June 27, 2013 for the process for the priority backlog; January 31, 2014 for processing of other 501(c)(4) applications

TIGTA Recommendation 6: Develop training or workshops to be held before each election cycle including, but not limited to: a) what constitutes political campaign intervention versus issue advocacy (including case examples) and b) the ability to refer for follow-up those organizations that may conduct activities in a future year which may cause them to lose their tax exempt status.

a. **Status**: Ongoing
b. **Actions Taken to Date**:
   i. The Acting Director, EO engaged the EO Determination Manager to initiate development of training material and to establish the delivery timeline.
   ii. The material for part (a) will be based on the revenue rulings found in Appendix D, as well as the additional guidance referenced in the response to Recommendation 5.
   iii. The material for part (b) will be influenced by the business process analysis described in the response to Recommendation 2.
c. **Pending Actions**:
   i. IRS Chief Counsel will review additional training materials that are produced.
   ii. Training will be delivered on an as-needed basis, with a particular focus on the timeframe leading up to the future election cycles.
d. **Estimated Completion Date**: January 31, 2014

TIGTA Recommendation 7: Provide oversight to ensure that potential political cases, some of which have been in process for three years, are approved or denied expeditiously.

a. **Status**: Ongoing
b. **Actions Taken to Date**:
    i. Appropriately resolving the cases that have been in the queue for action and resolution for unacceptable periods of time is a top priority for the IRS, and we have already taken a number of steps to not only begin to clear that backlog, but also to dramatically improve both the oversight and the throughput within the evaluation process.
    ii. For the purposes of this discussion, we have defined the "priority backlog" for our *initial* focus to be 501(c)(4) applications that have been previously identified as "potential political cases" – i.e., the focus of the TIGTA audit – and that were submitted to the IRS for initial review more than 120 days prior to May 28, 2013 (the first week of new leadership at the IRS). There were 132 cases that fell into this category at that time.
    iii. Specifically, we are following two primary paths that will help us to clear this backlog. Of note, Path 2 is available specifically for those applicants in the priority backlog, and is not available to other applicants at this time.

    iv. Path 1: Strategic Utilization of Additional Resources and Process Refinement

        1. In recognizing the challenge in evaluating some of these applications (in particular trying to determine whether the applicant is primarily engaged in social welfare activities), we have taken steps to dedicate additional resources from other segments of the IRS to support the determinations that are pending in this backlog (as mentioned in the response to Recommendation 5). We recognize that many of these determinations are "close calls" based on the current laws and regulations and the specific facts and circumstances of each individual submission. There is a detailed body of fact-based guidance that informs these determinations, thereby often requiring a sophisticated legal and complex factual review to evaluate the application. Path 1 to implementing this Recommendation focuses on providing additional staff to support specific elements of this complex evaluation process, as well as refinements to the review and approval process:
            a. Additional clerical staff members have been provided from the Wage and Investment Division to assist in managing

the logistics associated with the current backlog, to ensure that packages are moving quickly from one stage in the process to the next.

b. Front-line EO Determinations Unit staff members have received instructions to escalate applications to the EO Technical Unit where there is evidence of a non-insubstantial degree of potential political campaign intervention in the applications.
c. The EO Technical Unit has received additional instructions on how to evaluate these cases.
d. The EO Technical Unit now has the ability to engage additional attorneys assigned by IRS Chief Counsel to assist in these complicated determinations. The additional attorneys began to provide this support on June 11, 2013.
e. We have created a three-member "Advocacy Application Review Committee," consisting of executive counsel and the new executive leadership in TE/GE that will review the file, apply the law to the facts presented, and evaluate whether the applicant has satisfied the requirements for exemption under Section 501(c)(4). This Review Committee will render the final determination for any cases for which additional review has been requested and for any case for which a denial has been proposed.
f. The Review Committee will also be responsible for frequent updates (at least weekly) to the Office of the Deputy Commissioner, Services and Enforcement, on the status of resolving all cases in the priority backlog, providing expanded oversight to ensure the milestones put forth in this Report remain on track to be met.

2. Thus far, we have made determinations on 34 cases in the original backlog (26%). Those determinations include 17 approvals, 4 applications withdrawn by the applicants, and 13 cases closed for "failure to establish" (i.e., failure to provide necessary information). None of the cases in this backlog have been disapproved to date.
3. Importantly, due to the fact that some of these determinations represent difficult and complex judgments, some may still take longer to resolve than others.

v. Path 2: Streamlined Approval Process for the Priority Backlog

1. The primary challenge associated with making a determination for the cases in this backlog relates to the significance of potential or actual political campaign intervention activity associated with the applicant. The current regulatory standard allows for some political campaign intervention or other activity, but the organization must be "primarily" engaged in activities that promote social welfare.
2. Within certain parameters, it is appropriate for applicants in the priority backlog to have the opportunity to self-certify the degree to which political campaign intervention may be part of their organization's scope of activity. With this new option, applicants who self-certify that their level of political campaign intervention activity is below a defined threshold, and that their level of social welfare activity is above a defined threshold, will be approved on an expedited basis, which is expected to be two weeks or less (see below for threshold levels).
3. Specifically, we have crafted the following statements for certification by applicants in the priority backlog:
    1) During each past tax year of the organization, during the current tax year, and during each future tax year in which the organization intends to rely on a determination letter issued under the optional expedited process, the organization has spent and anticipates that it will spend 60% or more of both the organization's total expenditures and its total time (measured by employee and volunteer hours) on activities that promote the social welfare (within the meaning of Section 501(c)(4) and the regulations thereunder).
    2) During each past tax year of the organization, during the current tax year, and during each future tax year in which the organization intends to rely on a determination letter issued under the optional expedited process, the organization has spent and anticipates that it will spend less than 40% of both the organization's total expenditures and its total time (measured by employee and volunteer hours) on direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office (within the meaning of the regulations under Section 501(c)(4)).

4. Appendix E contains a sample letter providing the option for Path 2 to an applicant that is currently part of the priority backlog. This letter also contains a brief set of additional instructions and safe harbors for counting activities. In order to use Path 2, the organization must use the specific safe harbors and must include the following activities when counting the amount of political campaign intervention it is engaged in:
    a. Public communication identifying a candidate within 60 days prior to a general election or 30 days prior to a primary;
    b. Events at which only one candidate, or candidates of only one party, are invited to speak; and
    c. Grants to other 501(c) organizations that engage in political campaign intervention.
5. We chose the thresholds described here (below 40% for political campaign intervention activity and above 60% for social welfare activity) and provided special instructions for measuring activities in order to provide a basis for determining what is meant by "primarily" engaged in social welfare activities (with the understanding that no precise definition exists in relevant revenue rulings, cases, or regulations for "primarily" in this specific context and that the statute does not provide clear guidance on how the determination should be made). Organizations that wish to be evaluated under all the facts and circumstances rather than to conduct their own measurements retain that option via Path 1.
6. Any entity in the priority backlog that determines that its political campaign intervention activity represents less than 40% of its total activity using the safe harbor rules established in the instructions should be able to confidently respond to this assertion in the affirmative. If the estimate is above 40% or cannot be made because of the safe harbor counting rules, the case involves a "closer call" that would be more appropriate to go through the review process outlined in Path 1 above. Similarly, if the estimate for social welfare activity is below 60%, also representing a "closer call," then we believe it would be more appropriate to go through the review process outlined in Path 1.
7. Applicants will have 45 days to return the optional representations to the IRS, and no denial determinations will be made in that 45-day timeframe.

8. Path 2 is completely optional for the applicant and no inference will be drawn from an applicant's choice about whether or not to participate.
9. If the applicant declines to pursue Path 2, the application will continue to be worked through Path 1 for its determination.
10. In either case, the applicant may still be subject to an examination by the IRS at a later date.

vi. Concurrent with the publication of this Report, and while continuing to process applications via Path 1, we are sending Path 2 representation letters this week to those applicants that remain in our priority backlog at the time of this Report.

c. **Pending Actions**:
   i. Continue processing the priority backlog items via the Path 1 option, while pursuing the Path 2 option in parallel.
   ii. Applications that are determined to be approved via Path 1 will receive their determination notice immediately upon decision.
   iii. Applications that are supported by the certifications associated with Path 2 will cease to be reviewed in the determinations process, and will receive their approval notice within two weeks of IRS's receipt of the certifications.
d. **Estimated Completion Date**: September 30, 2013.

TIGTA Recommendation 8: Recommend to IRS Chief Counsel and the Department of the Treasury that guidance on how to measure the "primary activity" of I.R.C. § 501(c)(4) social welfare organizations be included for consideration in the Department of the Treasury Priority Guidance Plan.

a. **Status**: Complete
b. **Actions Taken to Date**:
   i. IRS initiated discussion with the Department of the Treasury in May 2013 to discuss possible changes to the guidance on how to measure "primary activity" with respect to social welfare for 501(c)(4) applications. These discussions included the consideration of how to clarify the definition of "political campaign intervention."
   ii. The Department of the Treasury agreed to include these items in the next Priority Guidance Plan, consistent with the TIGTA recommendation.
   iii. See section below, Additional Considerations, for additional discussion.
c. **Pending Actions**:
   i. None remaining
d. **Estimated Completion Date**: May 2013

TIGTA Finding No. 3

The Determinations Unit Requested Unnecessary Information for Many Potential Political Cases

TIGTA Recommendation 9: Develop training or workshops to be held before each election cycle including, but not limited to, how to word questions in additional information request letters and what additional information should be requested.

a. **Status**: Ongoing
b. **Actions Taken to Date**:
    i. The Acting Director, EO has updated the business process associated with creating letters which request additional information from 501(c)(4) applicants, particularly with respect to potential political campaign intervention activity.
    ii. In particular, the Office of Taxpayer Correspondence, which resides in the Return Integrity and Correspondence Services unit within the Wage and Investment Division, has been engaged to begin to assist in this process in both an advisory role and an oversight role.
        1. The Office of Taxpayer Correspondence is the IRS hub for comprehensive correspondence services, ranging from design and development to effectiveness and downstream impact. This office helps the IRS business units provide consistency, quality, and plain language for notices and letters, with the goal of helping taxpayers take the appropriate action to resolve their tax issues.
c. **Pending Actions**:
    i. Under the oversight of EO management, the Office of Taxpayer Correspondence will create guidance on the appropriate content and wording of questions for use by the case workers who actually prepare the letters that request this additional information.
    ii. The Office of Taxpayer Correspondence will also assist EO Management in further enhancing the business process of letter preparation, providing a review of the content of these letters and the consistency in the application of the standards prior to dissemination to applicants.
d. **Estimated Completion Date**: The process changes and initiation of advisory services by the Officer of Taxpayer Correspondence went into effect on June 4, 2013. The pending actions will continue to develop, including the formal delivery of training, until January 2014 (or longer, if the support is still required).

Additional Consideration

It is important to make clear that the IRS does not write the country's laws (the Constitution places that responsibility in the hands of Congress), nor is the IRS responsible for the development of tax policy (the Department of the Treasury maintains that responsibility on behalf of the Administration). The IRS is responsible for *administering* the nation's tax laws and regulations. However, we would be remiss in any analysis of the problems associated with 501(c)(4) applications not to highlight the significant challenges that exist within the current construct of laws and regulations that govern this set of applications.

It has been a common refrain from Congress and the public that the rules that are applicable for 501(c)(4) eligibility are ambiguous and confusing, both for the taxpayer and for the staff within the IRS whose responsibility it is to administer those laws and regulations. Section 501(c)(4) provides exemption for organizations that, among other things, are "operated exclusively for the promotion of social welfare." Under regulations promulgated in 1959, an organization is deemed to meet this test if it is "primarily engaged in promoting in some way the common good and general welfare of the people of the community." The same regulations expressly exclude political campaign intervention from the definition of social welfare. The distinction between campaign intervention and social welfare activity, and the measurement of an organization's social welfare activities relative to its total activities, have created considerable confusion for both the public and the IRS in making appropriate 501(c)(4) determinations.

Both the taxpayer and the IRS would benefit greatly from clear definitions of these concepts. The lack of clarity did not cause the inappropriate screening and poor managerial oversight noted in the TIGTA report, nor does it excuse them. But we do believe that it played a role in the lengthy delays in at least some of the determinations associated with these cases.

3. Broad Review of IRS Operations and Challenges

Section Summary

In addition to fixing the problems identified in the TIGTA report, it is important that we respond to emerging questions from taxpayers on the extent to which similar issues may exist in other parts of the organization. To address these questions, we have initiated:

- A thorough review and vetting of the organizational failures that resulted in the problems identified in the TIGTA report;
- An assessment of whether similar issues exist in other IRS business units;
- A series of reforms to address each finding.

The table below summarizes our current conclusions resulting from this review.

Problem Area from TIGTA Report	Broader Applicability	Planned Reform
Use of inappropriate criteria to select taxpayers for increased compliance scrutiny. Criteria used to select taxpayers for increased compliance scrutiny in the 501(c)(4) application process violated the IRS Mission Statement.	There is no current evidence of the use of inappropriate criteria in other IRS business units or processes; however we recognize there is public concern in this regard and therefore additional mechanisms to evaluate appropriateness of criteria should be initiated.	Validate that screening and selection criteria are fully documented across all IRS business units and make them subject to routine objective review to address the concern that has been expressed.
Deficiencies in taxpayer service. Taxpayers confronting undue burden and delays with respect to the review of 501(c)(4) applications did not appear to have an effective mechanism to resolve matters through the IRS.	The IRS has mechanisms, such as the Taxpayer Advocate Service, to assist taxpayers who are having difficulty resolving matters with the IRS. However these mechanisms are not well understood by taxpayers and therefore are not being sufficiently leveraged.	Raise taxpayer awareness of their rights and tools, such as the Taxpayer Advocate Service, and further elevate the transparency of, and accountability for, taxpayer issues being routinely raised by the National Taxpayer Advocate.
Leadership awareness and accountability. Substantial delay occurred with IRS leaders responsible for overseeing the EO unit in identifying and addressing emerging risks.	The IRS Commissioner and other leaders across the organization have not always had sufficient knowledge of emerging operational risks within the various IRS business units.	Structural enhancements to improve the systematic and timely flow of information on emerging operational risks to the attention of the IRS Commissioner and other key IRS leaders, including the establishment of a new Enterprise Risk Management Program.

Disclosure of critical information to external stakeholders. Information on emerging risks within the EO unit shared with Congress was insufficient, despite specific inquiries into the matter.	Overall lack of information by IRS leaders on emerging risks stifles the timely flow of such information to external stakeholders, such as Congress and the IRS Oversight Board.	Establish routine reporting on IRS operational risks with Congress and the IRS Oversight Board (in cases where disclosure would involve taxpayer sensitive information, disclosure would occur on a confidential basis to the relevant Congressional tax committees).

Our broader review of the IRS also evaluated other challenges and opportunities that may exist. All organizations face challenges and risks, and it is our intent to raise awareness of these elements of our business in order to proactively mitigate them before they manifest themselves as true operational issues that could impact our ability to effectively fulfill our core mission. We will explore some of our challenges with respect to budget, cost management, human capital, and the overall complexity of our mission responsibilities.

Finally, any comprehensive review of IRS operations must recognize the many critical successes of the IRS in carrying out its mission. These successes not only positively impact the lives of many citizens, but also serve as a foundation for greater improvements in IRS operations in the future. They also remind us of the talented and dedicated employees of the IRS who are passionate about their mission to effectively serve the taxpayer and who stand ready to make the necessary changes to sustain a more effective IRS in the future.

Taxpayer Concerns – Issue Areas and Solutions

A thorough response to the TIGTA report requires an assessment of whether the risks and failures identified therein extend to other areas within the IRS. Our review has provided an opportunity to develop an initial set of conclusions regarding the IRS as a whole, beyond the inappropriate activities that occurred with respect to applications for tax exempt status. Our framework for thinking about this broader review has been grounded in the concerns and questions we are hearing from the public. We have summarized these issue areas as follows:

- Improved processes for IRS to validate the appropriateness of our compliance and enforcement efforts, and their consistency with the IRS Mission Statement;
- Enhanced mechanisms for taxpayers to address situations where they feel IRS actions are causing undue burden or delays; and

- Broader opportunities to drive greater accountability, transparency, and effectiveness in the IRS execution of its core mission.

The remainder of this Report provides a description of these issues and planned actions steps.

Improved Processes for Assessment of IRS Compliance / Enforcement Efforts

It is critically important to the effective working of our tax system that the public believes it is receiving appropriate treatment from the IRS that is consistent with principles of our mission statement. This was not the case for certain organizations applying for tax exempt status. The first two sections of this Report have highlighted how we are addressing those problems. In this section, we begin to assess such challenges in the context of other parts of the organization.

From what we have learned, the selection processes followed by the Determinations Group in the EO Unit are fundamentally different from the rest of the IRS in a number of ways. First, unlike most other parts of the laws that the IRS enforces, the 501(c)(3) and 501(c)(4) determinations processes involve the review of an applicant's political activity because whether the applicant is engaged in political campaign intervention is a factor in determining tax exempt status. Second, as previously discussed, the definitions and criteria associated with the laws and regulations for determining 501(c)(4) tax exempt status suffer from ambiguity that contributed in part, along with poor management and judgment, to the development of inappropriate selection criteria and subsequent delays encountered by taxpayers. All current indications are that this sort of political activity analysis, ambiguity, and subjective utilization of criteria does not occur elsewhere in the IRS. Whether in the divisions of Wage and Investment, Small Business / Self-Employed, or Large Business and International (our other major business units), there is no current evidence that our selection criteria is applied inappropriately. The selection criteria are constantly reviewed and adjusted based on extensive data collection and analysis, with the intent to yield the highest return on our enforcement dollars.

Despite these conclusions, the nature of the problems identified in the tax exempt application process, coupled with the concerns raised by taxpayers, warrants a review of certain process controls within the IRS. To this end, the new Chief Risk Officer at the IRS will establish a plan within 60 days that will initiate a comprehensive, agency-wide review of our compliance selection criteria, encompassing all business units across the IRS. To prepare for this review and assessment, we are working with the leadership of the major business units to conduct a thorough evaluation of all relevant documentation, and to prepare updates as warranted. This step will be followed by an analysis of these documented criteria and an objective assessment of the appropriateness of such criteria. We will then share the details of this assessment with the leadership of the Department of the Treasury, the IRS Oversight Board, and the Chairpersons of

the House Ways and Means Committee and the Senate Finance Committee.[5] After the initial agency-wide assessment is complete, we will pursue similar reviews of these processes and selection criteria for at least one of our major business units on an annual basis, and share those results in a similar fashion. Our expectation in carrying out these new procedures is that, with respect to the appropriateness and effectiveness of our compliance or enforcement selection criteria, we maintain consistent and robust standards across the IRS for:

- Documentation;
- Frequency of updates;
- Benchmarking across IRS business units;
- Objective testing and assessments; and
- Routine collaboration with appropriate external stakeholders on the results of all the aforementioned activities.

Enhanced Mechanisms for Taxpayer Recourse

As detailed in the TIGTA report, many of the applicants for tax exempt status faced long delays and unnecessary information requests, compromising their ability to reach an effective, timely, and appropriate resolution of their matter with the IRS. As detailed throughout this Report, breakdowns in managerial effectiveness at various levels within the IRS contributed to these unacceptable results. In addition to management missteps, our system also failed in this instance because more steps could have been taken to make these applicants aware of the avenues they can pursue to resolve open issues with the IRS.

The primary option for taxpayers that have difficulty resolving their IRS problems through normal channels is the Taxpayer Advocate Service (TAS). TAS was established as part of the IRS Restructuring and Reform Act of 1998, and has four primary functions:

i. Assist taxpayers in resolving problems with the Internal Revenue Service;
ii. Identify areas in which taxpayers have problems in dealing with the Internal Revenue Service;
iii. To the extent possible, propose changes in the administrative practices of the Internal Revenue Service to mitigate problems identified under clause (ii); and
iv. Identify potential legislative changes which may be appropriate to mitigate such problems.[6]

The Taxpayer Advocate has the authority to determine significant hardship and issue Taxpayer Assistance Orders that, among other things, can require the IRS "to cease any action, take any

[5] These entities are identified because they are allowed to review taxpayer information, pursuant to Internal Revenue Code Section 6103. To the extent legally allowable, this information will further be shared with the Ranking Members of these Committees along with other interested Committees within Congress.
[6] Internal Revenue Code § 7803(c)(2)(A)

action as permitted by law, or refrain from taking any action with respect to the taxpayer as permitted under the law."[7] According to the Taxpayer Advocate Service website (http://www.taxpayeradvocate.irs.gov/About-TAS/Who-We-Are):

> The Taxpayer Advocate Service (TAS) is *Your Voice at the IRS*. Our job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights. We offer free help to guide you through the often-confusing process of resolving your tax problems that you haven't been able to solve on your own. **Remember, the worst thing you can do is nothing at all!**

According to this same web site, TAS received nearly 220,000 new cases in Fiscal Year (FY) 2012, and was able to provide full or partial relief to the taxpayers in nearly 77% of the cases it closed. Moreover, both IRS employees and taxpayers can identify and elevate systemic problems to TAS through its Systemic Advocacy Management System (SAMS) at http://www.irs.gov/uac/Systemic-Advocacy-Management-System-(SAMS).

Thus, there is an avenue for taxpayers when they believe they are being treated inappropriately, are searching for recourse in resolving matters before the IRS, or need help because they have hardship circumstances that merit immediate attention. But, in this case, TAS was not involved in virtually any of the cases associated with the inappropriate treatment outlined in the TIGTA report with regard to 501(c)(4) applications. In fact, only 19 such cases were referred to TAS over the three-year period beginning at the start of 2010, the majority of which were referred by Members of Congress and not the taxpayer or IRS personnel. These results warrant specific improvements to the overall effectiveness of our TAS framework.

One of the primary sources of cases being referred to TAS is the IRS workforce. The workforce has an obligation to refer cases to TAS when they are unable to resolve a taxpayer's problem. Historically, this has rarely occurred within the EO unit and, as noted, did not occur for the concerned 501(c)(4) applicants in the matters described in the TIGTA report. It was the responsibility of IRS personnel in the EO unit to refer these cases to TAS, but that did not occur. As an important first step in addressing this shortcoming, the Acting Commissioner of the TE/GE division and the Acting Director, EO will work with the National Taxpayer Advocate to put a training program in place for all EO personnel on their responsibilities with respect to referring cases to TAS.

Of note, these processes often work as intended across most of the IRS. Personnel are properly trained and frequently do refer cases to TAS as required, although there are steps we can take to further emphasize these responsibilities on an ongoing basis. Moreover, there are other mandatory protections in place that are routinely administered in the proper fashion. For example, whenever any taxpayer has been identified for audit, among the first acts performed by the IRS is to send the taxpayer a copy of "Publication 1," *Your Rights as a Taxpayer* (see

[7] Internal Revenue Code § 7811

Appendix F for a copy of "Publication 1"). This document provides a clear listing of some of the most important rights provided to all taxpayers, including the following categories:

I. Protection of Your Rights
II. Privacy and Confidentiality
III. Professional and Courteous Service
IV. Representation
V. Payment of Only the Correct Amount of Tax
VI. Help with Unresolved Tax Problems (including contact information for the Taxpayer Advocate Service)
VII. Appeals and Judicial Review
VIII. Relief from Certain Penalties and Interest

Your Rights as a Taxpayer also explains the basic processes and rights associated with examinations, appeals, collections, and refunds. However, since the applicants for 501(c)(4) tax exempt status were not selected for audit, they did not receive "Publication 1." We are currently reviewing areas across the IRS where we believe the distribution of "Publication 1" may be appropriate even when audit selection is not occurring. We expect to complete this analysis and implement any changes in our current processes before the end of the current fiscal year.

Thus, processes are in place to inform taxpayers of their rights and to refer cases to the Taxpayer Advocate Service. However, the nature of the problems identified in the TIGTA report warrant additional steps to ensure these processes are fully leveraged across the IRS. We need to be sure that all IRS employees are aware of their responsibilities with respect to ensuring taxpayers know their rights, and, in particular, how to engage TAS when they feel they are being treated inappropriately or are encountering excessive bureaucratic obstacles. Therefore, beyond the additional training we will pursue specifically for the EO unit as highlighted above, the Acting Deputy Commissioner for Services and Enforcement will work with the National Taxpayer Advocate to evaluate the training provided to all of IRS employees in this regard, and modify it, as appropriate, to make necessary improvements to fill whatever gaps may exist in the current processes or actual behavior. These IRS officials will deliver an action plan to the Commissioner's Office within 60 days with any recommendations that will help mitigate the IRS's risks in this area. Finally, the National Taxpayer Advocate will provide the Commissioner's Office with any additional suggestions that should be considered for expanding national awareness of the TAS program. We recognize that budgetary constraints may limit our efforts in this regard, but we would like the opportunity to evaluate suggestions on how we can improve awareness of this important element of ensuring appropriate and consistent treatment of all taxpayers when dealing with the IRS.

Opportunities and Challenges in Driving Greater Effectiveness in IRS Operations

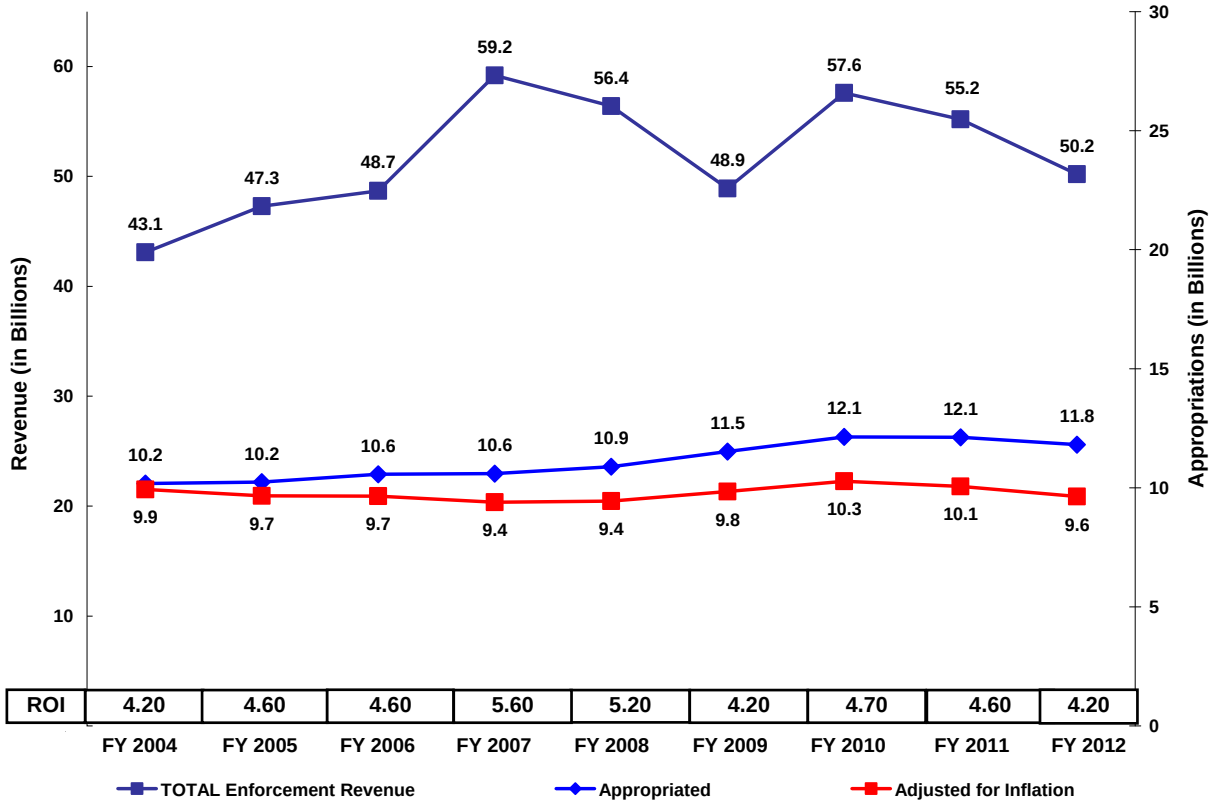
The IRS has an essential responsibility on behalf of the United States Government and the public. The IRS collects 92% of the Government's receipts, representing $2.524 trillion in gross tax receipts before tax refunds in FY 2012. At the same time, the IRS is challenged by many of the same concerns affecting other large organizations, both public and private sector, including budgetary concerns, human capital concerns, and overall programmatic execution concerns. In this section of this Report, we reflect on where we perceive challenges exist for the IRS at this point in time, as well as some concrete actions we are taking and ideas we have under consideration that will continue to position the IRS to successfully execute its mission. The specific topics for discussion include:

- Positive Results and Trends
- Budgetary Concerns
- Human Capital Challenges
- Mission Complexity
- Better Early Warning Systems Needed
- Transparency with Critical Oversight Organizations

Positive Results and Trends

Our first observation is that the IRS has been highly successful in mission execution across its broad portfolio for many years. From an investment standpoint, enforcement actions alone generate revenue of nearly $52 billion per year over the last decade, yielding an average Return on Investment (ROI) of $4.65 for every dollar invested in the IRS during that time (see Figure 2).

Figure 2: IRS: Positive Return on Investment



In terms of the most recent fiscal year, the following are just some of the key accomplishments that were delivered by the IRS in FY 2012:

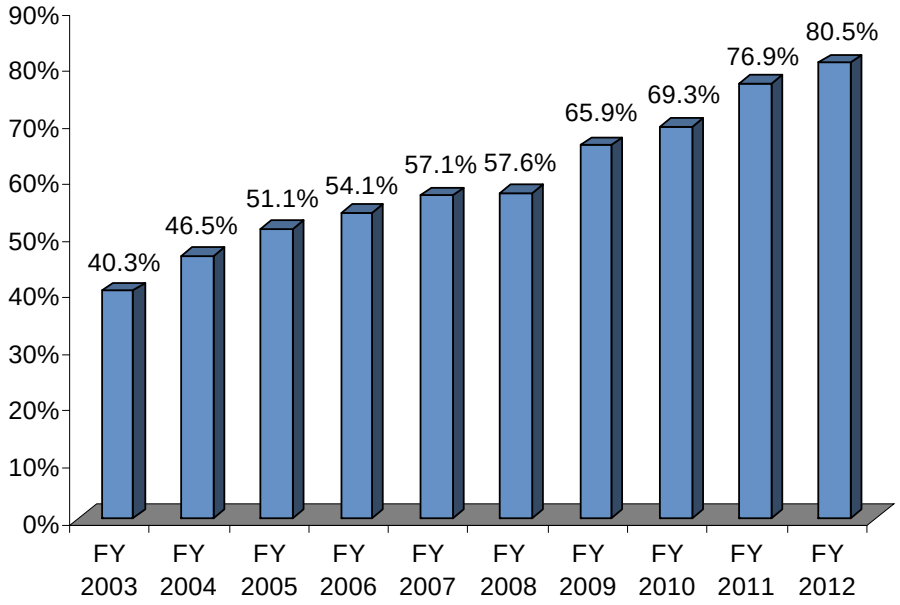
- The IRS enhanced international compliance efforts by implementing new legislation and programs such as the Offshore Voluntary Disclosure Program (OVDP). In January 2012, the IRS reopened the OVDP indefinitely with tightened eligibility requirements in response to strong interest from taxpayers and tax practitioners. From the establishment of the program in 2009 through the end of FY 2012, the OVDP has resulted in more than 38,000 disclosures of underpaid or unpaid taxes and the collection of more than $5 billion in back taxes, interest, and penalties.
- The IRS is working closely with businesses and foreign governments to implement the Foreign Account Tax Compliance Act (FATCA). This legislation strengthens offshore compliance efforts by creating new information reporting requirements on foreign financial institutions with respect to U.S. accounts and establishing new withholding, documentation, and reporting requirements for payments made to certain foreign entities.
- The IRS continues to implement its Return Preparer Program initiative, which began in FY 2011. The foundation of this program is mandatory registration for all paid tax return preparers. Through September 2012, more than 860,000 preparers have requested Preparer Tax Identification Numbers (PTINs) using the online application system. This

PTIN requirement provides an important and improved view of the return preparer community from which the IRS can leverage information to improve communications, analyze trends, spot anomalies, and detect potential fraud, including the refund fraud associated with the Earned Income Tax Credit (EITC) and identity theft. As a result of these efforts, the IRS initiated several hundred criminal investigations into return preparers and achieved a 97.3% conviction rate. The IRS also leveraged real-time data during the 2012 filing season to improve the compliance of more than 1,400 preparers with high numbers of EITC errors.

- The IRS provides year-round assistance to millions of taxpayers through many sources, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, www.irs.gov, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites.
- The IRS's Criminal Investigative unit was the lead agency in the takedown of Liberty Reserve, one of the world's largest and most widely used digital currency companies, and seven of its principals and employees. This investigation, which uncovered an alleged $6 billion money laundering scheme and the operation of an unlicensed money transmitting business, is believed to be the largest money laundering prosecution in history, involving law enforcement actions in 17 countries.
- The IRS continues to identify and stop fraudulent return filings and refunds through our Accounts Management Taxpayer Assurance Program (AMTAP) and Questionable Refund Program (QRP). In FY 2012 alone:
    - AMTAP stopped more than 2.6 million fraudulent returns and more than $19.2 billion in fraudulent refunds; and
    - QRP identified 1,708 schemes comprising more than 2,045,080 individual returns, detecting and preventing $12.3 billion in QRP refunds.

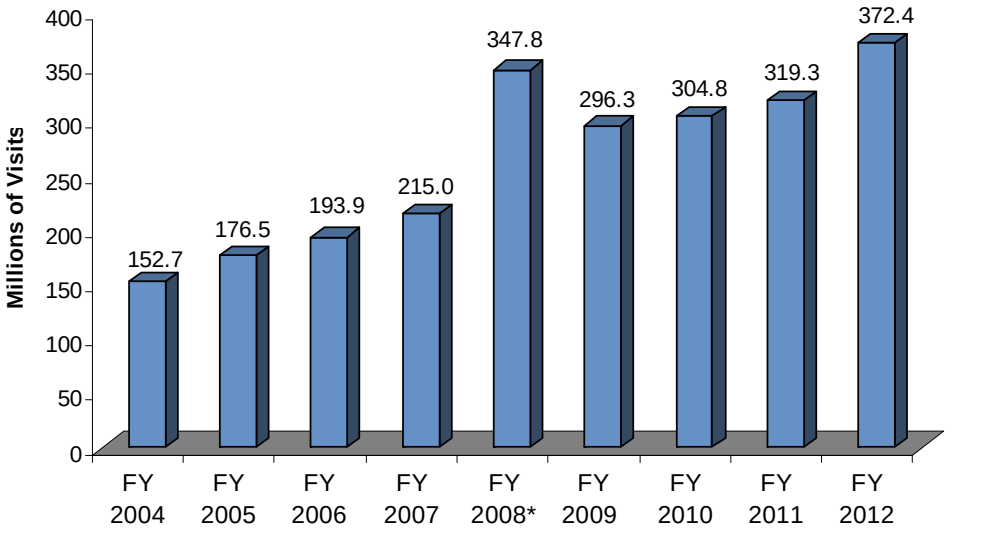
In addition to these positive results in recent years, we have seen a number of positive performance trends. For example, the percentage of individual taxpayers submitting their returns electronically has doubled in the last decade (see Figure 3), with more than 80% of taxpayers now using the e-File process.

Figure 3: Percentage of Individual Taxpayers Filing Electronically



The number of visits to IRS.gov has more than doubled in the last decade (see Figure 4).

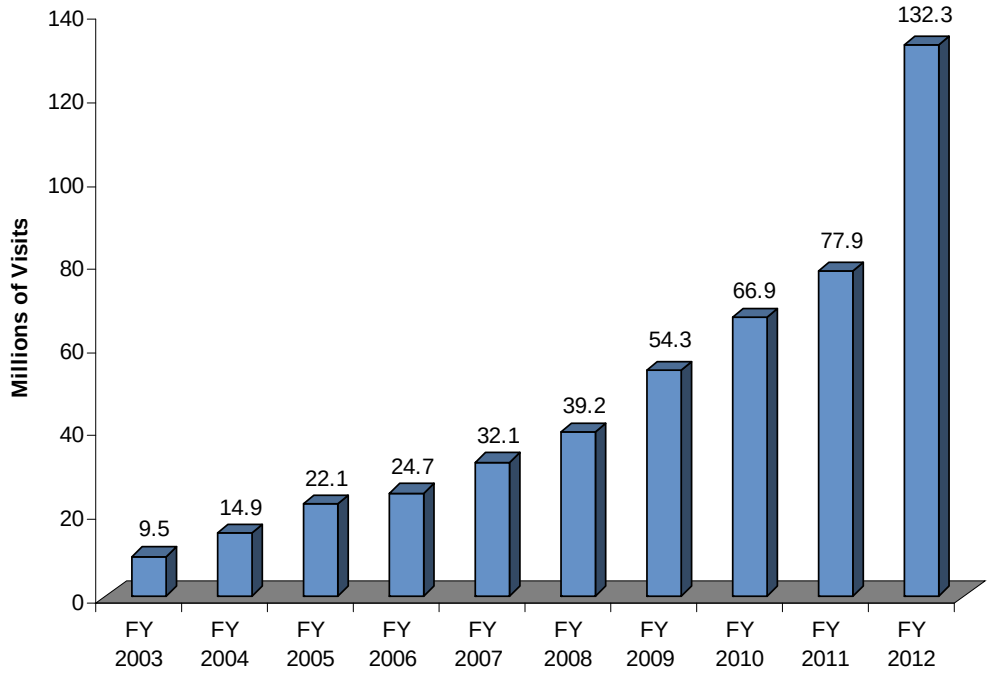
Figure 4: Number of Visits to IRS.gov



* The FY 2008 increase was primarily the result of taxpayers accessing the "Where's My Stimulus Payment?" application

We have also seen a dramatic increase in the use of the "Where's My Refund?" feature on the IRS website (see Figure 5). This tool, which is updated every 24 hours, has the most up-to-date information on refund status, thereby eliminating the need to contact the IRS by phone.

Figure 5: Use of "Where's My Refund?" On IRS.gov



These are just some of the technology-enabled innovations deployed and adopted in recent years that are driving down cost, driving up quality, and increasing the timeliness of taxpayer service.

Importantly, the Government Accountability Office (GAO) has also recognized the tremendous progress that the IRS has made in this area of information technology-enabled business modernization. In fact, GAO recently removed IRS from its bi-annual High Risk list in the category of Business Systems Modernization, where it had been for the previous 18 years. According to the GAO report:

> The Internal Revenue Service (IRS) made progress in addressing significant weaknesses in information technology and financial management capabilities. IRS delivered the initial phase of its cornerstone tax processing project and began the daily processing and posting of individual taxpayer accounts in January 2012. This enhanced tax administration and improved service by enabling faster refunds for more taxpayers, allowing more timely account updates, and faster issuance of taxpayer notices. In addition, IRS has put in place close to 80% of the practices needed for an effective investment management process, including all of the processes needed for effective project oversight.[8]

These modernizations have been critical to improving both the efficiency and effectiveness of the IRS, thereby decreasing risk to the organization and taxpayers. One of our biggest concerns, however, is our ability to continue to innovate and invest in modernization due to the significant budget challenges facing the agency, which is the subject of the next section of this review.

[8] *High Risk Series: An Update*, Government Accountability Office. GAO-13-283. February 14, 2013.

Budgetary Concerns

Like all Federal agencies, the IRS has been challenged in this period of budgetary constraints and uncertainty. Since FY 2010, the IRS has received reductions to appropriated funding totaling almost $1 billion. In FY 2013 alone, sequestration and a rescission combined to reduce the IRS budget by $618 million. As an example of the effects of these constraints, during the period of time that this Report was being developed, we have experienced two agency-wide furlough days where the entire agency was shut down. The IRS will have another furlough day in early July, with the possibility of up to two additional furlough days before the end of the fiscal year. These furloughs, coupled with another year of an exception-only hiring freeze, are having real impacts, not only on our workforce, but also on our ability to serve the taxpayer.

The IRS's FY 2014 budget request projects the resource needs to solidify our workforce and invest in critical programs that will enable better service to the taxpayer and a better return on the investment in the IRS. We have core program needs that must be addressed, or service and enforcement will undoubtedly be impacted. In addition, we have taken on new legislatively mandated responsibilities, including the implementation of Merchant Card Reporting, the Foreign Account Tax Compliance Act (FATCA), and the tax-related provisions of the Affordable Care Act (ACA), each requiring an investment in resources that, without additional funding, must be absorbed into our declining baseline budget. Moreover, we have clear opportunities to increase tax revenue through enhanced enforcement and prevention of refund fraud activities, and by being more responsive to taxpayers, but we will fall short on these opportunities if sequester-level funding persists into FY 2014. The bottom line is that many of our most innovative and far-reaching programs are at risk for delay or cancellation without adequate funding.

We are acutely aware that simply increasing budgetary resources does not always solve the problem. In fact, very few of the solutions proposed in this Report thus far implicate the need for additional funding. The primary emphasis of this review and the solutions posed herein is on leadership, training, processes, policies, communication, accountability, and risk mitigation as focus areas for enabling solutions that address the challenges we face at the IRS. However, the negative repercussions that will result if our funding is inadequate to meet our mission objectives present real issues for this organization and must be considered in any overarching review of IRS operations and risks. If we do not have funds to invest in our people in terms of recruiting new talent and sufficiently training our existing staff, as well as investing in the technology necessary to continue to build on the modernization efforts delivered over the last several years, there is no question that our service levels will suffer.

Confronted with the current reality of declining budgets, the IRS has already taken numerous steps to reduce our cost of doing business. Beginning more than two years ago, the IRS began putting into place new guidance and controls to create additional efficiencies in routine operations, in order to ensure minimal impact to the delivery of our core mission. Specific

actions that the IRS has taken to achieve greater cost savings and efficiencies fall into several major areas, including the following:

Personnel

- In FY 2011, a hiring policy started that allowed hiring only on an exception basis, requiring approval by the Deputy Commissioners.
- Buyouts were offered to 7,000 employees in FY 2012, with 1,244 employees accepting the offers.
- Full-time staffing at the IRS has declined by more than 8% over the last two years – about 8,000 positions.

Travel and training

- The IRS limited employee travel and training to mission-critical projects beginning in FY 2011. Training travel alone has been reduced by $83 million from FY 2010 to FY 2012.
- The IRS has expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel. The IRS estimates that, by the end of FY 2013, training costs will have been reduced by about 83% and training-related travel costs by 87% when compared to FY 2010 levels.

Space optimization

- In May 2012, the IRS announced a sweeping office space and rent reduction initiative that over two years is projected to close 43 smaller offices and reduce space in many larger facilities. Once complete, the initiative will slash IRS office space by more than 1 million square feet.
- The IRS continues to find innovative ways to do more with existing space, such as developing new workspace standards to decrease individual office size, as well as enhancing telework opportunities for our staff.

Printing and postage

- In FY 2011, the IRS eliminated the practice of mailing tax form packages to taxpayers at the beginning of the filing season. Taxpayers are now directed to IRS.gov for the tax forms they need.
- All non-campus IRS employees have been converted to paperless Earnings and Leave statements.

These have been successful efforts to try to maintain our levels of service while absorbing the budget reductions we have experienced. However, there are risks associated with such dramatic reductions in resources in such a short period of time. For example, as part of our recent workforce attrition, staffing for key enforcement occupations fell by 5,000 during the last two years, and, in the past year, enforcement positions declined by more than 1,300 jobs — a nearly 6% reduction. There are limits to the efficiencies we can absorb without negative ramifications

on our ability to fulfill our mission in the manner expected of us by the public. If we are not allowed to invest in future priorities, such as through strategic hiring, critical training, and targeted innovations in information technology, we will undoubtedly see a degradation in taxpayer service that adds risk to our voluntary compliance program, as well as a reduction in returns in the area of enforcement revenue, thereby further eroding government receipts. We will also lose critical institutional knowledge and compromise overall productivity if we fail to replace departing staff and inhibit our ability to recruit and grow the future leaders of the IRS.

Given the seriousness of our budget situation, and the uncertainty about the prospects for funding increases in the near future, we must be dedicated to investing every dollar entrusted to us by the public in a wise and prudent manner. Simply put, we have no room for unnecessary expense in the IRS. Moreover, we have also begun to revisit policies that may have been considered appropriate in the past but that are no longer fiscally prudent given our current constraints.

In this regard, we benefit from the fact that TIGTA is also on the lookout for inappropriate or unnecessary spending across the IRS that should be eliminated. Two TIGTA reviews, one included in a recently released report on training and conferences and another ongoing review on executive travel, have resulted in further opportunities to assess expenses, identify opportunities for change, and issue new policies where appropriate to further constrain spending. In both of these instances we have initiated policy changes to eliminate the kinds of expenditures that are no longer appropriate for the IRS.

On May 31, 2013, TIGTA issued a report on a conference held for managers in the Small Business / Self-Employed Division in Anaheim, California in 2010.[9] The report highlighted a number of management lapses that led to wasteful spending of taxpayer dollars. Many of these failures reflected a lack of judgment that, unfortunately, was not uncommon across the Federal Government in the years leading up to 2010 when this conference took place. We are pleased to report that, under the leadership and direction of the Department of the Treasury, the IRS has been aggressive in changing its business practices in this area, taking a completely new approach to training and conferences since that time. In fact, through FY 2012, the IRS reduced its annual spending on training and conferences sessions with more than 50 travelers by more than 80% since FY 2010. New procedures and management oversight structures are now in place at the IRS in this area, and we are confident that an event like the one referenced in the TIGTA report would not occur at the IRS today.

Another example in which work by TIGTA is informing our thoughts on management processes at the IRS is an ongoing review on the topic of executive travel. Based on details that have materialized through the course of this audit, we have come to conclusions regarding a long-standing IRS policy on executive travel that we believe is no longer appropriate in our current

[9] *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California*, Treasury Inspector General for Tax Administration. Reference Number 2013-10-037. May 31, 2013.

fiscal environment. TIGTA has examined how the IRS defines an individual's Post of Duty (POD) location, and our practice with a number of senior executives who have been permitted to reside in the location of their POD, but travel to another location to conduct their principal work. A few of IRS's senior executives have been operating in this mode for a number of years, receiving reimbursement for air travel, lodging, and per diem costs while traveling to their regular work location. It is important to note that this practice has been within permissible guidelines in the Federal Travel Regulation and with appropriate approvals from IRS senior management. In fact, those executives who have been commuting in this fashion more than six months of the year do so in a Long-Term Taxable Travel status and pay income taxes on a portion of their travel reimbursement. However, in the tight fiscal environment in which we find ourselves, and at a time where the entire IRS population is experiencing furloughs, the practice is no longer an appropriate use of scarce funds, and we have put a new policy into place that will no longer support this practice in the future.

Our immediate challenge in implementing this new policy is that a number of senior and critical members of our executive team are participants in this program, and an immediate halt to the current practice without a reasonable transition period would be unacceptably disruptive to an organization that is already undergoing significant organizational and leadership adjustments. To that end, we will facilitate the transition in a responsible way that does not introduce unnecessary short-term risks to the agency and allows a reasonable, yet limited, transition period to the new policy for the current executives.

Budgetary risks exist throughout the IRS, and it is incumbent on all of our managers and staff to protect every dollar as much as possible. Where we find opportunities to reduce costs, we will take them. We cannot afford any unnecessary expenditures when so much is at risk in terms of our ability to maintain the necessary level of service, our ability to invest in high-return innovations, and our ability to effectively implement our highest priority programs.

Human Capital Challenges

We have made a number of references in this Report to how critical the IRS workforce is in fulfilling our mission, which includes the objective to make improvements across the IRS whenever necessary. In spite of extensive modernization and automation deployed at the IRS over the years, we are still fundamentally a "people organization." Nearly 75% of our budget goes to human resources. People execute and oversee our processes. They are our primary source of mission accomplishment and our first line of defense against inappropriate behavior. Typically they help mitigate risks, but if not adequately trained, they can also create risk on behalf of the IRS.

We have already discussed the importance of effective leadership as a fundamental necessity for successful execution of any organizational mission. When that leadership is ineffective, as it was

in the case of the management associated with the processing of applications for tax exempt status, then changes need to be made. The actions we have taken in this regard further emphasize the importance we put on having effective leaders in place as essential for successful outcomes in performance.

The various business units of the IRS are led by highly experienced and talented leaders, many of whom have spent 20 or more years dedicated to fulfilling the mission of the IRS. In fact, one of our primary risks is that many of our most valuable leaders are eligible for retirement. We also have several talented leaders in place in newly assigned positions, but they are only in Acting status, and thus we require long-term solutions for these positions. Re-establishing stability at all levels of leadership within of the organization is a top priority as we lead the IRS and its workforce beyond the current set of challenges.

We also recognize that these have been difficult times for our overall workforce, more than 99% of whom had nothing to do with the actions related to the processing of applications for tax exempt status. The IRS workforce, which is also undergoing furloughs, has also had to absorb additional work as new legal and regulatory requirements continue to be assigned to the IRS, often without additional resources, and during a period in which a hiring freeze has limited the ability to bring in additional staff to support the additional workload. Our entire leadership team must actively engage with our staffs during these difficult times, providing them the support they need to effectively fulfill their duties.

We also see this point in time as a "back-to-basics" opportunity to remind our employees why we are here and what our fundamental role is, as well as the core elements of our Mission Statement, our values, and our overall responsibilities. To this end, we are preparing to design and deliver universal, mandatory training on many of these core principles. When employees join the IRS, they must go through an on-boarding process that emphasizes the critical responsibilities we have on behalf of the public, and the ethics to which we must adhere each and every day. We also learn upon entry about a number of key elements of internal controls and our collective responsibility to adhere to these systemic and behavioral guidelines that minimize the risk of inappropriate behavior from occurring. We further communicate the basics about what to do when inappropriate behavior is observed and how to address issues before they expand into highly impactful situations. This includes elevating issues to the appropriate levels of management and to the National Taxpayer Advocate when solutions are not forthcoming in a timely fashion. It is these elements that keep us on the right path, especially when confronted with challenging situations for which competing perspectives may make decision-making difficult. Adherence to these values, principles, and behaviors is evident throughout the IRS, embedded in the daily actions of the vast majority of our workforce. However, it is appropriate to be routinely reminded of the core values on which decisions must be made, and the institutional aids and protections that are available to assist when confronted with the issues and concerns we face today.

The training we are preparing will be a combination of these elements, representing a conscious attempt to remind our workforce of these responsibilities and specific guidelines on how best to achieve them on a daily basis. We will begin with instructor-led training for all of our executives and front-line managers, and then transition to online training that will be required for our entire workforce. We have established the following timeline for the creation and delivery of this critical set of training:

- Creation of instructor-led training material: August 31, 2013
- Delivery of instructor-led training (regionally and/or via video) to senior executives and managers: September 30, 2013
- Adaptation of training material for online utilization: September 30, 2013
- Completion of online training by entire IRS workforce: December 31, 2013

For much of the IRS population, this training will primarily represent reminders for behaviors that they already exhibit on a daily basis. Nevertheless, we believe they are important reminders to ensure we remain grounded in these principles and continue to adhere to them on a consistent basis throughout the entire IRS community.

Mission Complexity

As mentioned in Section 2 of this Report, the IRS does not make the nation's tax laws. Rather, we administer and enforce them. However, a review of IRS mission execution must entail some review of IRS mission complexity. A few facts from the *2012 Annual Report to Congress* from the National Taxpayer Advocate[10] are helpful in framing this discussion:

- "A search of the [Internal Revenue] Code conducted using the 'word count' feature in Microsoft Word turned up nearly four million words.
- Individual taxpayers find return preparation so overwhelming that about 59% now pay preparers to do it for them. Among unincorporated business taxpayers, the figure rises to about 71%.
- According to a TAS analysis of IRS data, individuals and businesses spend about 6.1 billion hours a year complying with the filing requirements of the Internal Revenue Code. And that figure does not include the millions of additional hours that taxpayers must spend when they are required to respond to IRS notices or audits.
- Despite the fact that about 90% of individual taxpayers rely on preparers or tax software packages, the IRS received more than 115 million calls in each of the last two fiscal years."

[10] The data in this section can be found in: *National Taxpayer Advocate, 2012 Annual Report to Congress (Volume One)*. December 31, 2012.

The data point that may be the most relevant to this question of the ongoing challenge facing the IRS in terms of its ability to execute its mission is that, according to this same report from December 2012 by the National Taxpayer Advocate, "there have been approximately 4,680 changes to the tax code since 2001, an average of more than one a day." The IRS has a long history of successfully meeting these challenges. For example, substantial tax law changes were enacted as late as January 2, 2013, just before the IRS would normally begin accepting e-filed returns. IRS staff worked quickly and diligently to make the changes to systems and forms necessary to open what turned out to be another successful tax filing season. Similar examples of rapid adjustment to emerging requirements can be found throughout the history of the IRS, and we will continue to always strive to respond to new requirements in an efficient and effective manner. Nevertheless, a review of the overall challenges faced by the IRS with respect to mission execution must recognize that this constant change in the tax code makes its administration more difficult for the IRS and the public. This is especially true for the IRS at a time of dramatically decreased funding, reduced staff, and major new requirements that continue to add to the complexity of our mission.

Better Early Warning Systems Needed

All organizations face challenges. A leadership imperative is to establish the ability to quickly and accurately identify those challenges and put solutions into place long before they turn into operational issues. One of the most critical failures identified in the TIGTA audit is the timeline associated with how long issues were allowed to persist without management engagement to resolve them. It has become clear that part of these inexcusable delays resulted from inadequate mechanisms put in place to alert various levels of senior management to the presence of inappropriate criteria, the growing backlog, and the dissatisfaction by the applicants for tax exempt status. The performance measures in place failed to highlight these emerging risks, and the communication flow up and down the chain of command from staff to senior management failed to effectively convey these circumstances. To address these failures, and enhance protocols that already exist in other units across the IRS, we are initiating a number of actions to establish a risk-based "early warning system" that will focus on many of the potential risks discussed in this section of this Report.

There are three specific elements that will comprise these current efforts:

- Establishing a robust Enterprise Risk Management Program;
- Strengthening the IRS-wide Performance Management System; and
- Enhancing communication flow to all layers of management, up to and including the IRS Commissioner's office.

Establishing a Robust Enterprise Risk Management Program

Large and complex organizations such as the IRS are always under threat of risks – large and small, strategic and tactical – presenting the potential to dramatically affect performance in both mission delivery and operational support. The recent failures that occurred with respect to applications for tax exempt status highlight the need to evaluate how risks are identified, prioritized, evaluated, and mitigated across the IRS enterprise. A robust Enterprise Risk Management (ERM) Program is being established that will:

- Provide clear lines of sight into key risks and related controls;
- Determine what risk areas could negatively affect the IRS's ability to carry out our mission;
- Identify resources, processes, policies, and procedures needed to proactively manage risk;
- Create awareness and leverage any existing risk management infrastructure in the operating units;
- Provide a coordinated and common framework for capturing and reporting risk information; and
- Share risk mitigation practices across the IRS.

We will establish a risk office, governance structure, policies, procedures, tools, and training needed to carry out the ERM program.

Our ERM program will be led by the Chief Risk Officer, a position established in late May 2013 as one of the first acts of the new Principal Deputy Commissioner of the IRS. This new position is strategically placed at the top of the organization to assist the Commissioner and the Deputy Commissioners in identifying and mitigating risks before they evolve into significant issues, as well as providing transparency to these risks to our oversight stakeholders such as the IRS Oversight Board and our authorizing committees in Congress. The Chief Risk Officer will also be a central player in addressing some of the key risks that emerged from the TIGTA report and that have potential implications across the entire IRS. To fill this role, we have appointed David Fisher, who will also serve as a Senior Advisor to the Commissioner. Mr. Fisher formerly served as the Chief Administrative Officer / Chief Financial Officer at the Government Accountability Office, responsible for all internal operations at the nonpartisan Congressional watchdog.

The goal of the ERM program is not to achieve zero risks. Rather, the objective is to have a program in place that can properly identify and assess risks, and provide senior management the information necessary to make sound decisions, with risk being one of the core elements of the decision-making framework. Our new Chief Risk Officer has already begun evaluating many of the elements of risk management currently in place throughout the IRS. He will be synthesizing

that information with best practices utilized at other organizations of similar size and complexity to formally establish a robust Enterprise Risk Management program at the IRS.

Finally, it is important to note that risk management cannot be an isolated function. It requires a seat at the table with the most senior executives in the organization, where enterprise-level risks can be identified, assigned for action, and monitored for success or further mitigation. The IRS Chief Risk Officer will be responsible for implementing such a program, but will do so in collaboration with the business owners in order to yield the kind of results that will bring transparency to critical organizational risks and provide the opportunity to mitigate them long before they have negative impacts on the IRS.

Strengthening the IRS-wide Performance Management System

The foundations for an effective performance management system are establishing the right metrics, at the right time, in the hands of the right people. It is apparent that the IRS maintains a robust set of measures that track performance at many levels of the organization. It is also clear that there is room for improvement. For example, despite all of these metrics, early warning signs were not sufficient to enable IRS management and senior leadership, including the IRS Commissioner's Office, to detect the inappropriate criteria and growing backlog associated with the processing of applications for tax exempt status for an extended period of time.

The fundamental purpose of a performance management system is to provide management with insight into deviations from expected and planned performance. When performance exceeds plan, it is an opportunity to understand and share good practices. When performance is below plan, it should provide alerts for prompt corrective actions *before* unacceptable levels of activity are allowed to persist. In particular, the use of leading indicators that can inform an organization of potential problems before performance is impacted. Moreover, the selection of the right metrics is far more important that the sheer volume of measures that may be tracked. In fact, greater quantity of measures can sometimes overwhelm the system, thereby inhibiting proper risk analysis when buried in too many numbers and graphs.

Some potential metrics that could have been helpful in this particular case, include:

- Comprehensive aging of inventory backlog of applications received yet not resolved
    - The EO unit did track aged inventory, as do most IRS organizations, but not at a level of detail that would provide sufficient insight into the rapidly evolving nature of the growing backlog of 501(c)(4) applications;

- Frequency with which senior managers review work product and criteria established for evaluation purposes, with a particular focus on those work products that represent the greatest risks to the IRS; and
- Number of Congressional inquiries on a particular topic.
    - While this is clearly a lagging indicator, it is another mechanism in which to draw attention to significant risks for senior management.

Getting performance information into the right hands is also critical. The current performance measurement system is designed for the IRS Commissioner to receive formal performance briefings only from the offices that report directly to the Commissioner's Office. This includes offices such as Appeals, the Office of Research, Analysis and Statistics, and the Taxpayer Advocate. By contrast, the key tax administration business units (Wage and Investment, Small Business / Self-Employed, Large Business and International, and Tax Exempt / Government Entities) conduct their performance reviews with the Deputy Commissioner for Services and Enforcement, while the Chief Officers do the same with the Deputy Commissioner for Operations Support. These reviews are currently conducted on a quarterly basis. While the reviews have consistently generated positive outcomes, our current circumstances require adjustments to these practices, with reviews to be performed on a more frequent basis and with more direct involvement by the Commissioner.

To strengthen our performance management system, the new IRS Chief of Staff, in conjunction with the IRS Deputy Commissioners and our new Chief Risk Officer, will perform a comprehensive review of the performance measures in place today at the IRS. This process will be done in two phases. We will immediately begin monthly performance reviews for the IRS Commissioner with the four tax administration units, with a program that streamlines the quarterly process currently in place. For the longer term, we have directed that this review be focused on risk-oriented indicators, and if gaps are found with our current measures in this regard, they are to further evaluate the means by which new measures can be established that will provide more timely and useful insight into these important risk areas. We expect this review to be concluded by the end of the fiscal year, and to include recommendations on how to adjust our performance measurement system under the guise of a risk-based early warning system, thereby providing senior management with the visibility to emerging systemic risks long before they materialize on a widespread basis.

Enhancing Communication Flow to All Layers of Management

As indicated in this Report, the timeline in the TIGTA report indicates extensive delays in processing and inappropriate treatment of taxpayers applying for tax exempt status, apparently with no or limited knowledge by senior management. This lack of awareness was not only a failure to communicate from the bottom-up, but also a failure on behalf of senior management to

remain aware of what was going on in their units of responsibility. Managers are there to manage and solve problems, yet they cannot do so without knowledge of the situation, highlighting an imperative for effective communication that must exist at all levels of the organization. We must understand the nature of impediments to effective communication flow at the IRS, and mitigate the risks that ensue by implementing solutions for improvement in this regard.

Our ability to effectively manage the IRS and maintain the commitments in our Mission Statement will be strongly influenced by our ability to overcome the barriers to effective communication and issue escalation within the management ranks of the IRS. One of the cultural aspects of the IRS, like many large institutions, is that individual business units are motivated to solve their own problems. While this can often lead to positive results, many IRS business units have historically been reluctant to elevate issues, at least in part, out of concerns of being perceived as somehow failing to fulfill their duties. This is a cultural element that needs to change. Front-line staff members and management must be comfortable elevating issues without concern of negative repercussions. Training is needed for both staff and management to overcome this cultural barrier to effective communication. The new IRS Chief of Staff will work with the IRS Senior Executive Team to understand the nature of this challenge and provide recommendations to the IRS Commissioner's Office on how to change this pattern of behavior.

Our risk-based approach to performance measures described above will also play a role in our improved effectiveness in communication throughout the organization. As we select these risk-based measures, they will assist in helping the IRS management team to become more accustomed to the kinds of risks that require escalation and collaboration. Transparency and frequency of results from these strategically identified risk-based measures will provide a platform to engage in mutual recognition of evolving risks for front-line managers, senior executives, and the oversight community with which we will share these results. Effective communication amongst and between these responsible parties must be a part of any solution to improve the IRS's ability to quickly and effectively address issues before they materialize on a grand scale.

Major issues, such as the ones experienced with applications for tax exempt status, cannot be allowed to persist without knowledge of and the opportunity for intervention by senior management. This is a risk area for the IRS that requires immediate attention and long-term solutions, with a clear focus on transparency and a willingness to communicate up and down the management chain.

Transparency with Critical Oversight Organizations

External stakeholder organizations provide the IRS with an invaluable function of guiding us to the right outcomes and approaches in fulfilling our mission. Therefore, our improvement plans

must include greater input and involvement of our oversight organizations, beginning with Congress. One of our failures in relation to the application process for tax exempt status was not only that the IRS did not properly inform Congress about the issues as they were occurring, but that we failed to do so even after Congressional committees specifically began asking questions on the topic. As we develop early warning systems, enhance communication, and establish additional policies and reviews, it will be our commitment to inform our authorizing committees in Congress about our plans and results. We further commit to inform these committees when we identify significant deviations in performance or expectations. Finally, it will be our commitment to collaborate with these committees on solutions to problems, sharing ideas and listening to suggestions, and not trying to problem-solve in isolation but rather embracing a more open exchange of ideas.

Another external entity that can provide similar oversight and insight across this spectrum of challenges is the IRS Oversight Board. The Board was created by the IRS Restructuring and Reform Act of 1998, which was enacted to improve the IRS so that it may better serve the public and meet the needs of taxpayers. The Oversight Board is a nine-member independent body charged with overseeing the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws and to provide experience, independence, and stability to the IRS so that it may move forward in a cogent, focused direction.

The Board has informed the IRS Commissioner's Office that it recently established a Risk Committee, to focus and enhance the oversight that it provides. The Risk Committee charter is under development, with an emerging expectation that it will focus on monitoring a number of risk categories, such as some of the following:

- Fair and impartial treatment to all taxpayers;
- Timely, accurate, and professional customer service to taxpayers;
- Taxpayer information is safe from inappropriate disclosure;
- The Service manages its costs in a manner that optimizes taxpayer resources;
- Major initiatives are effectively managed and executed to achieve expected results;
- The Service has the appropriate human resources in place to sufficiently meet the needs of fulfilling the IRS mission; and
- The effective enforcement of the U.S. tax laws and regulations.

The establishment of this committee fits with our vision of elevating the management of risks across the IRS through a new Enterprise Risk Management program. Moreover, these risk categories are consistent with many of the findings and needs identified in this Report. We look forward to close collaboration with this committee, and the Oversight Board in general, as we

fulfill our responsibilities to ensure that the IRS is operating in an efficient and effective manner that yields positive results.

To sum up this initial review, it is clear that the IRS is a large, complex, and essential enterprise, responsible for a critically important mission on behalf of the public. But with that scale and complexity comes inherent challenges. Our new leadership team is focusing on these challenges and on aligning our resources to address them with greater openness and transparency, enhanced internal communication, and greater engagement with our external oversight bodies. We anticipate that many of these actions will validate that existing processes are effective and provide confidence for robust mission execution. Where opportunities for improvement are identified, we will have enhanced processes in place to execute those improvements. These actions are designed to sustain the trust with the American people and to allow us to fulfill our critically important mission.

Concluding Thoughts

This Report represents an initial review and action plan. We had a series of failures in the process for review of tax exempt applications, and we are moving quickly to address them. We have made a number of changes already, more are in the works, and more will develop as we learn additional information. We are also moving aggressively to identify any other risks that might exist throughout the IRS, and we are putting procedures into place to bring them to light sooner, with a commitment to transparency to share what we find with all relevant stakeholders, including the oversight community.

Our external outreach efforts will continue as we look to implement the aggressive program that has been put forth in this Report. These are our ideas and plans, but we are now looking for feedback. We have identified specific actions we are taking in this Report, but we also raise questions. Those questions deserve further dialogue amongst key external stakeholders and the public, and we will be listening for input.

The IRS is committed to correcting its mistakes, holding people accountable, and establishing control elements that will help us mitigate the risks we face. The people of the IRS are committed to the principles of our Mission Statement, which calls for us to operate with integrity and fairness to all. We serve a vital purpose for this country, and we need to earn and maintain the trust of the public in order to accomplish that mission. We are firmly moving in that direction, and we will continue to report on our progress on a regular basis as we fulfill our commitments.

Appendix A: The "Douglas Factors"

Appendix A

The "Douglas Factors"

(1) The nature and seriousness of the offense, and its relation to the employee's duties, position, and responsibilities, including whether the offense was intentional or technical or inadvertent, or was committed maliciously or for gain, or was frequently repeated;

(2) The employee's job level and type of employment, including supervisory or fiduciary role, contacts with the public, and prominence of the position;

(3) The employee's past disciplinary record;

(4) The employee's past work record, including length of service, performance on the job, ability to get along with fellow workers, and dependability;

(5) The effect of the offense upon the employee's ability to perform at a satisfactory level and its effect upon supervisors' confidence in the employee's work ability to perform assigned duties;

(6) Consistency of the penalty with those imposed upon other employees for the same or similar offenses;

(7) Consistency of the penalty with any applicable agency table of penalties;

(8) The notoriety of the offense or its impact upon the reputation of the agency;

(9) The clarity with which the employee was on notice of any rules that were violated in committing the offense, or had been warned about the conduct in question;

(10) The potential for the employee's rehabilitation;

(11) Mitigating circumstances surrounding the offense such as unusual job tensions, personality problems, mental impairment, harassment, or bad faith, malice or provocation on the part of others involved in the matter; and

(12) The adequacy and effectiveness of alternative sanctions to deter such conduct in the future by the employee or others.

Appendix B: "Be on the Lookout" (BOLO) Process Update Memo (May 17, 2012)

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

May 17, 2012

MEMORANDUM FOR MANAGER, EO DETERMINATIONS

FROM: Holly Paz /s/ *Holly Paz*
Director, EO Rulings and Agreements

SUBJECT: Be On the Look Out (BOLO) Spreadsheet

The purpose of this memorandum is to set forth the procedures to be used with regard to the Be On the Look Out (BOLO) spreadsheet.

Abusive Transactions and Fraud Issues, Emerging Issues, and Coordinated Processing[1] cases will all be tracked on a single combined Be On the Look Out (BOLO) spreadsheet.

(a) The spreadsheet is maintained to enable EO Determinations specialists to be informed about the current status of abusive transactions and fraud issues, emerging issues, coordination, and watch issues, and to process cases in a consistent manner.

(b) Abusive Transactions and Fraud Issues, Emerging Issues, and Coordinated Processing will each occupy a separate tab of the spreadsheet.

(c) A fourth tab, the “Watch List” will list recent developments such as changes in the law, current events, or specific issues that EO Determinations management believes has the potential to impact the filing of applications.

The Emerging Issues coordinator will maintain the combined spreadsheet including:

(a) Creating original entries for new emerging issues and entering them on the appropriate tab of the spreadsheet.

(b) Creating original entries for new coordinated processing cases and entering them on the appropriate tab of the spreadsheet.

(c) Receiving issue updates from the abusive transaction and fraud group and entering them on the appropriate tab of the spreadsheet.

[1] Coordinated Processing cases are cases that present similar issues and thus are to be handled by a single team or group in order to facilitate consistency.

(d) Receiving “Watch List” updates from senior management and entering them on the appropriate tab of the spreadsheet.

(e) Updating the spreadsheet as necessary.

All original entries and updates to the BOLO must be approved by the group manager of the Emerging Issues Coordinator. The group manager of the Emerging Issues Coordinator must obtain the approval of the Manager, EO Determinations to all original entries and updates to the BOLO. The Manager, EO Determinations must obtain the approval of the Director, EO Rulings & Agreements to all original entries and updates to the BOLO.

Only after the approval of the group manager of the Emerging Issues Coordinator, the Manager, EO Determinations and Director, EO Rulings & Agreements have been obtained will EO Determinations groups be notified of new or updated Watch List items, Potential Abusive Transaction and Fraud Issues, Emerging Issues, and Coordinated Processing cases through single e-mail alerts. The Emerging Issues coordinator is responsible for issuing all e-mail alerts after all of the required approvals have been obtained.

The most recent updated copy of the spreadsheet will be posted on the EO Determinations shared drive folder.

The content of this memorandum will be incorporated in IRM 7.20.4.

Appendix C: Memo Suspending use of BOLO Lists (June 20, 2013)

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

June 20, 2013

Control No: TEGE-07-0613-06

MEMORANDUM FOR MANAGER, EO DETERMINATIONS

FROM: Karen Schiller
Acting Director, EO Rulings and Agreements

SUBJECT: Interim Guidance on the Suspension of BOLO List Usage

Effective immediately, the use of watch lists to identify cases or issues requiring heightened awareness is suspended until further notice, with the exception of categories or cases required to be identified by Criminal Investigations, Appeals, or other functional divisions for the purposes of preventing waste, fraud and abuse. This includes the Be on the Lookout (BOLO) list and the TAG (Touch and Go) monthly alerts as defined in IRM 7.20.6.3.

These lists were used to identify potential issues or cases that required heightened or coordinated efforts. They involved cases with potential terrorist connections, abusive transactions, fraud issues, emerging issues, coordinated processing[1] and watch-out cases to allow for more consistent treatment of similarly situated taxpayers.

EO Rulings and Agreements is undertaking a comprehensive review of screening and identification of critical issues. We intend to develop proper procedures and uses for these types of documents. Until a more formal process for identification, approval and distribution of this type of data is established, Rulings and Agreements will not use this technique to elevate issues. All efforts will be made to provide a balance between ensuring taxpayer privacy and safeguards and ensuring consistent treatment in cases involving complex or sensitive issues.

Specialists should follow the instructions in IRM 7.20.1.4 regarding cases requiring transfer to EO Technical, as well as IRM 7.20.5.4 regarding cases requiring mandatory review prior to closing. All EO Determinations Specialists and Screeners will continue to check the names of organizations and individuals referenced in the case against the Office of Foreign Asset Control (OFAC) list. If the specialist identifies an emerging issue or one that might require special handling, he or she should discuss the case with his or her manager, who in turn will elevate the issue.

[1] Coordinated processing cases are ones that present similar issues and thus are to be handled by a single team or group in order to facilitate consistency.

Appendix D: Revenue Rulings 2004-06 and 2007-41

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

	Groups	Nov. 2002	Nov. 2003	Percent Change from Nov. 2002 to Nov. 2003[1]
1.	Piece Goods	473.3	480.5	1.5
2.	Domestics and Draperies	571.3	548.6	-4.0
3.	Women's and Children's Shoes	652.4	649.8	-0.4
4.	Men's Shoes	899.2	845.3	-6.0
5.	Infants' Wear	622.7	598.3	-3.9
6.	Women's Underwear	551.8	514.2	-6.8
7.	Women's Hosiery	345.3	343.3	-0.6
8.	Women's and Girls' Accessories	559.1	555.8	-0.6
9.	Women's Outerwear and Girls' Wear	373.5	375.7	0.6
10.	Men's Clothing	572.1	549.5	-4.0
11.	Men's Furnishings	603.6	598.3	-0.9
12.	Boys' Clothing and Furnishings	461.3	451.0	-2.2
13.	Jewelry	871.7	866.8	-0.6
14.	Notions	793.1	797.2	0.5
15.	Toilet Articles and Drugs	972.5	976.2	0.4
16.	Furniture and Bedding	622.2	612.9	-1.5
17.	Floor Coverings	600.6	594.5	-1.0
18.	Housewares	738.6	712.6	-3.5
19.	Major Appliances	221.6	210.0	-5.2
20.	Radio and Television	47.5	44.3	-6.7
21.	Recreation and Education[2]	84.6	82.2	-2.8
22.	Home Improvements[2]	125.2	124.9	-0.2
23.	Automotive Accessories[2]	111.7	112.0	0.3
	Groups 1–15: Soft Goods	575.9	567.7	-1.4
	Groups 16–20: Durable Goods	404.5	388.9	-3.9
	Groups 21–23: Misc. Goods[2]	95.4	93.9	-1.6
	Store Total[3]	513.0	503.1	-1.9

[1]Absence of a minus sign before the percentage change in this column signifies a price increase.

[2]Indexes on a January 1986 = 100 base.

[3]The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Burkom of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7924 (not a toll-free call).

Section 527.—Political Organizations

26 CFR 1.527–2: Definitions.
(Also § 501.)

Public advocacy; public policy issues. This ruling concerns certain public advocacy activities conducted by social welfare organizations, unions and trade associations. The guidance clarifies the tax implications of advocacy that meets the definition of political campaign activity.

Rev. Rul. 2004–6

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) may, consistent with their exempt purpose, publicly advocate positions on public policy issues. This advocacy may include lobbying for legislation consistent with these positions. Because public policy advocacy may involve discussion of the positions of public officials who are also candidates for public office, a public policy advocacy communication may constitute an exempt function within the meaning of § 527(e)(2). If so, the organization would be subject to tax under § 527(f).

ISSUE

In each of the six situations described below, has the organization exempt from federal income tax under § 501(a) as an organization described in § 501(c)(4), § 501(c)(5), or § 501(c)(6) that engages in public policy advocacy expended funds for an exempt function as described in § 527(e)(2)?

LAW

Section 501(c)(4) provides exemption from taxation for civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)–1 of the Income Tax Regulations states 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.

Section 501(c)(5) provides exemption from taxation for labor, agricultural, or horticultural organizations.

Section 1.501(c)(5)–1 requires that labor, agricultural, or horticultural organizations have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

Section 501(c)(6) provides exemption from taxation for business leagues, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)–1 provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. A business league's activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Section 527 generally provides that political organizations that collect and expend monies for exempt function purposes as described in § 527(e)(2) are exempt from Federal income tax except on their investment income.

Section 527(e)(1) defines a political organization as a party, committee, association, fund or other organization (whether or not incorporated), organized and operated primarily for the purpose of accepting contributions or making expenditures, or both, for an exempt function.

Section 527(e)(2) provides that the term "exempt function" for purposes of § 527 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. By its terms, § 527(e)(2) includes all attempts to influence the selection, nomination, election, or appointment of the described officials.

Section 527(f)(1) provides that an organization described in § 501(c) and exempt from tax under § 501(a) is subject to tax on any amount expended for an exempt function described in § 527(e)(2) at the highest tax rate specified in § 11(b). The tax is imposed on the lesser of the net investment income of the organization for the taxable year or the amount expended on an exempt function during the taxable year. A § 501(c) organization is taxed under § 527(f)(1) only if the expenditure is from its general treasury rather than from a separate segregated fund described in § 527(f)(3).

Section 527(f)(3) provides that if an organization described in § 501(c) and exempt from tax under § 501(a) sets up a separate segregated fund (which segregates monies for § 527(e)(2) exempt function purposes) that fund will be treated as a separate political organization described in § 527 and, therefore, be subject to tax as a political organization under § 527.

Section 527(i) provides that, in order to be tax-exempt, a political organization is required to give notice that it is a political organization described in § 527, unless excepted. An organization described in § 501(c) that does not set up a separate segregated fund, but makes exempt function expenditures subject to tax under § 527(f) is not subject to this requirement. § 527(i)(5)(A).

Section 527(j) provides that, unless excepted, a tax-exempt political organization that has given notice under § 527(i) and does not timely make periodic reports of contributions and expenditures, or that fails to include the information required, must pay an amount calculated by multiplying the amount of contributions and expenditures that are not disclosed by the highest corporate tax rate. An organization described in § 501(c) that does not set up a separate segregated fund, but makes exempt function expenditures subject to tax under § 527(f), is not subject to the reporting requirements under § 527(j).

Section 1.527–2(c)(1) provides that the term "exempt function" includes all activities that are directly related to and support the process of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to public office or office in a political organization. Whether an expenditure is for an exempt function depends on all the facts and circumstances.

Section 1.527–6(f) provides that an organization described in § 501(c) that is exempt under § 501(a) may, if it is consistent with its exempt status, establish and maintain a separate segregated fund to receive contributions and make expenditures in a political campaign.

Rev. Rul. 2003–49, 2003–20 I.R.B. 903 (May 19, 2003), discusses the reporting and disclosure requirements for political organizations in question and answer format. In Q&A–6, the ruling holds that while a § 501(c) organization that makes an expenditure for an exempt function under § 527(e)(2) is not required to file the notice required under § 527(i), if the § 501(c) organization establishes a separate segregated fund under § 527(f)(3), that fund is required to file the notice in order to be tax-exempt unless it meets one of the other exceptions to filing.

Certain broadcast, cable, or satellite communications that meet the definition of "electioneering communications" are regulated by the Bipartisan Campaign Reform Act of 2002 (BCRA), 116 Stat. 81. An exempt organization that violates the regulatory requirements of BCRA may well jeopardize its exemption or be subject to other tax consequences.

ANALYSIS OF FACTUAL SITUATIONS

An organization exempt from federal income tax under § 501(a) as an organization described in § 501(c) that, consistent with its tax-exempt status, wishes to engage in an exempt function within the meaning of § 527(e)(2) may do so with its own funds or by setting up a separate segregated fund under § 527(f)(3). If the organization chooses to establish a separate segregated fund, that fund, unless excepted, must give notice under § 527(i) in order to be tax-exempt. A separate segregated fund that has given notice under § 527(i) is then subject to the reporting requirements under § 527(j). *See* Rev. Rul. 2003–49. If the organization chooses to use its own funds, the organization is not subject to the notice requirements under § 527(i) and the reporting requirements under § 527(j), but is subject to tax under § 527(f)(1) on the lesser of its investment income or the amount of the exempt function expenditure.

All the facts and circumstances must be considered to determine whether an expenditure for an advocacy communication relating to a public policy issue is for an exempt function under § 527(e)(2). When an advocacy communication explicitly advocates the election or defeat of an individual to public office, the expenditure clearly is for an exempt function under § 527(e)(2). However, when an advocacy communication relating to a public policy issue does not explicitly advocate the election or defeat of a candidate, all the facts and circumstances need to be considered to determine whether the expenditure is for an exempt function under § 527(e)(2).

In facts and circumstances such as those described in the six situations, factors that tend to show that an advocacy communication on a public policy issue is for an exempt function under § 527(e)(2) include, but are not limited to, the following:

a) The communication identifies a candidate for public office;

b) The timing of the communication coincides with an electoral campaign;

c) The communication targets voters in a particular election;

d) The communication identifies that candidate's position on the public policy issue that is the subject of the communication;

e) The position of the candidate on the public policy issue has been raised as distinguishing the candidate from others in the campaign, either in the communication itself or in other public communications; and

f) The communication is not part of an ongoing series of substantially similar advocacy communications by the organization on the same issue.

In facts and circumstances such as those described in the six situations, factors that tend to show that an advocacy communication on a public policy issue is not for an exempt function under § 527(e)(2) include, but are not limited to, the following:

a) The absence of any one or more of the factors listed in a) through f) above;

b) The communication identifies specific legislation, or a specific event outside the control of the organization, that the organization hopes to influence;

c) The timing of the communication coincides with a specific event outside the control of the organization that the organization hopes to influence, such as a legislative vote or other major legislative action (for example, a hearing before a legislative committee on the issue that is the subject of the communication);

d) The communication identifies the candidate solely as a government official who is in a position to act on the public policy issue in connection with the specific event (such as a legislator who is eligible to vote on the legislation); and

e) The communication identifies the candidate solely in the list of key or principal sponsors of the legislation that is the subject of the communication.

In all of the situations, the advocacy communication identifies a candidate in an election, appears shortly before that election, and targets the voters in that election. Even though these factors are present, the remaining facts and circumstances must be analyzed in each situation to determine whether the advocacy communication is for an exempt function under § 527(e)(2).

Each of the situations assumes that:

1. All payments for the described activity are from the general treasury of the organization rather than from a separate segregated fund under § 527(f)(3);

2. The organization would continue to be exempt under § 501(a), even if the described activity is not a § 501(c) exempt activity, because the organization's primary activities are described in the appropriate subparagraph of § 501(c); and

3. All advocacy communications described also include a solicitation of contributions to the organization.

Situation 1. *N*, a labor organization recognized as tax exempt under § 501(c)(5), advocates for the betterment of conditions of law enforcement personnel. Senator *A* and Senator *B* represent State *U* in the United States Senate. In year 200x, *N* prepares and finances full-page newspaper advertisements supporting increased spending on law enforcement, which would require a legislative appropriation. These advertisements are published in several large circulation newspapers in State *U* on a regular basis during year 200x. One of these full-page advertisements is published shortly before an election in which Senator *A* (but not Senator *B*) is a candidate for re-election. The advertisement published shortly before the election stresses the importance of increased federal funding of local law enforcement and refers to numerous statistics indicating the high crime rate in State *U*. The advertisement does not mention Senator *A*'s or Senator *B*'s position on law enforcement issues. The advertisement ends with the statement "Call or write Senator *A* and Senator *B* to ask them to support increased federal funding for local law enforcement." Law enforcement has not been raised as an issue distinguishing Senator *A* from any opponent. At the time this advertisement is published, no legislative vote or other major legislative activity is scheduled in the United States Senate on increased federal funding for local law enforcement.

Under the facts and circumstances in *Situation 1*, the advertisement is not for an exempt function under § 527(e)(2). Although *N*'s advertisement identifies Senator *A*, appears shortly before an election in which Senator *A* is a candidate, and targets voters in that election, it is part of an ongoing series of substantially similar advocacy communications by *N* on the same issue during year 200x. The advertisement identifies both Senator *A* and Senator *B*, who is not a candidate for re-election, as the representatives who would vote on this issue. Furthermore, *N*'s advertisement does not identify Senator *A*'s position on the issue, and law enforcement has not been raised as an issue distinguishing Senator *A* from any

opponent. Therefore, there is nothing to indicate that Senator *A*'s candidacy should be supported or opposed based on this issue. Based on these facts and circumstances, the amount expended by *N* on the advertisement is not an exempt function expenditure under § 527(e)(2) and, therefore, is not subject to tax under § 527(f)(1).

Situation 2. *O*, a trade association recognized as tax exempt under § 501(c)(6), advocates for increased international trade. Senator *C* represents State *V* in the United States Senate. *O* prepares and finances a full-page newspaper advertisement that is published in several large circulation newspapers in State *V* shortly before an election in which Senator *C* is a candidate for nomination in a party primary. The advertisement states that increased international trade is important to a major industry in State *V*. The advertisement states that S. 24, a pending bill in the United States Senate, would provide manufacturing subsidies to certain industries to encourage export of their products. The advertisement also states that several manufacturers in State *V* would benefit from the subsidies, but Senator *C* has opposed similar measures supporting increased international trade in the past. The advertisement ends with the statement "Call or write Senator *C* to tell him to vote for S. 24." International trade concerns have not been raised as an issue distinguishing Senator *C* from any opponent. S. 24 is scheduled for a vote in the United States Senate before the election, soon after the date that the advertisement is published in the newspapers.

Under the facts and circumstances in *Situation 2*, the advertisement is not for an exempt function under § 527(e)(2). *O*'s advertisement identifies Senator *C*, appears shortly before an election in which Senator *C* is a candidate, and targets voters in that election. Although international trade issues have not been raised as an issue distinguishing Senator *C* from any opponent, the advertisement identifies Senator *C*'s position on the issue as contrary to *O*'s position. However, the advertisement specifically identifies the legislation *O* is supporting and appears immediately before the United States Senate is scheduled to vote on that particular legislation. The candidate identified, Senator *C*, is a government official who is in a position to take action on the public policy issue in connection with the specific event. Based on these facts and circumstances, the amount expended by *O* on the advertisement is not an exempt function expenditure under § 527(e)(2) and, therefore, is not subject to tax under § 527(f)(1).

Situation 3. *P*, an entity recognized as tax exempt under § 501(c)(4), advocates for better health care. Senator *D* represents State *W* in the United States Senate. *P* prepares and finances a full-page newspaper advertisement that is published repeatedly in several large circulation newspapers in State *W* beginning shortly before an election in which Senator *D* is a candidate for re-election. The advertisement is not part of an ongoing series of substantially similar advocacy communications by *P* on the same issue. The advertisement states that a public hospital is needed in a major city in State *W* but that the public hospital cannot be built without federal assistance. The advertisement further states that Senator *D* has voted in the past year for two bills that would have provided the federal funding necessary for the hospital. The advertisement then ends with the statement "Let Senator *D* know you agree about the need for federal funding for hospitals." Federal funding for hospitals has not been raised as an issue distinguishing Senator *D* from any opponent. At the time the advertisement is published, a bill providing federal funding for hospitals has been introduced in the United States Senate, but no legislative vote or other major legislative activity on that bill is scheduled in the Senate.

Under the facts and circumstances in *Situation 3*, the advertisement is for an exempt function under § 527(e)(2). *P*'s advertisement identifies Senator *D*, appears shortly before an election in which Senator *D* is a candidate, and targets voters in that election. Although federal funding of hospitals has not been raised as an issue distinguishing Senator *D* from any opponent, the advertisement identifies Senator *D*'s position on the hospital funding issue as agreeing with *P*'s position, and is not part of an ongoing series of substantially similar advocacy communications by *P* on the same issue. Moreover, the advertisement does not identify any specific legislation and is not timed to coincide with a legislative vote or other major legislative action on the hospital funding issue. Based on these facts and circumstances, the amount expended by *P* on the advertisement is an exempt function expenditure under § 527(e)(2) and, therefore, is subject to tax under § 527(f)(1).

Situation 4. *R*, an entity recognized as tax exempt under § 501(c)(4), advocates for improved public education. Governor *E* is the governor of State *X*. *R* prepares and finances a radio advertisement urging an increase in state funding for public education in State *X*, which requires a legislative appropriation. The radio advertisement is first broadcast on several radio stations in State *X* beginning shortly before an election in which Governor *E* is a candidate for re-election. The advertisement is not part of an ongoing series of substantially similar advocacy communications by *R* on the same issue. The advertisement cites numerous statistics indicating that public education in State *X* is under-funded. While the advertisement does not say anything about Governor *E*'s position on funding for public education, it ends with "Tell Governor *E* what you think about our under-funded schools." In public appearances and campaign literature, Governor *E*'s opponent has made funding of public education an issue in the campaign by focusing on Governor *E*'s veto of an income tax increase the previous year to increase funding of public education. At the time the advertisement is broadcast, no legislative vote or other major legislative activity is scheduled in the State *X* legislature on state funding of public education.

Under the facts and circumstances in *Situation 4*, the advertisement is for an exempt function under § 527(e)(2). *R*'s advertisement identifies Governor *E*, appears shortly before an election in which Governor *E* is a candidate, and targets voters in that election. Although the advertisement does not explicitly identify Governor *E*'s position on the funding of public schools issue, that issue has been raised as an issue in the campaign by Governor *E*'s opponent. The advertisement does not identify any specific legislation, is not part of an ongoing series of substantially similar advocacy communications by *R* on the same issue, and is not timed to coincide with a legislative vote or other major legislative action on that issue. Based on these facts and circumstances, the amount expended by *R* on the advertisement is an exempt function expenditure under § 527(e)(2) and, therefore, is subject to tax under § 527(f)(1).

Situation 5. *S*, an entity recognized as tax exempt under § 501(c)(4), advocates to abolish the death penalty in State *Y*. Governor *F* is the governor of State *Y*. *S* regularly prepares and finances television advertisements opposing the death penalty. These advertisements appear on several television stations in State *Y* shortly before each scheduled execution in State *Y*. One such advertisement opposing the death penalty appears on State *Y* television stations shortly before the scheduled execution of *G* and shortly before an election in which Governor *F* is a candidate for re-election. The advertisement broadcast shortly before the election provides statistics regarding developed countries that have abolished the death penalty and refers to studies indicating inequities related to the types of persons executed in the United States. Like the advertisements appearing shortly before other scheduled executions in State *Y*, the advertisement notes that Governor *F* has supported the death penalty in the past and ends with the statement "Call or write Governor *F* to demand that he stop the upcoming execution of *G*."

Under the facts and circumstances in *Situation 5*, the advertisement is not for an exempt function under § 527(e)(2). *S*'s advertisement identifies Governor *F*, appears shortly before an election in which Governor *F* is a candidate, targets voters in that election, and identifies Governor *F*'s position as contrary to *S*'s position. However, the advertisement is part of an ongoing series of substantially similar advocacy communications by *S* on the same issue and the advertisement identifies an event outside the control of the organization (the scheduled execution) that the organization hopes to influence. Further, the timing of the advertisement coincides with this specific event that the organization hopes to influence. The candidate identified is a government official who is in a position to take action on the public policy issue in connection with the specific event. Based on these facts and circumstances, the amount expended by *S* on the advertisements is not an exempt function expenditure under § 527(e)(2) and, therefore, is not subject to tax under § 527(f)(1).

Situation 6. *T*, an entity recognized as tax exempt under § 501(c)(4), advocates to abolish the death penalty in State *Z*. Governor *H* is the governor of State *Z*. Beginning shortly before an election in which Governor *H* is a candidate for re-election, *T* prepares and finances a television advertisement broadcast on several television stations in State *Z*. The advertisement is not part of an ongoing series of substantially similar advocacy communications by *T* on the same issue. The advertisement provides statistics regarding developed countries that have abolished the death penalty, and refers to studies indicating inequities related to the types of persons executed in the United States. The advertisement calls for the abolishment of the death penalty. The advertisement notes that Governor *H* has supported the death penalty in the past. The advertisement identifies several individuals previously executed in State *Z*, stating that Governor *H* could have saved their lives by stopping their executions. No executions are scheduled in State *Z* in the near future. The advertisement concludes with the statement "Call or write Governor *H* to demand a moratorium on the death penalty in State *Z*."

Under the facts and circumstances in *Situation 6*, the advertisement is for an exempt function under § 527(e)(2). *T*'s advertisement identifies Governor *H*, appears shortly before an election in which Governor *H* is a candidate, targets the voters in that election, and identifies Governor *H*'s position as contrary to *T*'s position. The advertisement is not part of an ongoing series of substantially similar advocacy communications by *T* on the same issue. In addition, the advertisement does not identify and is not timed to coincide with a specific event outside the control of the organization that it hopes to influence. Based on these facts and circumstances, the amount expended by *T* on the advertisement is an exempt function expenditure under § 527(e)(2) and, therefore, is subject to tax under § 527(f)(1).

HOLDINGS

In Situations 1, 2, and 5, the amounts expended by *N*, *O*, and *S* are not exempt function expenditures under § 527(e)(2) and, therefore, are not subject to tax under § 527(f)(1). In Situations 3, 4, and 6, the amounts expended by *P*, *R* and *T* are exempt function expenditures under § 527(e)(2) and, therefore, are subject to tax under § 527(f)(1).

DRAFTING INFORMATION

The principal author of this revenue ruling is Judith E. Kindell of Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact Judith E. Kindell at (202) 283–8964 (not a toll-free call).

not issued to Taxpayer by the same company in the same calendar year. The result in this case would be the same if, instead of individually issued MECs, the Original Contracts and New Contracts were evidenced by certificates that were issued under a group contract or master contract and that were treated as separate contracts for purposes of §§ 817(h), 7702, and 7702A.

HOLDING

If a taxpayer that owns multiple modified endowment contracts (MECs) issued by the same insurance company in the same calendar year exchanges some of those MECs for new MECs issued by a second insurance company, the new contracts are not required to be aggregated with the remaining original contracts under § 72(e)(12).

DRAFTING INFORMATION

The principal author of this revenue ruling is Melissa S. Luxner of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Ms. Luxner at (202) 622–3970 (not a toll-free call).

Section 430.—Minimum Funding Standards for Single-Employer Defined Benefit Pension Plans

Procedures with respect to applications for requests for letter rulings on substitute mortality tables under section 430(h)(3)(C) of the Code and section 303(h)(3)(C) of the Employee Retirement Income Security Act of 1974 are set forth. See Rev. Proc. 2007-37, page 1433.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, etc.

26 CFR 1.501(c)(3)–1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary or educational purposes, or for the prevention of cruelty to children or animals.

Exempt organizations; political campaigns. This ruling provides 21 examples illustrating the application of the facts and circumstances to be considered to determine whether an organization exempt from income tax under section 501(a) of the Code as an organization described in section 501(c)(3) has participated in, or intervened in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Rev. Rul. 2007–41

Organizations that are exempt from income tax under section 501(a) of the Internal Revenue Code as organizations described in section 501(c)(3) may 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.

ISSUE

In each of the 21 situations described below, has the organization participated or intervened in a political campaign on behalf of (or in opposition to) any candidate for public office within the meaning of section 501(c)(3)?

LAW

Section 501(c)(3) provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable or educational purposes, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in section 501(h)), and which does 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.

Section 1.501(c)(3)–1(c)(3)(i) of the Income Tax Regulations states that an organization is not operated exclusively for one or more exempt purposes if it is an "action" organization.

Section 1.501(c)(3)–1(c)(3)(iii) of the regulations defines an "action" organization as an organization that participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. The term "candidate for public office" is defined as an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local. The regulations further provide that activities that constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written statements or the making of oral statements on behalf of or in opposition to such a candidate.

Whether an organization is participating or intervening, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office depends upon all of the facts and circumstances of each case. For example, certain "voter education" activities, including preparation and distribution of certain voter guides, conducted in a non-partisan manner may not constitute prohibited political activities under section 501(c)(3) of the Code. Other so-called "voter education" activities may be proscribed by the statute. Rev. Rul. 78–248, 1978–1 C.B. 154, contrasts several situations illustrating when an organization that publishes a compilation of candidate positions or voting records has or has not engaged in prohibited political activities based on whether the questionnaire used to solicit candidate positions or the voters guide itself shows a bias or preference in content or structure with respect to the views of a particular candidate. See also Rev. Rul. 80–282, 1980–2 C.B. 178, amplifying Rev. Rul. 78–248 regarding the timing and distribution of voter education materials.

The presentation of public forums or debates is a recognized method of educating the public. See Rev. Rul. 66–256, 1966–2 C.B. 210 (nonprofit organization formed to conduct public forums at which lectures and debates on social, political, and international matters are presented qualifies for exemption from federal income tax under section 501(c)(3)). Providing a forum for candidates is not, in and of itself, prohibited political activity. See Rev. Rul. 74–574, 1974–2 C.B. 160 (organization operating a broadcast station is not participating in political campaigns on behalf of public candidates by providing reasonable amounts of air time equally available to all legally qualified candidates for election to public office in compliance with the reasonable access provisions of the Communications Act of

1934). However, a forum for candidates could be operated in a manner that would show a bias or preference for or against a particular candidate. This could be done, for example, through biased questioning procedures. On the other hand, a forum held for the purpose of educating and informing the voters, which provides fair and impartial treatment of candidates, and which does not promote or advance one candidate over another, would not constitute participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office. See Rev. Rul. 86–95, 1986–2 C.B. 73 (organization that proposes to educate voters by conducting a series of public forums in congressional districts during congressional election campaigns is not participating in a political campaign on behalf of any candidate due to the neutral form and content of its proposed forums).

ANALYSIS OF FACTUAL SITUATIONS

The 21 factual situations appear below under specific subheadings relating to types of activities. In each of the factual situations, all the facts and circumstances are considered in determining whether an organization's activities result in political campaign intervention. Note that each of these situations involves only one type of activity. In the case of an organization that combines one or more types of activity, the interaction among the activities may affect the determination of whether or not the organization is engaged in political campaign intervention.

Voter Education, Voter Registration and Get Out the Vote Drives

Section 501(c)(3) organizations are permitted to conduct certain voter education activities (including the presentation of public forums and the publication of voter education guides) if they are carried out in a non-partisan manner. In addition, section 501(c)(3) organizations may encourage people to participate in the electoral process through voter registration and get-out-the-vote drives, conducted in a non-partisan manner. On the other hand, voter education or registration activities conducted in a biased manner that favors (or opposes) one or more candidates is prohibited.

Situation 1. *B*, a section 501(c)(3) organization that promotes community involvement, sets up a booth at the state fair where citizens can register to vote. The signs and banners in and around the booth give only the name of the organization, the date of the next upcoming statewide election, and notice of the opportunity to register. No reference to any candidate or political party is made by the volunteers staffing the booth or in the materials available at the booth, other than the official voter registration forms which allow registrants to select a party affiliation. *B* is not engaged in political campaign intervention when it operates this voter registration booth.

Situation 2. *C* is a section 501(c)(3) organization that educates the public on environmental issues. Candidate *G* is running for the state legislature and an important element of her platform is challenging the environmental policies of the incumbent. Shortly before the election, *C* sets up a telephone bank to call registered voters in the district in which Candidate *G* is seeking election. In the phone conversations, *C*'s representative tells the voter about the importance of environmental issues and asks questions about the voter's views on these issues. If the voter appears to agree with the incumbent's position, *C*'s representative thanks the voter and ends the call. If the voter appears to agree with Candidate *G*'s position, *C*'s representative reminds the voter about the upcoming election, stresses the importance of voting in the election and offers to provide transportation to the polls. *C* is engaged in political campaign intervention when it conducts this get-out-the-vote drive.

Individual Activity by Organization Leaders

The political campaign intervention prohibition is not intended to restrict free expression on political matters by leaders of organizations speaking for themselves, as individuals. Nor are leaders prohibited from speaking about important issues of public policy. However, for their organizations to remain tax exempt under section 501(c)(3), leaders cannot make partisan comments in official organization publications or at official functions of the organization.

Situation 3. President *A* is the Chief Executive Officer of Hospital *J*, a section 501(c)(3) organization, and is well known in the community. With the permission of five prominent healthcare industry leaders, including President *A*, who have personally endorsed Candidate *T*, Candidate *T* publishes a full page ad in the local newspaper listing the names of the five leaders. President *A* is identified in the ad as the CEO of Hospital *J*. The ad states, "Titles and affiliations of each individual are provided for identification purposes only." The ad is paid for by Candidate *T*'s campaign committee. Because the ad was not paid for by Hospital *J*, the ad is not otherwise in an official publication of Hospital *J*, and the endorsement is made by President *A* in a personal capacity, the ad does not constitute campaign intervention by Hospital *J*.

Situation 4. President *B* is the president of University *K*, a section 501(c)(3) organization. University *K* publishes a monthly alumni newsletter that is distributed to all alumni of the university. In each issue, President *B* has a column titled "My Views." The month before the election, President *B* states in the "My Views" column, "It is my personal opinion that Candidate *U* should be reelected." For that one issue, President *B* pays from his personal funds the portion of the cost of the newsletter attributable to the "My Views" column. Even though he paid part of the cost of the newsletter, the newsletter is an official publication of the university. Because the endorsement appeared in an official publication of University *K*, it constitutes campaign intervention by University *K*.

Situation 5. Minister *C* is the minister of Church *L*, a section 501(c)(3) organization and Minister *C* is well known in the community. Three weeks before the election, he attends a press conference at Candidate *V*'s campaign headquarters and states that Candidate *V* should be reelected. Minister *C* does not say he is speaking on behalf of Church *L*. His endorsement is reported on the front page of the local newspaper and he is identified in the article as the minister of Church *L*. Because Minister *C* did not make the endorsement at an official church function, in an official church publication or otherwise use the church's assets, and did not state that he was speaking as a representative of Church *L*, his actions do not constitute campaign intervention by Church *L*.

Situation 6. Chairman *D* is the chairman of the Board of Directors of *M*, a section 501(c)(3) organization that educates the public on conservation issues. During a regular meeting of *M* shortly before the election, Chairman *D* spoke on a number of issues, including the importance of voting in the upcoming election, and concluded by stating, "It is important that you all do your duty in the election and vote for Candidate *W*." Because Chairman *D*'s remarks indicating support for Candidate *W* were made during an official organization meeting, they constitute political campaign intervention by *M*.

Candidate Appearances

Depending on the facts and circumstances, an organization may invite political candidates to speak at its events without jeopardizing its tax-exempt status. Political candidates may be invited in their capacity as candidates, or in their individual capacity (not as a candidate). Candidates may also appear without an invitation at organization events that are open to the public.

When a candidate is invited to speak at an organization event in his or her capacity as a political candidate, factors in determining whether the organization participated or intervened in a political campaign include the following:

- Whether the organization provides an equal opportunity to participate to political candidates seeking the same office;
- Whether the organization indicates any support for or opposition to the candidate (including candidate introductions and communications concerning the candidate's attendance); and
- Whether any political fundraising occurs.

In determining whether candidates are given an equal opportunity to participate, the nature of the event to which each candidate is invited will be considered, in addition to the manner of presentation. For example, an organization that invites one candidate to speak at its well attended annual banquet, but invites the opposing candidate to speak at a sparsely attended general meeting, will likely have violated the political campaign prohibition, even if the manner of presentation for both speakers is otherwise neutral.

When an organization invites several candidates for the same office to speak at a public forum, factors in determining whether the forum results in political campaign intervention include the following:

- Whether questions for the candidates are prepared and presented by an independent nonpartisan panel,
- Whether the topics discussed by the candidates cover a broad range of issues that the candidates would address if elected to the office sought and are of interest to the public,
- Whether each candidate is given an equal opportunity to present his or her view on each of the issues discussed,
- Whether the candidates are asked to agree or disagree with positions, agendas, platforms or statements of the organization, and
- Whether a moderator comments on the questions or otherwise implies approval or disapproval of the candidates.

Situation 7. President *E* is the president of Society *N*, a historical society that is a section 501(c)(3) organization. In the month prior to the election, President *E* invites the three Congressional candidates for the district in which Society *N* is located to address the members, one each at a regular meeting held on three successive weeks. Each candidate is given an equal opportunity to address and field questions on a wide variety of topics from the members. Society *N*'s publicity announcing the dates for each of the candidate's speeches and President *E*'s introduction of each candidate include no comments on their qualifications or any indication of a preference for any candidate. Society *N*'s actions do not constitute political campaign intervention.

Situation 8. The facts are the same as in *Situation 7* except that there are four candidates in the race rather than three, and one of the candidates declines the invitation to speak. In the publicity announcing the dates for each of the candidate's speeches, Society *N* includes a statement that the order of the speakers was determined at random and the fourth candidate declined the Society's invitation to speak. President *E* makes the same statement in his opening remarks at each of the meetings where one of the candidates is speaking. Society *N*'s actions do not constitute political campaign intervention.

Situation 9. Minister *F* is the minister of Church *O*, a section 501(c)(3) organization. The Sunday before the November election, Minister *F* invites Senate Candidate *X* to preach to her congregation during worship services. During his remarks, Candidate *X* states, "I am asking not only for your votes, but for your enthusiasm and dedication, for your willingness to go the extra mile to get a very large turnout on Tuesday." Minister *F* invites no other candidate to address her congregation during the Senatorial campaign. Because these activities take place during official church services, they are attributed to Church *O*. By selectively providing church facilities to allow Candidate *X* to speak in support of his campaign, Church *O*'s actions constitute political campaign intervention.

Candidate Appearances Where Speaking or Participating as a Non-Candidate

Candidates may also appear or speak at organization events in a non-candidate capacity. For instance, a political candidate may be a public figure who is invited to speak because he or she: (a) currently holds, or formerly held, public office; (b) is considered an expert in a non political field; or (c) is a celebrity or has led a distinguished military, legal, or public service career. A candidate may choose to attend an event that is open to the public, such as a lecture, concert or worship service. The candidate's presence at an organization-sponsored event does not, by itself, cause the organization to be engaged in political campaign intervention. However, if the candidate is publicly recognized by the organization, or if the candidate is invited to speak, factors in determining whether the candidate's appearance results in political campaign intervention include the following:

- Whether the individual is chosen to speak solely for reasons other than candidacy for public office;
- Whether the individual speaks only in a non-candidate capacity;
- Whether either the individual or any representative of the organization

makes any mention of his or her candidacy or the election;
- Whether any campaign activity occurs in connection with the candidate's attendance;
- Whether the organization maintains a nonpartisan atmosphere on the premises or at the event where the candidate is present; and
- Whether the organization clearly indicates the capacity in which the candidate is appearing and does not mention the individual's political candidacy or the upcoming election in the communications announcing the candidate's attendance at the event.

Situation 10. Historical society *P* is a section 501(c)(3) organization. Society *P* is located in the state capital. President *G* is the president of Society *P* and customarily acknowledges the presence of any public officials present during meetings. During the state gubernatorial race, Lieutenant Governor *Y*, a candidate, attends a meeting of the historical society. President *G* acknowledges the Lieutenant Governor's presence in his customary manner, saying, "We are happy to have joining us this evening Lieutenant Governor *Y*." President *G* makes no reference in his welcome to the Lieutenant Governor's candidacy or the election. Society *P* has not engaged in political campaign intervention as a result of President *G*'s actions.

Situation 11. Chairman *H* is the chairman of the Board of Hospital *Q*, a section 501(c)(3) organization. Hospital *Q* is building a new wing. Chairman *H* invites Congressman *Z*, the representative for the district containing Hospital *Q*, to attend the groundbreaking ceremony for the new wing. Congressman *Z* is running for reelection at the time. Chairman *H* makes no reference in her introduction to Congressman *Z*'s candidacy or the election. Congressman *Z* also makes no reference to his candidacy or the election and does not do any political campaign fundraising while at Hospital *Q*. Hospital *Q* has not intervened in a political campaign.

Situation 12. University *X* is a section 501(c)(3) organization. *X* publishes an alumni newsletter on a regular basis. Individual alumni are invited to send in updates about themselves which are printed in each edition of the newsletter. After receiving an update letter from Alumnus *Q*, *X* prints the following: "Alumnus *Q*, class of 'XX is running for mayor of Metropolis." The newsletter does not contain any reference to this election or to Alumnus *Q*'s candidacy other than this statement of fact. University *X* has not intervened in a political campaign.

Situation 13. Mayor *G* attends a concert performed by Symphony *S*, a section 501(c)(3) organization, in City Park. The concert is free and open to the public. Mayor *G* is a candidate for reelection, and the concert takes place after the primary and before the general election. During the concert, the chairman of *S*'s board addresses the crowd and says, "I am pleased to see Mayor *G* here tonight. Without his support, these free concerts in City Park would not be possible. We will need his help if we want these concerts to continue next year so please support Mayor *G* in November as he has supported us." As a result of these remarks, Symphony *S* has engaged in political campaign intervention.

Issue Advocacy vs. Political Campaign Intervention

Section 501(c)(3) organizations may take positions on public policy issues, including issues that divide candidates in an election for public office. However, section 501(c)(3) organizations must avoid any issue advocacy that functions as political campaign intervention. Even if a statement does not expressly tell an audience to vote for or against a specific candidate, an organization delivering the statement is at risk of violating the political campaign intervention prohibition if there is any message favoring or opposing a candidate. A statement can identify a candidate not only by stating the candidate's name but also by other means such as showing a picture of the candidate, referring to political party affiliations, or other distinctive features of a candidate's platform or biography. All the facts and circumstances need to be considered to determine if the advocacy is political campaign intervention.

Key factors in determining whether a communication results in political campaign intervention include the following:

- Whether the statement identifies one or more candidates for a given public office;
- Whether the statement expresses approval or disapproval for one or more candidates' positions and/or actions;
- Whether the statement is delivered close in time to the election;
- Whether the statement makes reference to voting or an election;
- Whether the issue addressed in the communication has been raised as an issue distinguishing candidates for a given office;
- Whether the communication is part of an ongoing series of communications by the organization on the same issue that are made independent of the timing of any election; and
- Whether the timing of the communication and identification of the candidate are related to a non-electoral event such as a scheduled vote on specific legislation by an officeholder who also happens to be a candidate for public office.

A communication is particularly at risk of political campaign intervention when it makes reference to candidates or voting in a specific upcoming election. Nevertheless, the communication must still be considered in context before arriving at any conclusions.

Situation 14. University *O*, a section 501(c)(3) organization, prepares and finances a full page newspaper advertisement that is published in several large circulation newspapers in State *V* shortly before an election in which Senator *C* is a candidate for nomination in a party primary. Senator *C* represents State *V* in the United States Senate. The advertisement states that S. 24, a pending bill in the United States Senate, would provide additional opportunities for State *V* residents to attend college, but Senator *C* has opposed similar measures in the past. The advertisement ends with the statement "Call or write Senator *C* to tell him to vote for S. 24." Educational issues have not been raised as an issue distinguishing Senator *C* from any opponent. S. 24 is scheduled for a vote in the United States Senate before the election, soon after the date that the advertisement is published in the newspapers. Even though the advertisement appears shortly before the election and iden-

tifies Senator *C*'s position on the issue as contrary to *O*'s position, University *O* has not violated the political campaign intervention prohibition because the advertisement does not mention the election or the candidacy of Senator *C*, education issues have not been raised as distinguishing Senator *C* from any opponent, and the timing of the advertisement and the identification of Senator *C* are directly related to the specifically identified legislation University *O* is supporting and appears immediately before the United States Senate is scheduled to vote on that particular legislation. The candidate identified, Senator *C*, is an officeholder who is in a position to vote on the legislation.

Situation 15. Organization *R*, a section 501(c)(3) organization that educates the public about the need for improved public education, prepares and finances a radio advertisement urging an increase in state funding for public education in State *X*, which requires a legislative appropriation. Governor *E* is the governor of State *X*. The radio advertisement is first broadcast on several radio stations in State *X* beginning shortly before an election in which Governor *E* is a candidate for re-election. The advertisement is not part of an ongoing series of substantially similar advocacy communications by Organization *R* on the same issue. The advertisement cites numerous statistics indicating that public education in State *X* is under funded. While the advertisement does not say anything about Governor *E*'s position on funding for public education, it ends with "Tell Governor *E* what you think about our under-funded schools." In public appearances and campaign literature, Governor *E*'s opponent has made funding of public education an issue in the campaign by focusing on Governor *E*'s veto of an income tax increase the previous year to increase funding of public education. At the time the advertisement is broadcast, no legislative vote or other major legislative activity is scheduled in the State *X* legislature on state funding of public education. Organization *R* has violated the political campaign prohibition because the advertisement identifies Governor *E*, appears shortly before an election in which Governor *E* is a candidate, is not part of an ongoing series of substantially similar advocacy communications by Organization *R* on the same issue, is not timed to coincide with a non election event such as a legislative vote or other major legislative action on that issue, and takes a position on an issue that the opponent has used to distinguish himself from Governor *E*.

Situation 16. Candidate *A* and Candidate *B* are candidates for the state senate in District *W* of State *X*. The issue of State *X* funding for a new mass transit project in District *W* is a prominent issue in the campaign. Both candidates have spoken out on the issue. Candidate *A* supports funding the new mass transit project. Candidate *B* opposes the project and supports State *X* funding for highway improvements instead. *P* is the executive director of *C*, a section 501(c)(3) organization that promotes community development in District *W*. At *C*'s annual fundraising dinner in District *W*, which takes place in the month before the election in State *X*, *P* gives a lengthy speech about community development issues including the transportation issues. *P* does not mention the name of any candidate or any political party. However, at the conclusion of the speech, *P* makes the following statement, "For those of you who care about quality of life in District *W* and the growing traffic congestion, there is a very important choice coming up next month. We need new mass transit. More highway funding will not make a difference. You have the power to relieve the congestion and improve your quality of life in District *W*. Use that power when you go to the polls and cast your vote in the election for your state senator." *C* has violated the political campaign intervention as a result of *P*'s remarks at *C*'s official function shortly before the election, in which *P* referred to the upcoming election after stating a position on an issue that is a prominent issue in a campaign that distinguishes the candidates.

Business Activity

The question of whether an activity constitutes participation or intervention in a political campaign may also arise in the context of a business activity of the organization, such as selling or renting of mailing lists, the leasing of office space, or the acceptance of paid political advertising. In this context, some of the factors to be considered in determining whether the organization has engaged in political campaign intervention include the following:

- Whether the good, service or facility is available to candidates in the same election on an equal basis,
- Whether the good, service, or facility is available only to candidates and not to the general public,
- Whether the fees charged to candidates are at the organization's customary and usual rates, and
- Whether the activity is an ongoing activity of the organization or whether it is conducted only for a particular candidate.

Situation 17. Museum *K* is a section 501(c)(3) organization. It owns an historic building that has a large hall suitable for hosting dinners and receptions. For several years, Museum *K* has made the hall available for rent to members of the public. Standard fees are set for renting the hall based on the number of people in attendance, and a number of different organizations have rented the hall. Museum *K* rents the hall on a first come, first served basis. Candidate *P* rents Museum *K*'s social hall for a fundraising dinner. Candidate *P*'s campaign pays the standard fee for the dinner. Museum *K* is not involved in political campaign intervention as a result of renting the hall to Candidate *P* for use as the site of a campaign fundraising dinner.

Situation 18. Theater *L* is a section 501(c)(3) organization. It maintains a mailing list of all of its subscribers and contributors. Theater *L* has never rented its mailing list to a third party. Theater *L* is approached by the campaign committee of Candidate *Q*, who supports increased funding for the arts. Candidate *Q*'s campaign committee offers to rent Theater *L*'s mailing list for a fee that is comparable to fees charged by other similar organizations. Theater *L* rents its mailing list to Candidate *Q*'s campaign committee. Theater *L* declines similar requests from campaign committees of other candidates. Theater *L* has intervened in a political campaign.

Web Sites

The Internet has become a widely used communications tool. Section 501(c)(3) organizations use their own web sites to disseminate statements and information.

They also routinely link their web sites to web sites maintained by other organizations as a way of providing additional information that the organizations believe is useful or relevant to the public.

A web site is a form of communication. If an organization posts something on its web site that favors or opposes a candidate for public office, the organization will be treated the same as if it distributed printed material, oral statements or broadcasts that favored or opposed a candidate.

An organization has control over whether it establishes a link to another site. When an organization establishes a link to another web site, the organization is responsible for the consequences of establishing and maintaining that link, even if the organization does not have control over the content of the linked site. Because the linked content may change over time, an organization may reduce the risk of political campaign intervention by monitoring the linked content and adjusting the links accordingly.

Links to candidate-related material, by themselves, do not necessarily constitute political campaign intervention. All the facts and circumstances must be taken into account when assessing whether a link produces that result. The facts and circumstances to be considered include, but are not limited to, the context for the link on the organization's web site, whether all candidates are represented, any exempt purpose served by offering the link, and the directness of the links between the organization's web site and the web page that contains material favoring or opposing a candidate for public office.

Situation 19. *M*, a section 501(c)(3) organization, maintains a web site and posts an unbiased, nonpartisan voter guide that is prepared consistent with the principles discussed in Rev. Rul. 78–248. For each candidate covered in the voter guide, *M* includes a link to that candidate's official campaign web site. The links to the candidate web sites are presented on a consistent neutral basis for each candidate, with text saying "For more information on Candidate *X*, you may consult [URL]." *M* has not intervened in a political campaign because the links are provided for the exempt purpose of educating voters and are presented in a neutral, unbiased manner that includes all candidates for a particular office.

Situation 20. Hospital *N*, a section 501(c)(3) organization, maintains a web site that includes such information as medical staff listings, directions to Hospital *N*, and descriptions of its specialty health programs, major research projects, and other community outreach programs. On one page of the web site, Hospital *N* describes its treatment program for a particular disease. At the end of the page, it includes a section of links to other web sites titled "More Information." These links include links to other hospitals that have treatment programs for this disease, research organizations seeking cures for that disease, and articles about treatment programs. This section includes a link to an article on the web site of *O*, a major national newspaper, praising Hospital *N*'s treatment program for the disease. The page containing the article on *O*'s web site contains no reference to any candidate or election and has no direct links to candidate or election information. Elsewhere on *O*'s web site, there is a page displaying editorials that *O* has published. Several of the editorials endorse candidates in an election that has not yet occurred. Hospital *N* has not intervened in a political campaign by maintaining the link to the article on *O*'s web site because the link is provided for the exempt purpose of educating the public about Hospital *N*'s programs and neither the context for the link, nor the relationship between Hospital *N* and *O* nor the arrangement of the links going from Hospital *N*'s web site to the endorsement on *O*'s web site indicate that Hospital *N* was favoring or opposing any candidate.

Situation 21. Church *P*, a section 501(c)(3) organization, maintains a web site that includes such information as biographies of its ministers, times of services, details of community outreach programs, and activities of members of its congregation. *B*, a member of the congregation of Church *P*, is running for a seat on the town council. Shortly before the election, Church *P* posts the following message on its web site, "Lend your support to *B*, your fellow parishioner, in Tuesday's election for town council." Church *P* has intervened in a political campaign on behalf of B.

HOLDINGS

In situations 2, 4, 6, 9, 13, 15, 16, 18 and 21, the organization intervened in a political campaign within the meaning of section 501(c)(3). In situations 1, 3, 5, 7, 8, 10, 11, 12, 14, 17, 19 and 20, the organization did not intervene in a political campaign within the meaning of section 501(c)(3)

DRAFTING INFORMATION

The principal author of this revenue ruling is Judith Kindell of Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact Ms. Kindell at (202) 283–8964 (not a toll-free call).

Section 707.—Transactions Between Partner and Partnership

26 CFR 1.707–1: Transactions between partner and partnership.

Partnership property; transfer. This ruling concludes that a transfer of partnership property to a partner in satisfaction of a guaranteed payment under section 707(c) of the Code is a sale or exchange under section 1001, and not a distribution under section 731.

Rev. Rul. 2007–40

ISSUE

Is a transfer of partnership property to a partner in satisfaction of a guaranteed payment under section 707(c) a sale or exchange under section 1001, or a distribution under section 731?

FACTS

Partnership purchased Blackacre for $500x. *A*, a partner in *Partnership*, is entitled to a guaranteed payment under section 707(c) of $800x. Subsequently, when the fair market value of Blackacre is $800x and *Partnership*'s adjusted basis in Blackacre is $500x, *Partnership* transfers Blackacre to *A* in satisfaction of the guaranteed payment to *A*.

Appendix E: IRS Letter to 501(c)(4) applicants on new business process option for self-certification and determination

Department of the Treasury
Internal Revenue Service
P.O. Box 2508, Room 4106
Cincinnati, OH 45201

Date:

Employer ID number:

Person to contact:

Contact telephone number:

Contact fax number:

Employee ID number:

Dear [Applicant]:

The IRS is instituting an optional expedited process for certain organizations applying for recognition of exemption under Section 501(c)(4) whose applications have been pending with the IRS for more than 120 days as of May 28, 2013. Organizations can make representations to the IRS under penalties of perjury regarding their past, current, and future activities and receive a determination letter based on those representations.

If you choose to apply for this expedited process, complete and return pages 5-7, *Representations and Specific Instructions*. We will send you a favorable determination letter within 2 weeks of receipt of the signed representations.

Determination letters issued under the optional process will be based on the representations of the organization and may not be relied upon if the organization's activities are different from what is represented to the IRS. The representations are subject to verification on audit. Organizations that don't make the representations will have their applications reviewed based on the legal standards applied to all the facts and circumstances.

If you can make the representations required for eligibility under this optional process and want to participate, please follow the instructions set forth at the end of this letter, *Optional Expedited Process for Certain Exemption Applications Under Section 501(c)(4).* Send the signed representations within 45 days from the date of this letter to the address below:

Internal Revenue Service
P.O. Box 2508, Room 4106
Cincinnati, OH 45201

You can send the information by fax to [ ]. Your fax signature becomes a permanent part of your filing. Do not send an additional copy by mail.

If you have questions, you can contact the person whose name and telephone number are shown in the heading of this letter.

Thank you for your cooperation.

Sincerely,

[Name]
[Title]

Optional Expedited Process for Certain Exemption Applications Under Section 501(c)(4)

In the interest of effective and efficient tax administration and to assist in the transparent and consistent review of applications for tax-exempt status under Section 501(c)(4), the IRS is offering an optional expedited process for certain organizations that have submitted 501(c)(4) applications. This optional expedited process is currently available only to applicants for 501(c)(4) status with applications pending for more than 120 days as of May 28, 2013, that indicate the organization may be involved in political campaign intervention or issue advocacy.

In this optional process, an organization will represent that it satisfies, and will continue to satisfy, set percentages with respect to the level of its social welfare activities and political campaign intervention activities (as defined in the specific instructions on pages 5-7). These percentage representations are not an interpretation of law but are a safe harbor for those organizations that choose to participate in the optional process.

Under this optional expedited process, an applicant will be presumed to be primarily engaged in activities that promote social welfare based on certain additional representations (on pages 5-7) made by the organization regarding its past, present, and future activities. Like the Form 1024 exemption application itself, these representations are signed on behalf of the organization under penalties of perjury. Applicants that provide the representations will receive a favorable determination letter within two weeks of receipt of the representations.

Importantly, this is an optional process. The standards and thresholds reflected in the representations are criteria for eligibility for expedited processing rather than new legal requirements. No inference will be drawn from an organization's choice not to participate. An organization that declines to make the representations will have its application reviewed under the regular process in which the IRS looks to all facts and circumstances to determine whether an organization primarily engages in activities that promote social welfare.

Like all organizations receiving a favorable determination of exempt status, organizations participating in this optional expedited process may be subject to examination by the IRS and the organization's exempt status may be revoked if, and as of the tax year in which, the facts and circumstances indicate exempt status is no longer warranted. An organization that receives a determination letter under this expedited process may rely on its determination letter as long as its activities are consistent with its application for exemption and the representations, and the determination letter will expressly indicate that the letter was based on the representations. An organization may no longer rely on the determination letter issued under this optional

expedited process as of the tax year in which its activities (including the amount of expenditures incurred or time spent on particular activities) cease to be consistent with its application for exemption and any of the representations, if the applicable legal standards change, or if the determination letter is revoked. If the organization determines that it continues to be described in Section 501(c)(4) notwithstanding the fact that its activities are no longer consistent with the representations below, it may continue to take the position that it is described in Section 501(c)(4) and file Form 990, *Return of Organization Exempt From Income Tax*, but it must notify the IRS about such representations ceasing to be correct on Schedule O, *Supplemental Information*, of the Form 990.

Representations and Specific Instructions

1. During each past tax year of the organization, during the current tax year, and during each future tax year in which the organization intends to rely on a determination letter issued under the optional expedited process, the organization has spent and anticipates that it will spend 60% or more of *both* the organization's total expenditures *and* its total time (measured by employee and volunteer hours) on activities that promote the social welfare (within the meaning of Section 501(c)(4) and the regulations thereunder).

2. During each past tax year of the organization, during the current tax year, and during each future tax year in which the organization intends to rely on a determination letter issued under the optional expedited process, the organization has spent and anticipates that it will spend less than 40% of *both* the organization's total expenditures *and* its total time (measured by employee and volunteer hours) on direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office (within the meaning of the regulations under Section 501(c)(4)).

Specific instructions

For purposes of these representations, "total expenditures" include administrative, overhead, and other general expenditures. An organization may allocate those expenditures among its activities using any reasonable method.

For purposes of these representations, activities that promote the social welfare do not include any expenditure incurred or time spent by the organization on--

- Any activity that benefits select individuals or organizations rather than the community as a whole;
- Direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office;
- Operating a social club for the benefit, pleasure, or recreation of the organization's members; and
- Carrying on a business with the general public in a manner similar to organizations operated for profit.

For purposes of these representations, direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office ("candidate") includes any expenditure incurred or time spent by the organization on:

- Any written (printed or electronic) or oral statement supporting (or opposing) the election or nomination of a candidate;
- Financial or other support provided to (or the solicitation of such support on behalf of) any candidate, political party, political committee, or Section 527 organization;
- Conducting a voter registration drive that selects potential voters to assist on the basis of their preference for a particular candidate or party;
- Conducting a "get-out-the-vote" drive that selects potential voters to assist on the basis of their preference for a particular candidate or (in the case of general elections) a particular party;
- Distributing material prepared by a candidate, political party, political committee, or Section 527 organization; and
- Preparing and distributing a voter guide that rates favorably or unfavorably one or more candidates.

In addition, ***solely*** for purposes of determining an organization's eligibility under this optional expedited process, direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate includes any expenditure incurred or time spent by the organization on:

- Any public communication within 60 days prior to a general election or 30 days prior to a primary election that identifies a candidate in the election. For this purpose, "public communication" means a communication by means of any broadcast, cable, or satellite communication; newspaper, magazine, or other periodical (excluding any periodical distributed only to the organization's dues paying members); outdoor advertising facility, mass mailing, or telephone bank to the general public; and communications placed for a fee on another person's Internet website;
- Conducting an event at which only one candidate is, or candidates of only one party are, invited to speak; and
- Any grant to an organization described in Section 501(c) if the recipient of the grant engages in political campaign intervention.[1]

[1] An organization may rely on a representation from an authorized officer of the recipient if the organization does not know whether the recipient engages in any political campaign intervention and may assume that a Section 501(c)(3) organization does not engage in political campaign intervention.

Although other activities may constitute direct or indirect participation or intervention in a political campaign (see Revenue Ruling 2007-41 for examples of factors to consider), representations may be based on the specific activities described in these instructions.

Under penalties of perjury, I declare that I am authorized to sign these representations on behalf of the above organization, and that to the best of my knowledge and belief, the facts stated in the representations are true, correct, and complete.

_____ _____

Signature of officer, director, trustee or other authorized official Date

_____

Title and printed name

_____

Organization name and Employer Identification Number

Appendix F: "Publication 1" (*Your Rights as a Taxpayer*)

IRS
Department of the Treasury
Internal Revenue Service
Publication 1
(Rev. September 2012)
Catalog Number 64731W
www.irs.gov

Your Rights as a Taxpayer

The first part of this publication explains some of your most important rights as a taxpayer. The second part explains the examination, appeal, collection, and refund processes. This publication is also available in Spanish.

Declaration of Taxpayer Rights

I. Protection of Your Rights

IRS employees will explain and protect your rights as a taxpayer throughout your contact with us.

II. Privacy and Confidentiality

The IRS will not disclose to anyone the information you give us, except as authorized by law. You have the right to know why we are asking you for information, how we will use it, and what happens if you do not provide requested information.

III. Professional and Courteous Service

If you believe that an IRS employee has not treated you in a professional, fair, and courteous manner, you should tell that employee's supervisor. If the supervisor's response is not satisfactory, you should write to the IRS director for your area or the center where you file your return.

IV. Representation

You may either represent yourself or, with proper written authorization, have someone else represent you in your place. Your representative must be a person allowed to practice before the IRS, such as an attorney, certified public accountant, or enrolled agent. If you are in an interview and ask to consult such a person, then we must stop and reschedule the interview in most cases.

You can have someone accompany you at an interview. You may make sound recordings of any meetings with our examination, appeal, or collection personnel, provided you tell us in writing 10 days before the meeting.

V. Payment of Only the Correct Amount of Tax

You are responsible for paying only the correct amount of tax due under the law—no more, no less. If you cannot pay all of your tax when it is due, you may be able to make monthly installment payments.

VI. Help With Unresolved Tax Problems

The Taxpayer Advocate Service can help you if you have tried unsuccessfully to resolve a problem with the IRS. Your local Taxpayer Advocate can offer you special help if you have a significant hardship as a result of a tax problem. For more information, call toll free 1–877–777–4778 (1–800–829–4059 for TTY/TDD) or write to the Taxpayer Advocate at the IRS office that last contacted you.

VII. Appeals and Judicial Review

If you disagree with us about the amount of your tax liability or certain collection actions, you have the right to ask the Appeals Office to review your case. You may also ask a court to review your case.

VIII. Relief From Certain Penalties and Interest

The IRS will waive penalties when allowed by law if you can show you acted reasonably and in good faith or relied on the incorrect advice of an IRS employee. We will waive interest that is the result of certain errors or delays caused by an IRS employee.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Examinations, Appeals, Collections, and Refunds

Examinations (Audits)

We accept most taxpayers' returns as filed. If we inquire about your return or select it for examination, it does not suggest that you are dishonest. The inquiry or examination may or may not result in more tax. We may close your case without change; or, you may receive a refund.

The process of selecting a return for examination usually begins in one of two ways. First, we use computer programs to identify returns that may have incorrect amounts. These programs may be based on information returns, such as Forms 1099 and W-2, on studies of past examinations, or on certain issues identified by compliance projects. Second, we use information from outside sources that indicates that a return may have incorrect amounts. These sources may include newspapers, public records, and individuals. If we determine that the information is accurate and reliable, we may use it to select a return for examination.

Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, explains the rules and procedures that we follow in examinations. The following sections give an overview of how we conduct examinations.

By Mail

We handle many examinations and inquiries by mail. We will send you a letter with either a request for more information or a reason why we believe a change to your return may be needed. You can respond by mail or you can request a personal interview with an examiner. If you mail us the requested information or provide an explanation, we may or may not agree with you, and we will explain the reasons for any changes. Please do not hesitate to write to us about anything you do not understand.

By Interview

If we notify you that we will conduct your examination through a personal interview, or you request such an interview, you have the right to ask that the examination take place at a reasonable time and place that is convenient for both you and the IRS. If our examiner proposes any changes to your return, he or she will explain the reasons for the changes. If you do not agree with these changes, you can meet with the examiner's supervisor.

Repeat Examinations

If we examined your return for the same items in either of the 2 previous years and proposed no change to your tax liability, please contact us as soon as possible so we can see if we should discontinue the examination.

Appeals

If you do not agree with the examiner's proposed changes, you can appeal them to the Appeals Office of IRS. Most differences can be settled without expensive and time-consuming court trials. Your appeal rights are explained in detail in both Publication 5, Your Appeal Rights and How To Prepare a Protest If You Don't Agree, and Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund.

If you do not wish to use the Appeals Office or disagree with its findings, you may be able to take your case to the U.S. Tax Court, U.S. Court of Federal Claims, or the U.S. District Court where you live. If you take your case to court, the IRS will have the burden of proving certain facts if you kept adequate records to show your tax liability, cooperated with the IRS, and meet certain other conditions. If the court agrees with you on most issues in your case and finds that our position was largely unjustified, you may be able to recover some of your administrative and litigation costs. You will not be eligible to recover these costs unless you tried to resolve your case administratively, including going through the appeals system, and you gave us the information necessary to resolve the case.

Collections

Publication 594, The IRS Collection Process, explains your rights and responsibilities regarding payment of federal taxes. It describes:

- What to do when you owe taxes. It describes what to do if you get a tax bill and what to do if you think your bill is wrong. It also covers making installment payments, delaying collection action, and submitting an offer in compromise.
- IRS collection actions. It covers liens, releasing a lien, levies, releasing a levy, seizures and sales, and release of property.

Your collection appeal rights are explained in detail in Publication 1660, Collection Appeal Rights.

Innocent Spouse Relief

Generally, both you and your spouse are each responsible for paying the full amount of tax, interest, and penalties due on your joint return. However, if you qualify for innocent spouse relief, you may be relieved of part or all of the joint liability. To request relief, you must file Form 8857, Request for Innocent Spouse Relief. For more information on innocent spouse relief, see Publication 971, Innocent Spouse Relief, and Form 8857.

Potential Third Party Contacts

Generally, the IRS will deal directly with you or your duly authorized representative. However, we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received. If we do contact other persons, such as a neighbor, bank, employer, or employees, we will generally need to tell them limited information, such as your name. The law prohibits us from disclosing any more information than is necessary to obtain or verify the information we are seeking. Our need to contact other persons may continue as long as there is activity in your case. If we do contact other persons, you have a right to request a list of those contacted.

Refunds

You may file a claim for refund if you think you paid too much tax. You must generally file the claim within 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later. The law generally provides for interest on your refund if it is not paid within 45 days of the date you filed your return or claim for refund. Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, has more information on refunds.

If you were due a refund but you did not file a return, you generally must file your return within 3 years from the date the return was due (including extensions) to get that refund.

Tax Information

The IRS provides the following sources for forms, publications, and additional information.

- ***Tax Questions:*** 1-800-829-1040 (1-800-829-4059 for TTY/TDD)
- ***Forms and Publications:*** 1-800-829-3676 (1-800-829-4059 for TTY/TDD)
- ***Internet:*** *www.irs.gov*
- ***Small Business Ombudsman:*** A small business entity can participate in the regulatory process and comment on enforcement actions of IRS by calling 1-888-REG-FAIR.
- ***Treasury Inspector General for Tax Administration:*** You can confidentially report misconduct, waste, fraud, or abuse by an IRS employee by calling 1-800-366-4484 (1-800-877-8339 for TTY/TDD). You can remain anonymous.

EXHIBIT B

Before the Internal Revenue Service
U.S. Department of the Treasury

Petition for Rulemaking On Campaign Activities by Section 501(c)(4) Organizations

---

Introduction

1. This petition for rulemaking, filed by Democracy 21 and the Campaign Legal Center, calls on the IRS to revise its existing regulations relating to the determination of whether an organization that intervenes or participates in elections is entitled to obtain or maintain an exemption from taxation under 26 U.S.C. § 501(c)(4). The existing IRS regulations do not conform with the statutory language of section 501(c)(4) of the Internal Revenue Code (IRC) nor with the judicial decisions that have interpreted this IRC provision and are, accordingly, contrary to law.

2. Following the Supreme Court's ruling last year in *Citizens United v. Federal Election Commission*¸ 130 S.Ct. 876 (2010), which struck down the ban on corporate spending in federal campaigns, non-profit corporations organized as "social welfare" organizations under section 501(c)(4) of the IRC engaged in an unprecedented amount of campaign spending to influence the 2010 congressional elections. According to the Center for Responsive Politics, spending by all section 501(c) groups in the 2010 election is estimated to have totaled as much as

$135 million.[1] Virtually all of the money used for these campaign expenditures came from sources kept secret from the American people. The 2010 campaign thus witnessed the return of huge amounts of secret money to federal elections not seen since the era of the Watergate scandals.

3. Section 501(c)(4) of the IRC establishes tax-exempt status for "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. . . ." 26 U.S.C. § 501(c)(4) (emphasis added). IRS regulations make clear that spending to intervene or participate in political campaigns does not constitute "promotion of social welfare." 26 C.F.R. § 1.501(c)(4)-l(a)(2)(ii).

4. Current IRS regulations, nevertheless, authorize section 501(c)(4) organizations to intervene and participate in campaigns as long as such campaign activities do not constitute the "primary" activity of the organization, which must be the promotion of social welfare. 26 C.F.R. § 1.501(c)(4)–1(a)(2)(i). The "primary" activity standard established by the IRS regulation is not further defined by the IRS. Instead, a revenue ruling explains that "all facts and circumstances are taken into account in determining a § 501(c)(4) organization's primary activity." Practitioners, however, have interpreted this "primary" activity requirement to mean that section 501(c)(4) organizations can spend up to 49 percent of their total expenditures in a tax year on campaign activities, without such campaign activities constituting the "primary" activity of the organization.

5. These regulations and interpretations are in direct conflict with the statutory language of the IRC that requires section 501(c)(4) organizations to engage *exclusively* in the promotion of social welfare and with court decisions that have held that section 501(c)(4)

---

[1] *See* http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&disp= O&type =U&chrt=D.

organizations cannot engage in a substantial amount of "nonexempt activity," such as campaign activity. Contrary to the IRC language and court decisions, the regulations permit 501(c)(4) organizations to engage in *substantial* campaign activity, as long as this nonexempt activity falls just short of being the organization's "primary" activity. Thus the regulations permit far more campaign activity by a 501(c)(4) organization than the limited amount allowed by the statute and court decisions. The IRS's regulations conflict with the IRC and court decisions interpreting the IRC, and are contrary to law**.**

6. This petition calls on the IRS to expeditiously adopt new regulations to provide that an organization that intervenes or participates in elections is not entitled to obtain or maintain tax- exempt status under section 501(c)(4) if the organization spends *more than an insubstantial amount* of its total expenditures in a tax year on campaign activity. The new regulations should include a bright-line standard to make clear that an "insubstantial amount" of campaign activities means a minimal amount, not 49 percent, of its activities. The bright-line standard should place a ceiling on campaign expenditures of no more than 5 or 10 percent of total annual expenditures in order to comply with the standard used by the courts that a section 501(c)(4) organization may engage in no more than an insubstantial amount of non-exempt activity.

7. Such a bright-line standard is necessary to ensure that the public and the regulated community have clear and proper guidance on the total amount of campaign activity that a section 501(c)(4) organization can conduct and to assist the IRS in obtaining compliance with, and in properly enforcing, the IRC.

8. If a section 501(c)(4) organization wants to engage in more than the insubstantial amount of campaign activities permitted by the IRC and court decisions, the organization can

establish an affiliated section 527 organization to do so. The IRS regulations, however, must make clear that a section 527 organization (or any other person) cannot be used by a section 501(c)(4) organization to circumvent the limit on how much a 501(c)(4) organization can spend on campaign activities. Accordingly, the new regulations should provide that a section 501(c)(4) organization may not obtain or maintain tax-exempt status if the section 501(c)(4) organization transfers funds to a section 527 organization or to any other person during its taxable year with the intention or reasonable expectation that the funds will be used to intervene or participate in campaigns, and if the transferred funds, when added to the amount directly spent by the section 501(c)(4) organization on campaign activities during the same taxable year exceeds the insubstantial amount restriction imposed by the IRC and the courts.

9. The petition calls on the IRS to act promptly to ensure that new regulations are put in place and made effective on a timely basis for the 2012 elections. The IRS must recognize the urgent need to prevent section 501(c)(4) organizations from being improperly used to spend hundreds of millions of dollars in secret contributions to influence the 2012 presidential and congressional elections.

Petitioners

10. Democracy 21 is a nonpartisan, nonprofit organization that works to strengthen our democracy, protect the integrity of our political system against corruption and provide for honest and accountable elected officeholders and public officials. The organization promotes campaign finance reform, lobbying and ethics reforms, transparency and other government integrity measures, conducts public education efforts to accomplish these goals, participates in litigation involving the constitutionality and interpretation of campaign finance laws and engages in efforts to help ensure that campaign finance laws are properly enforced and implemented.

11. The Campaign Legal Center is a nonpartisan, nonprofit organization that works in the areas of campaign finance and elections, political communication and government ethics. The Campaign Legal Center offers nonpartisan analyses of issues and represents the public interest in administrative, legislative and legal proceedings. The Campaign Legal Center also participates in generating and shaping our nation's policy debate about money in politics, disclosure, political advertising, and enforcement issues before the Congress, the Federal Communications Commission, FEC and the IRS.

Factual Background

12. The *Citizens United* decision was issued by the Supreme Court on January 21, 2010. According to one published report, "[O]utside groups were able to adapt quickly and take advantage of the *Citizens United* decision in early 2010 to spend enough to impact congressional elections just nine months later."[2] Much of this outside spending was done by section 501(c)(4) organizations that made campaign expenditures without disclosing the sources of these funds.

13. Section 501(c)(4) organizations played an important overall role in the 2010 campaign. A recent article in *Roll Call* states:

> Republican political operatives bestow immense credit for their party's competitiveness in 2010 on organizations such as Crossroads GPS and the American Action Network, both 501(c)(4) organizations. These groups can accept large donations they do not have to disclose, and Republicans believe their participation in the campaign brought the party to parity with Democrats, who typically benefit from the largesse of organized labor.[3]

---

[2] K. Doyle, "2010 Battle Over Citizens United Ruling Still Unresolved as 2012 Campaign Looms," *BNA Money & Politics Report* (Jan. 12, 2011)

[3] A. Becker and D. Drucker, "Members Weigh in on Draft Disclosure Order," *Roll Call* (May 24, 2011).

14. The role of secret money in the 2010 congressional races is illustrated by the activities of Crossroads GPS ("GPS" stands for "Grassroots Policy Strategies"), which was organized in July 2010 under section 501(c)(4) and was one of the organizations that engaged in the greatest amount of independent spending to influence the 2010 congressional races.[4] Crossroads GPS is affiliated with American Crossroads, a non-profit political organization registered under 26 U.S.C. §527. American Crossroads is registered with the Federal Election Commission as a political committee under the Federal Election Campaign Act.

15. According to a report in *Time*, "American Crossroads was the brainchild of a group of top Republican insiders, including two of George W. Bush's closest White House political advisers, Karl Rove and Ed Gillespie, both of whom remain informal advisers."[5] Another published report referred to American Crossroads and Crossroads GPS as "a political outfit conceived by Republican operatives Karl Rove and Ed Gillespie."[6] According to the *Los Angeles Times*, both groups "receive advice and fundraising support from Rove."[7]

---

[4] Democracy 21 and the Campaign Legal Center filed an IRS complaint against Crossroads GPS on October 5, 2010, requesting the IRS to investigate whether Crossroads GPS was operating in violation of the current requirements for obtaining or maintaining section 501(c)(4) tax status. Even under the existing, overly permissive IRS regulations, the complaint said the IRS "should investigate whether Crossroads GPS has a primary purpose of 'participation or intervention in political campaigns on behalf of or in opposition to' candidates for public office, which is not a permissible primary purpose for a section 501(c)(4) organization." Complaint at 15.

[5] M. Crowley, "The New GOP Money Stampede," *Time* (Sept. 16, 2010).

[6] K. Vogel, "Rove-tied group raises $2 million," *Politico* (Aug. 21, 2010).

[7] M. Reston and A. York, "Karl Rove-linked group launches new hit against Boxer," *The Los Angeles Times* (Aug. 25, 2010).

16. According to the Center for Responsive Politics, Crossroads GPS spent a total of $17.1 million on campaign activity, including both independent expenditures and electioneering communications, in the 2010 federal elections.[8]

17. According to published reports, Crossroads GPS was created as a section 501(c)(4) group to receive contributions to pay for campaign expenditures from donors who wanted to secretly influence federal elections and did not want their names disclosed, as they would have been if the contributions had gone instead to its section 527 affiliate, American Crossroads, which is required to disclose its donors.

18. As one published report states:

> A new political organization conceived by Republican operatives Karl Rove and Ed Gillespie formed a spin-off group last month that – thanks in part to its ability to promise donors anonymity – has brought in more money in its first month than the parent organization has raised since it started in March.[9]

The same article quotes Steven Law, the head of both American Crossroads and Crossroads GPS as saying that "the anonymity of the new 501(c)(4) GPS group was appealing for some donors." *Id.* The article also states:

> [A] veteran GOP operative familiar with the group's fundraising activities said the spin-off was formed largely because donors were reluctant to see their names publicly associated with giving to a 527 group, least of all one associated with Rove, who Democrats still revile for his role in running former President George W. Bush's political operation.

---

[8] *See* http://www.opensecrets.org/outsidespending/detail.php?cmte=Crossroads+ Grassroots+ Policy+Strategies&cycle=2010.

[9] K. Vogel, "Rove-linked group uses secret donors to fund attacks," *Politico* (July 21, 2010) (emphasis added).

Id. In another article, Law is quoted as saying, "I wouldn't want to discount the value of confidentiality to some donors."[10]

19. Another published report calls Crossroads GPS a "spinoff of American Crossroads" and states that "this 501-c-4 group can keep its donor list private – a major selling point for individuals and corporations who want to anonymously influence elections."[11] At a public appearance, Carl Forti, the political director for Crossroads GPS and its affiliate, American Crossroads, made clear that campaign spending was directed through a 501(c)(4) arm precisely because American Crossroads is seeking to provide donors with the opportunity to secretly finance these campaign expenditures:

> Forti acknowledged that his group relied heavily on its nonprofit arm, which isn't required to name the sources of its funding, simply because "some donors didn't want to be disclosed. . . .I know they weren't comfortable."[12]

In another article, Forti is quoted as saying, "You know, disclosure was very important to us, which is why the 527 was created. But some donors didn't want to be disclosed, and, therefore, the (c)(4) was created."[13]

20. According to press reports, Crossroads GPS will remain very active in the 2012 elections. One report states that American Crossroads, the section 527 arm, engaged in heavy

---

[10] K. Vogel, "Crossroads hauls in $8.5M in June," *Politico* (June 30, 2010).

[11] H. Bailey, "A guide to the 'shadow GOP': the groups that may define the 2010 and 2012 elections," *The Upshot-Yahoo News* (Aug. 5, 2010).

[12] S. Peoples, "Groups Target Democrats Using Nancy Pelosi," *Roll Call* (Dec. 14, 2010).

[13] P. Overby, "Group Behind Election Ads Weighs In On Tax Deal," *National Public Radio* (Dec. 14, 2010).

spending in a special congressional election in New York State held in May, 2011. According to this report:

> Crossroads and its nonprofit affiliate, Crossroads GPS, have vowed to raise $120 million for the 2012 cycle.
>
> Crossroads spokesman Jonathan Collegio said. . .Crossroads will continue to spend heavily in many competitive races through next November.
>
> "The Crossroads groups have stated that we'll be involved heavily in 2012, both in congressional races and the presidential side as well," Collegio said.[14]

The statement by the Crossroads spokesman makes clear that Crossroads GPS, the section 501(c)(4) arm, will be "heavily" involved in spending to influence the 2012 federal elections. According to another recent report, "American Crossroads and Crossroads GPS, two groups that have relied heavily on fundraising help from political guru Karl Rove, have said they're aiming to raise $120 million for the next election, versus the $71 million they raised in 2010. . . .In an early sign of its financial strength, Crossroads GPS announced Friday that it was launching a two-month, $20 million television ad blitz attacking Obama's record on jobs, the deficit and the overall economy. The first ads will start June 27 and run in key battleground states such as Colorado, Florida, Missouri, Nevada and Virginia."[15]

21. Section 501(c)(4) groups will be used by both Democratic and Republican groups in 2012 as vehicles to allow anonymous donors to secretly finance campaign expenditures. (In the 2010 congressional races, the section 501(c)(4) groups were primarily pro-Republican groups.) According to an article in the *Los Angeles Times* (April 29, 2011), former Obama

---

[14] D. Eggen, "Political groups, now free of limits, spending heavily ahead of 2012," *The Washington Post* (May 21, 2011) (emphasis added).

[15] P. Stone, "Obama groups raise $4-5 million in first two months," *iWatch News – The Center for Public Integrity* (June 24, 2011) (http://www.iwatchnews.org/2011/06/24/5025/obama-groups-raise-4-5-million-first-two-months).

White House officials and Democratic political operatives Bill Burton and Sean Sweeney have formed a new section 501(c)(4) group to participate in the 2012 presidential election:

> Priorities USA has been formed as a 501(c)(4) organization – a nonprofit social welfare group that can raise unlimited amounts of money without disclosing the identity of its donors. It putatively is designed to focus on issues – in this case, "to preserve, protect and promote the middle class" – but can spend up to half its money on political activities.[16]

An article in the *New York Times* states:

> The groups are to be called Priorities USA and Priorities USA Action, and, as such, are modeled after the Republican groups American Crossroads and Crossroads GPS that were started with the help from the strategist Karl Rove and were credited with helping greatly in the party's takeover of the House of Representatives this year – and, it happens, with facilitating a waterfall of anonymous donations from moneyed interests in the November elections.
>
> Like Crossroads GPS, Democrats connected to the groups – including a close onetime aide to Mr. Obama, the former deputy White House spokesman Bill Burton, and Sean Sweeney, a former aide to the former White House chief of staff Rahm Emanuel – said that Priorities USA would be set up under a section of the tax code that allows its donors to remain anonymous if they so choose (as most usually do).[17]

22. According to information compiled by the Center for Responsive Politics, there were 45 groups organized under section 501(c) of the Internal Revenue Code that reported making "independent expenditures" of $100,000 or more in the 2010 congressional elections, and which in aggregate totaled more than $50 million. These groups, with minor exceptions, did not disclose their donors.[18] "Independent expenditures" are defined as expenditures for

---

[16] M. Gold, "Former Obama aides launch independent fundraising groups," *Los Angeles Times*, April 29, 2011.

[17] J. Rutenberg, "Democrats Form Fund-Raising Groups," *The New York Times* (April 29, 2011) (emphasis added).

[18] *See* http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt= D&disp= O&type=I.

communications that contain "express advocacy" or the "functional equivalent" of express advocacy. 2 U.S.C. § 431(17)(a). The top section 501(c)(4) groups in this category included:

501(c)(4) Corporation	Amount Spent on Independent Expenditures in 2010 Elections	Disclosure of Contributors Funding Independent Expenditures in 2010
Crossroads GPS	$16 Million	None
American Future Fund	$7.4 Million	None
60 Plus Association	$6.7 Million	None
American Action Network	$5.6 Million	None
Americans for Tax Reform	$4.1 Million	None
Revere America	$2.5 Million	None

23. According to the Center for Responsive Politics, there were 20 section 501(c) groups that reported spending $100,000 or more for "electioneering communications" in the 2010 congressional elections, expenditures that in aggregate totaled more than $70 million. These groups, with minor exceptions, did not disclose their donors.[19] "Electioneering communications" are defined as expenditures for broadcast ads that refer to federal candidates and are aired in the period 60 days before a general election or 30 days before a primary election. 2 U.S.C. § 434(f)(3). The top section 501(c)(4) groups in this category included:

501(c)(4) Corporation	Amount Spent on Electioneering Communications in 2010 Elections	Disclosure of Contributors Funding Electioneering Communications in 2010
American Action Network	$20.4 Million	None
Center for Individual Freedom	$2.5 Million	None
American Future Fund	$2.2 Million	None
CSS Action Fund	$1.4 Million	None
Americans for Prosperity	$1.3 Million	None
Crossroads GPS	$1.1 Million	None

[19] *See* http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt=V&disp=O&type=E.

24. The Center for Responsive Politics reports that, in aggregate, section 501(c) groups that disclosed none of their donors spent a total of more than $137 million on independent expenditures and electioneering communications to influence the 2010 elections.[20]

25. Campaign spending by section 501(c)(4) organizations is expected to greatly increase in the 2012 presidential and congressional races. As one published report states,

> [W]ith a full two years instead of a few months to adapt to the changed legal landscape, such outside groups may be poised to have even bigger impact, experts say. Additionally, Democratic-leaning groups were somewhat subdued in 2010, due at least partly to the public stance of Obama and top congressional Democrats in opposition to the *Citizens United* ruling and its impact on campaign spending. This may not be the case in 2012, as many observers predict that Democratic-leaning groups will gear up to compete more effectively.[21]

Since 2012 involves a presidential election as well as congressional races, and since it is expected that Democratic and Republican groups will use section 501(c)(4) organizations to make campaign expenditures in 2012, section 501(c)(4) organizations are expected to spend far greater amounts of secret contributions in the 2012 elections than they did in 2010, absent the IRS adopting new regulations on a timely basis to ensure that section 501(c)(4) organizations can engage in no more than an "insubstantial" amount of campaign activities, in compliance with the IRC and court decisions.

---

[20] *See* http://www.opensecrets.org/outsidespending/summ.php?cycle=2010&chrt= D&disp=O&type=U.

[21] Doyle , *BNA Report, supra.*

Basis for New Rulemaking

26. Section 501(c)(4) of the Internal Revenue Code establishes tax-exempt status for "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. . . ." 26 U.S.C. § 501(c)(4) (emphasis added).

27. IRS regulations state that spending to intervene or participate in campaigns does not constitute promotion of social welfare. Section 1.501(c)(4)-l(a)(2)(ii) of the IRS regulations states, "The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office." 26 C.F.R. § 1.501(c)(4)–1(a)(2)(ii).

28. Contrary to the statutory language of the IRC, IRS regulations construe the requirement that a 501(c)(4) organization be "operated exclusively" for the promotion of social welfare to be met if the organization is "primarily engaged" in social welfare activities. This is a highly unusual interpretation of the word "exclusively." According to the IRS regulations, "An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about social betterments and civic improvements." 26 C.F.R. § 1.501(c)(4)–1(a)(2)(i) (emphasis added).

29. In a revenue ruling, the IRS has stated, "Although the promotion of social welfare within the meaning of section 501(c)(4)-1 of the regulations does not include political campaign activities, the regulations do not impose a complete ban on such activities for section 501(c)(4) organizations. Thus, an organization may carry on lawful political activities and remain exempt under section 501(c)(4) as long as it is engaged primarily in activities that promote social

welfare." Rev. Rul. 81–95, 1981–1 C.B. 332 (emphasis added). The "primarily engaged" standard established by the IRS regulation is not further defined by the IRS. Instead, a revenue ruling explains that "all facts and circumstances are taken into account in determining a § 501(c)(4) organization's primary activity." Rev. Rul. 68-45, 1968-1 C.B. 259.

30. In the absence of guidance from the IRS, practitioners have interpreted the "primarily engaged" standard to mean that a section 501(c)(4) organization can spend as much as 49 percent of its total expenditures in a taxable year on campaign activities and still be in compliance with the IRC. A report by the Congressional Research Service (CRS), for instance, states with regard to the "primarily engaged" standard, "some have suggested that primary simply means more than 50%. . . ."[22] The report notes that "others have called for a more stringent standard," but explains that even this "more stringent" standard would still permit substantial campaign expenditures of up to 40% of total program expenditures. *Id.*

31. Under the IRS "primarily engaged" standard, section 501(c)(4) groups have engaged in substantial campaign activity. This is contrary to the language of the IRC, which requires (c)(4) organizations to be "operated exclusively" for social welfare purposes and contrary to court rulings interpreting the IRC to mean that section 501(c)(4) organizations are not allowed to engage in a substantial amount of an activity that does not further their exempt purposes. As IRS regulations have made clear, intervention or participation in campaigns does not further the "social welfare" purposes of section 501(c)(4) organizations, and so the court rulings mean that section 501(c)(4) organizations cannot engage in more than an insubstantial amount of campaign activities.

---

[22] Congressional Research Service, "501(c)(4) Organizations and Campaign Activity: Analysis Under Tax and Campaign Finance Law," R40183 (January 29, 2009) at 2.

32. The courts have interpreted the section 501(c)(4) standard that requires an organization to be "operated exclusively" for social welfare purposes the same way they have interpreted a parallel provision of section 501(c)(3) that requires an organization that is tax exempt under that provision to be "organized and operated exclusively" for charitable, education or similar purposes. In *Better Business Bureau v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court construed a requirement that a non-profit organization be "organized and operated exclusively" for educational purposes to mean that "the presence of a single non-educational purpose, *if substantial in nature*, will destroy the exemption regardless of the number or importance of truly educational purposes." (emphasis added).

33. Based on the *Better Business Bureau* decision, the courts have concluded that the word "exclusively" in the context of sections 501(c)(3) and 501(c)(4) is "a term of art" that does not mean "exclusive" as that term is normally understood and used. The courts instead have said that, in the context of section 501(c)(4) of the IRC, this term means "that the presence of a single substantial non-exempt purpose precludes tax-exempt status regardless of the number or importance of the exempt purposes." *Contracting Plumbers Coop. Restor. Corp. v. U.S.*, 488 F.2d 684, 686 (2d. Cir. 1973) (section 501(c)(4)); *American Ass'n of Christian Sch. Vol. Emp. v. U.S.*, 850 F.2d 1510, 1516 (11th Cir. 1988) ("the presence of a substantial non-exempt purpose precludes exemption under Section 501(c)(4)"); *Mutual Aid Association v. United States,* 759 F.2d 792, 796 (10th Cir. 1985) (same; section 501(c)(4)). The courts have similarly held, in the context of section 501(c)(3) organizations, that "operated exclusively" test means that "not more than an insubstantial part of an organization's activities are in furtherance of a non-exempt purpose." *Easter House v. United States,* 12 Ct. Cl. 476, 483 (1987) (group not organized exclusively for a tax exempt purpose under section 501(c)(3)); *New Dynamics Foundation v.*

United States; 70 Fed. Cl. 782, 799 (Fed. Cl. Ct. 2006) (same); *Nonprofits Ins. Alliance of California v. U.S.*, 32 Fed. Cl. 277, 282 (Fed. Cl. Ct. 1994) (same).

34. Under these court rulings, a section 501(c)(4) organization cannot engage in more than an insubstantial amount of campaign activity and remain in compliance with the statutory requirements for tax-exempt status under section 501(c)(4). Any "substantial, non-exempt purpose" (such as campaign activity) will defeat an organization's tax-exempt status under section 501(c)(4). *Christian Sch. Vol. Emp., supra* at 1516.

35. Given that a number of section 501(c)(4) organizations have spent millions of dollars on campaign activities, and that it is reasonable to anticipate more will do so in 2012, it is clear that the current regulations are not preventing section 501(c)(4) organizations from impermissibly engaging in "substantial" campaign activities.

36. Accordingly, this petition calls on the IRS to promptly issue new regulations that properly define the statutory requirement for section 501(c)(4) organizations to be "operated exclusively" for social welfare purposes to mean that campaign activity may not constitute more than an insubstantial amount of the activities of a group organized under section 501(c)(4). These regulations are necessary to bring IRS rules into compliance with the IRC and with court rulings interpreting the IRC. The regulations also would have the effect of greatly diminishing the practice of section 501(c)(4) groups being improperly used to spend large amounts of secret contributions in federal elections.

37. In order to provide a clear definition of what constitutes an insubstantial amount of campaign activity, the IRS regulations should include a bright-line standard that specifies a cap on the amount that a section 501(c)(4) organization can spend on campaign activities. *See, e.g.*, 26 U.S.C. §501(h) (providing specific dollar limits on spending for lobbying activities by

section 501(c)(3) organizations). In order to comply with court decisions that limit spending for non-exempt purposes to an insubstantial amount, the bright line standard in the regulations should limit campaign expenditures to no more than 5 or 10 percent of the expenditures in a taxable year by a section 501(c)(4) organization.

38. The new regulations should ensure that a section 501(c)(4) organization cannot do indirectly through transfers what it is not permitted to do directly through its own spending. In order to accomplish this, the new regulations should provide that a section 501(c)(4) organization may not obtain or maintain its tax-exempt status if the it transfers funds to a section 527 organization or to any other person with the intention or reasonable expectation that the recipient will use those funds to intervene or participate in campaigns if, during the same taxable year, the amount of funds so transferred, when added to the amount spent directly for campaign activity by the section 501(c)(4) organization, exceeds an insubstantial amount of the total spending for the taxable year by the section 501(c)(4) organization.

Conclusion

39. Political operatives have established, and are continuing to establish, section 501(c)(4) organizations for the explicit purpose of providing a vehicle for donors to secretly finance campaign expenditures by these organizations. The overriding purpose of a number of these 501(c)(4) organizations is to conduct full-scale campaign activities in the guise of conducting “social welfare” activities.

40. IRS regulations that are contrary to law are enabling section 501(c)(4) organizations to conduct impermissible amounts of campaign activities and in doing so to keep secret from the American people the sources of tens of millions of dollars being spent by the

section 501(c)(4) organizations to influence federal elections. In so doing, the IRS regulations are serving to deny citizens essential campaign finance information that the Supreme Court in *Citizens United* said "permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages." 130 S.Ct. at 916.

41. The Supreme Court in *Citizens United* explained the importance to citizens of this disclosure, stating:

> With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters.
>
> Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits, and citizens can see whether elected officials are "'in the pocket' of so-called moneyed interests."

Id. By an 8-1 vote, the Supreme Court in *Citizens United* held that disclosure of campaign activities by corporations, including tax-exempt corporations, is constitutional and serves important public purposes. Such disclosure, however, is being widely circumvented and evaded by section 501(c)(4) organizations as a result of improper IRS regulations and the failure of the IRS to properly interpret and enforce the IRC to prohibit section 501(c)(4) organizations from making substantial expenditures to influence political campaigns. This failure comes at great expense to the American people who have a right to know who is providing the money that is being spent to influence their votes.

42. The large scale spending of secret contributions in federal elections by section 501(c)(4) organizations is doing serious damage to the integrity and health of our democracy and political system. The IRS needs to act promptly to address this problem by issuing new regulations to stop section 501(c)(4) organizations from being improperly used to inject tens of

millions of dollars in secret contributions into federal elections. The new regulations must conform with the IRC and with court rulings interpreting the IRC. The regulations should provide a bright-line standard that implements the insubstantial expenditures standard set forth by the courts and specifies a limit on the amount of campaign activity that a section 501(c)(4) organization may undertake consistent with its tax-exempt status. The IRS needs to act expeditiously to ensure that the new regulations are in effect in time for the 2012 elections.

Respectfully submitted,

/s/ Fred Wertheimer

Fred Wertheimer
DEMOCRACY 21
2000 Massachusetts Ave, N.W.
Washington, D.C. 20036
(202) 355-9610

Donald J. Simon
SONOSKY CHAMBERS SACHSE
ENDRESON & PERRY, LLP
1425 K Street, N.W.
Suite 600
Washington, D.C. 20005
(202) 682-0240

Counsel for Democracy 21

J. Gerald Hebert
Paul S. Ryan
Tara Malloy
CAMPAIGN LEGAL CENTER
215 E Street NE
Washington, D.C. 20002
(202) 736-2200

Counsel for the Campaign Legal Center

July 27, 2011

EXHIBIT C

March 22, 2012

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

Lois Lerner
Director of the Exempt Organizations Division
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Petition for rulemaking on candidate election activities by Section 501(c)(4) groups

Dear Commissioner Shulman and Director Lerner:

On July 27, 2011, Democracy 21 and the Campaign Legal Center submitted to the Internal Revenue Service a "Petition for Rulemaking on Campaign Activities by Section 501(c)(4) Groups."

The Petition challenged as contrary to law the existing regulations that define eligibility for an organization to qualify for section 501(c)(4) tax-exempt status. The Petition called on the IRS to initiate a rulemaking proceeding to revise and clarify its regulations regarding the extent of candidate election activities that a "social welfare" organization can engage in under 26 U.S.C. § 501(c)(4).

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

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

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

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

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

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

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

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

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

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

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

---

[1] E. Carney, "Rules of the Game: Bad News for Nation's Nonprofits," *Roll Call* (March 20, 2012).

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

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

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

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

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

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

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

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

---

[2] *See* Letters of October 5, 2010, September 28, 2011, December 14, 2011 and March 9, 2012.

> Instead, corporate lobbyists and others say companies have preferred to give to politically active nonprofits that allow their donations to stay anonymous. . . .
>
> Millionaires and others might see an advantage to giving to super PACs, but one in-house corporate lobbyist told POLITICO that "nondisclosure is always preferred" when it comes to any contribution to mitigate any public perception issues and shareholder controversy.
>
> It's unclear how much money is being directed to nonprofit advocacy organizations – 501(c)(4)s – which do not have to disclose their donors to the Federal Election Commission but are in many cases associated with Super PACs.[3]

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

This is information that the Supreme Court in *Citizens United* said "permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages." *Citizens United v. FEC,* 130 S. Ct. 876, 916 (2010).

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

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

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

Sincerely,

/s/ Gerald Hebert	*/s/ Fred Wertheimer*
J. Gerald Hebert	Fred Wertheimer
Executive Director	President
Campaign Legal Center	Democracy 21

[3] A. Palmer and A. Phillip, "Corporations not funding super PACs," *Politico* (March 8, 2012).

EXHIBIT D

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

JUL 17 2012

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

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

Dear Messrs. Wertheimer and Hebert:

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

The IRS is aware of the current public interest in this issue. These regulations have been in place since 1959. We will consider proposed changes in this area as we work with the IRS Office of Chief Counsel and the Treasury Department's Office of Tax Policy to identify tax issues that should be addressed through regulations and other published guidance.

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

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

EXHIBIT E

July 23, 2012

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

Lois Lerner
Director of the Exempt Organizations Division
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Petition for rulemaking on campaign activities by Section 501(c)(4) tax-exempt organizations

Dear Commissioner Shulman and Director Lerner:

Democracy 21 and the Campaign Legal Center acknowledge and welcome the letter we received from Ms. Lerner on July 17, 2012 in response to our letter of July 27, 2011 which transmitted a "Petition for Rulemaking on Campaign Activities by Section 501(c)(4) organizations," and our subsequent letter of March 22, 2012 following up on the Petition request.

Our letters and Petition urged the Internal Revenue Service (IRS) to undertake a rulemaking to clarify and bring into compliance with the law the IRS regulations that govern campaign activity by "social welfare" organizations claiming tax-exempt status under section 501(c)(4) of the Internal Revenue Code (IRC).

In her July 17, 2012 letter, Ms. Lerner stated:

> The IRS is aware of the current public interest in this issue. These regulations have been in place since 1959. We will consider proposed changes in this area as we work with the IRS Office of Chief Counsel and the Treasury Department's Office of Tax Policy to identify tax issues that should be addressed through regulations and other published guidance.

As you know from our letters, we believe the "proposed changes in this area" that Ms. Lerner says the IRS will now consider are crucially important and need to be made with urgency.

The circumstances surrounding the role being played today by a number of section 501(c)(4) groups in presidential and congressional elections are dramatically different than the circumstances that existed 53 years ago when the current IRS regulations were put in place.

We believe the letter from Ms. Lerner recognizes the controversy that currently exists over the role that groups claiming status as "social welfare" organizations are playing in our elections, post-*Citizens United.*

One year ago, on July 27, 2011, Democracy 21 and the Campaign Legal Center submitted a Petition for rulemaking to the IRS on this important matter.

The Petition challenged as contrary to law the existing regulations that define eligibility for an organization to qualify for section 501(c)(4) tax status. The Petition called on the IRS to initiate a rulemaking proceeding to revise and clarify its regulations regarding the extent of candidate election activities that a "social welfare" organization can engage in under 26 U.S.C. § 501(c)(4).

The Petition called for expeditious action by the IRS in order to protect the integrity of the 2012 federal elections:

> The large scale spending of secret contributions in federal elections by section 501(c)(4) organizations is doing serious damage to the integrity and health of our democracy and political system. The IRS needs to act promptly to address this problem by issuing new regulations to stop section 501(c)(4) organizations from being improperly used to inject tens of millions of dollars in secret contributions into federal elections. The new regulations must conform with the IRC and with court rulings interpreting the IRC. The regulations should provide a bright-line standard that implements the insubstantial expenditures standard set forth by the courts and specifies a limit on the amount of campaign activity that a section 501(c)(4) organization may undertake consistent with its tax-exempt status. <u>The IRS needs to act expeditiously to ensure that the new regulations are in effect in time for the 2012 presidential and congressional elections</u>.

Petition at 18-19 (emphasis added).

We wrote to you again on March 22, 2012 to urge you to take action on our Petition and initiate a rulemaking proceeding.

Meanwhile, developments in the course of the 2012 national elections have served to underscore that IRS regulations that are contrary to law are facilitating widespread misuse and abuse of the tax laws by organizations claiming tax-exempt status under section 501(c)(4) as

"social welfare" organizations, in order to keep secret the donors financing their campaign-related expenditures.

Campaign-related spending by section 501(c)(4) groups whose overriding purpose clearly appears to be influencing elections, has grown exponentially since we first called on the IRS to conduct a rulemaking proceeding a year ago.

For example, we have written to you previously on several occasions challenging the claim by Crossroads GPS, a group affiliated with the American Crossroads super PAC, that it is entitled to section 501(c)(4) tax-status. We have repeatedly asked you to investigate this matter.

According to a recent news article, Crossroads GPS and American Crossroads together "are poised to inject up to $70 million into a battle for the Senate on behalf of the Republicans."[1]

Another article recently noted, "The GOP independent spending goliath American Crossroads and its affiliate group Crossroads GPS are launching a new barrage of attack ads in six competitive Senate races, assailing a range of Democratic candidates as big-spending, liberal, ethically challenged and overly close to President Barack Obama."[2] The article states that American Crossroads is targeting the Nebraska, Nevada and Virginia Senate contests "while 501(c)(4) Crossroads GPS is funding the ads in North Dakota, Missouri and Ohio."

An earlier article reported that a $25 million advertising campaign by Crossroads GPS in 10 swing states that began on May 23, 2012 "is expected to become one of the most heavily broadcast political commercials of this phase of the general election." According to the article, Crossroads GPS conducted "18 different focus groups" that took place "over nearly a year" and that provided "a clear rationale for voters to deny Mr. Obama a second term."[3]

There is little doubt that Crossroads GPS is spending tens of millions of dollars to influence the 2012 national elections and also little reason to doubt that influencing elections, and not "social welfare activities," is the overriding purpose of the group.

While Crossroads GPS may be the biggest and most blatant example of massive campaign spending by a group claiming tax-exempt status as a section 501(c)(4) "social welfare" organization, it is by no means the only such group.

We have also previously written to you on several occasions challenging the claims to 501(c)(4) tax-exempt status by American Action Network, Priorities USA and Americans Elect,

---

[1] D. Drucker and S. Toeplitz, "American Crossroads' $70 Million Senate Blitz," *Roll Call* (July 11, 2012).

[2] A. Burns, "Crossroads bombards six Dem Senate candidates, hits Berkley on ethics," *Politico* (June 13, 2012).

[3] J. Peters, "Subtler Entry From Masters of Attack Ads," *The New York Times* (May 22, 2012)

and asking for IRS investigations of these groups which have also been spending large sums to influence federal elections.

For example, we informed you in our letter of December 14, 2011 that American Action Network in 2010 reportedly spent $26 million of its total expenditures of $30 million, or 87 percent, on campaign-related activities that the group reported to the FEC as "independent expenditures" and "electioneering communications."[4] It is hard to see on what conceivable basis this group could qualify for tax-exempt status as a section 501(c)(4) "social welfare" group.

The reason that section 501(c)(4) groups are being used as vehicles for spending large amounts to influence elections is that they are providing anonymity to their donors. A recent article about Crossroads GPS and one of its donors, casino executive Steve Wynn, stated:

> Unlike super PACs, Crossroads GPS is registered under a section of the tax code for so-called "social welfare" groups – 501(c)(4) – that does not require groups to reveal their donors' names, only donation amounts. The promise of anonymity is one of the main reasons GPS was established – it allows Wynn and like-minded contributors to avoid the controversy that has dogged top political donors like competing casino mogul Sheldon Adelson, as well as the libertarian industrialist Koch Brothers or the liberal financier George Soros.[5]

Political operatives are using "social welfare" organizations as conduits for injecting secret money into federal elections by attempting to exploit what they claim to be purported ambiguities in existing IRS standards.

These operatives argue, for example, that as long as ads do not contain "express advocacy" they can attack or promote candidates in whatever way they want and such ads do not constitute "intervention or participation" in campaigns, and thus may be run without limit by a section 501(c)(4) organization.

The IRS, however, has made clear that ads do not need to contain "express advocacy" in order to be treated as "intervention or participation" in campaigns for purposes of section 501(c)(4). *See, e.g.*, Rev. Rul. 2004-6 (listing six factors that "tend to show" that an ad is for the purpose of influencing a candidate election.)

The political operatives also argue that a "social welfare" organization can spend up to 49 percent of its revenues on overt campaign intervention, without running afoul of the rules that currently require a section 501(c)(4) organization to be "primarily engaged" in social welfare activities. *See* 26 C.R.F. 1.501(c)(4)-1(a)(2)(i).

---

[4] P. Stone, "Fine line between politics and issues spending by secretive 501(c)(4) groups," *iWatch News* (Oct. 31, 2011).

[5] K. Vogel & S. Friess, "Karl Rove hits big: The birth of a mega-donor," *Politico* (July 13, 2012) (emphasis added).

Such claims have gone unchallenged by the IRS, despite the fact that the IRS has never set forth a "49 percent" rule. The IRS has failed to clarify its rules regarding the amount of candidate election-related activity a section 501(c)(4) "social welfare" group is permitted to conduct. As a result, groups claiming status as section 501(c)(4) organizations have been allowed to become major players in influencing the 2012 federal elections and to use secret contributions to do so.

The failure of the IRS to take action on this matter has allowed groups that are in reality campaign operations – but claim to be 501(c)(4) "social welfare" groups – to make assertions about IRS rules that are unsupported by law, and thereby to provide a veil of secrecy for the donors financing their campaign-related expenditures.

We welcome Ms. Lerner's statement in your July 17 letter that the IRS "will consider proposed changes" in the regulations governing eligibility for tax-exempt status under section 501(c)(4). But we want to stress once again that the need for urgent action we noted in our July 27, 2011 letter is all the more true today.

We strongly urge the IRS to promptly institute a rulemaking proceeding to address this matter. We also strongly urge the IRS to act expeditiously in the interim to stop the blatant abuses of the tax laws that are resulting in massive amounts of secret money being laundered into our national elections by groups claiming to be "social welfare" organizations.

Sincerely,

/s/ Gerald Hebert	*/s/ Fred Wertheimer*
J. Gerald Hebert	Fred Wertheimer
Executive Director	President
Campaign Legal Center	Democracy 21