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June 18, 2012

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

**RE: Violations of the Internal Revenue Laws by  
The American Legislative Exchange Council (EIN: 52-0140979)**

Dear Commissioner Shulman:

I am writing on behalf of my client, Clergy VOICE, a group of Christian clergy located in Ohio. The members of Clergy VOICE are committed to principles of social justice and believe that the defense of these principles is a central tenet of their faith. They gather together as individual clergy and not as representatives of any congregation, judicatory, or denomination. Among them are religious leaders from within the following religious traditions: the American Baptist Churches/USA; the Christian Church (Disciples of Christ); the Episcopal Church in the USA; the Evangelical Lutheran Church in America; the United Church of Christ; and the United Methodist Church.

The members of Clergy VOICE are quite troubled by the activities of the American Legislative Exchange Council ("ALEC") that have been brought to the public's attention in numerous media reports and were the subject of a recent IRS whistleblower complaint filed by the nonprofit advocacy organization, Common Cause. The information in these materials suggests that ALEC is significantly misrepresenting its activities to the IRS, the states, and the public in order to advance a legislative agenda—an agenda largely crafted by the organization's corporate members—that elevates commercial gain for a few over the well-being of society's less fortunate. My clients' theological concerns with ALEC's behavior are set forth more fully in the attached letter. I am writing today to discuss the serious legal implications of that same behavior.

The information in this submission, a great deal of which was not presented in prior complaints, confirms that ALEC has deliberately and repeatedly failed to comply with some of the most fundamental federal tax requirements applicable to public charities. The information in this submission also suggests, quite strongly, that the conduct of ALEC and certain of its representatives violates other civil and criminal tax laws and may violate other federal and state criminal statutes as well. Thus, Clergy VOICE urges the Service to investigate immediately and, after verifying this

information, to assess penalties and other appropriate sanctions—including revocation of ALEC’s tax-exempt status. Indeed, given the visibility of the organization, the significant dollars involved, and the continuing nature of ALEC’s troubling activities, any inaction on the part of the Service would undermine the integrity of the law itself.

## OVERVIEW OF KEY FINDINGS

- A pattern of lobbying activity far beyond the limits set by federal tax law;
- Excessive private benefit to corporate members, including the promotion of legislation applicable to only one or a small number of corporate members;
- Excessive private benefit to state legislators, including unreported taxable income for personal expenses, which may also implicate state ethics laws and federal anti-bribery laws;
- Excessive private benefit to the Republican Party in a manner similar to that in *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989); and
- A pattern of filing multiple inaccurate Forms 990—which include affirmative statements that ALEC engaged in no lobbying activities (even in years when it had registered two of its attorneys as lobbyists for the organization), and affirmative statements that ALEC made no payments to or for the benefit of government officials (even when it paid travel and entertainment expenses for state legislators and their families)—indicating both civil and criminal violation of federal tax laws.

## BACKGROUND

### 1. Overview of ALEC’s Mission, Governance, and Activities.

As you know, ALEC is a membership organization that is tax-exempt under section 501(c)(3) of the Internal Revenue Code, as a publicly-supported charity described in section 170(b)(1)(A)(vi).<sup>1</sup> Its stated mission is “to advance the Jeffersonian principles of free markets, limited government, federalism, and individual liberty” through a “nonpartisan public-private partnership between America’s state legislators, concerned members of the private sector, the federal government, and the general public.”<sup>2</sup>

ALEC self-identifies as “the nation’s largest nonpartisan, individual membership association of state legislators,”<sup>3</sup> suggesting that it differs little from the National Conference of State Legislatures and similar nonprofits that provide research, technical assistance, and an opportunity for bipartisan collaboration among state lawmakers. In fact, ALEC differs markedly from these organizations. For example:

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<sup>1</sup> Unless otherwise stated, section references are to the Internal Revenue Code of 1986, as amended (the “Code” or “I.R.C.”), and all regulatory references are to the Treasury Regulations currently in effect under the Code (the “Regulations” or “Treas. Reg.”).

<sup>2</sup> ALEC, 2010 Form 990, Part III, line 1 (brief description of the organization’s mission); *see also* <http://www.alec.org/AM/Template.cfm?Section=About> (“Our Mission”).

<sup>3</sup> ALEC Legislative Membership Brochure, available at <http://www.alec.org/membership/legislative-membership/>.

- ALEC's members include not only state legislators ("Legislative Members"), but also representatives from private corporations ("Private Sector Members"). As described below, Private Sector Members pay steep fees for the privilege of membership, which gives them access to the Legislative Members and a voice in setting ALEC's legislative agenda.
- While ALEC professes to be nonpartisan, "the vast majority [of its members] are Republican,"<sup>4</sup> and its governance structure reveals an even more glaring partisan imbalance. 72 of ALEC's 74 filled State Chairman seats are held by Republican legislators.<sup>5</sup> 16 of the 17 state legislators serving on ALEC's Board of Directors are Republican. And every legislator serving as an officer of ALEC is Republican.<sup>6</sup>
- "[ALEC's] Board of Directors . . . is advised by a Private Enterprise Board, representing major corporate and foundation sponsors."<sup>7</sup> According to ALEC's Bylaws, the "Private Enterprise Board of Directors" meets jointly with ALEC's Board of Directors at least once per year.<sup>8</sup> Members of the Private Enterprise Board represent tobacco, pharmaceutical, alcoholic beverage, oil and gas, and insurance companies, as well as lobbying firms that serve these industries.<sup>9</sup>

ALEC's Private Sector Members pay significant sums to sit down at the table with its Legislative Members. Whereas legislators pay membership fees of \$50 per year,<sup>10</sup> private companies pay between \$7,000 and \$25,000, depending on the membership tier.<sup>11</sup> Buying into a more costly membership tier gives the corporation access to a greater number of ALEC meetings, policy summits, "VIP Events," and Board of Directors receptions<sup>12</sup>—and with this access, more opportunities for the corporation's representative (which, we understand, is frequently an in-house attorney or lobbyist) to interact directly with ALEC's Legislative Members.

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<sup>4</sup> See Report of the American Association for Justice, *ALEC: Ghostwriting the Law for Corporate America*, (May 2010) at 6 (hereinafter "AAJ Report").

<sup>5</sup> See <http://www.alec.org/about-alec/state-chairmen/> (as of May 15, 2012). One is held by a Democratic legislator, one is held by a nonpartisan legislator. Two seats are vacant.

<sup>6</sup> See list of ALEC's officers and directors, at <http://www.alec.org/about-alec/board-of-directors/> (as of May 15, 2012).

<sup>7</sup> ALEC, *Proposing Constitutional Amendments by a Convention of the States: A Handbook for State Lawmakers*, available at <http://www.alec.org/publications/article-v-handbook/>. The reference to "foundation sponsors" is a bit misleading. While the Private Enterprise Board includes a representative from an industry-focused trade association—the American Bail Coalition—no private or company foundations are represented.

<sup>8</sup> See American Legislative Exchange Council Bylaws (Rev. July 10, 2007) ("Bylaws"), art. V, § 5.10; see also *id.* § XV (describing the role, composition, and responsibilities of the Private Enterprise Board).

<sup>9</sup> ALEC Private Enterprise Board, at <http://www.alec.org/about-alec/private-enterprise-board/> (as of May 15, 2012).

<sup>10</sup> See ALEC Legislative Membership Brochure, available at <http://www.alec.org/membership/legislative-membership/>; Laura Sullivan, National Public Radio, *Shaping State Laws With Little Scrutiny* (Oct. 29, 2010), available at <http://www.npr.org/templates/story/story.php?storyId=130891396>;

<sup>11</sup> See ALEC Private Sector Membership, at <http://www.alec.org/membership/private-sector-membership/>.

<sup>12</sup> See ALEC Private Sector Membership Brochure, available at <http://www.alec.org/membership/private-sector-membership/>.

In addition to paying substantial membership fees, some Private Sector Members pay separate fees to participate in ALEC's eight issue-focused "Task Forces"—the "public policy laboratories" where ALEC's Legislative Members "welcome their private sector counterparts to the table as equals" to jointly draft "model legislation" in areas like healthcare, energy and the environment, communications and civil justice.<sup>13</sup> These industry-written bills are introduced with few alterations—and, in many cases, passed—at statehouses around the country.<sup>14</sup> Indeed, ALEC's Bylaws state that one of the organization's purposes is to "disseminate model legislation and promote the introduction of companion bills in Congress and state legislatures"<sup>15</sup> and, consistent with this objective, the organization tracks the success of its legislative efforts on "Legislative Scorecards," which detail the number of ALEC-drafted bills introduced and enacted each year.<sup>16</sup> As ALEC boasts:

To date, ALEC has considered, written, and approved hundreds of model bills, resolutions, and policy statements. Historically, during each legislative cycle, ALEC legislators introduce more than 1,000 pieces of legislation based on these models, approximately 17 percent of which are enacted.<sup>17</sup>

ALEC's Private Enterprise Board hand-picks the Private Sector Members serving on each Task Force. Those selected must pay additional annual dues of \$2,500 to \$10,000 for the privilege of participating.<sup>18</sup>

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<sup>13</sup> See ALEC Legislative Membership Brochure, *supra* note 10.

<sup>14</sup> See, e.g., Sullivan, *supra* note 10 ("Since Arizona Gov. Jan Brewer signed [ALEC-drafted] SB 1070 into law in April, five state legislators have introduced eight bills similar to it. Like SB 1070, four of them were also named 'Support Our Law Enforcement and Safe Neighborhoods Act.' Lawmakers in many more states NPR interviewed have said they would introduce or support a similar bill."); Beth Hawkins, *Treyvon Martin Case Leads to Corporate Exodus from ALEC*, MinnPost (April 16, 2012), at <http://www.minnpost.com/politics-policy/2012/04/trayvon-martin-case-leads-corporate-exodus-alec> ("In total over the last two years Minnesota lawmakers have introduced some 60 bills identical or very similar to model legislation drafted by ALEC."); Salvador Rizzo, *Some of Christie's biggest bills match model legislation from D.C. group called ALEC*, New Jersey Online (April 1, 2012), at [http://www.nj.com/news/index.ssf/2012/04/alec\\_model\\_bills\\_used\\_in\\_nj\\_la.html](http://www.nj.com/news/index.ssf/2012/04/alec_model_bills_used_in_nj_la.html) ("The Star-Ledger found a pattern of similarities between ALEC's proposals and several measures championed by the Christie administration. At least three bills, one executive order and one agency rule accomplish the same goals set out by ALEC using the same specific policies. In eight passages contained in those documents, New Jersey initiatives and ALEC proposals line up almost word for word. Two other Republican bills not pushed by the governor's office are nearly identical to ALEC models."); Paul Krugman, *Lobbyists, Guns, and Money*, N.Y. Times (Mar. 25, 2012), at <http://www.nytimes.com/2012/03/26/opinion/krugman-lobbyists-guns-and-money.html> ("[ALEC] doesn't just influence laws, it literally writes them, supplying fully drafted bills to state legislators. In Virginia, for example, more than 50 ALEC-written bills have been introduced, many almost word for word. And these bills often become law.").

<sup>15</sup> Bylaws, § 2.01.

<sup>16</sup> See, e.g., 2010 ALEC Legislative Scorecard, at [http://www.commoncause.org/atf/cf/%7Bfb3c17e2-cdd1-4df6-92be-bd4429893665%7D/9-Legislative\\_Scorecard%202010.pdf](http://www.commoncause.org/atf/cf/%7Bfb3c17e2-cdd1-4df6-92be-bd4429893665%7D/9-Legislative_Scorecard%202010.pdf) (noting that 826 pieces of model legislation-based laws were introduced nationwide, and 115 enacted, during the 2009 legislative season—"an enactment rate of 14%").

<sup>17</sup> *Id.*

<sup>18</sup> ALEC Private Sector Membership Brochure, *supra* note 12.

## 2. ALEC's "Model Legislation"

ALEC's Private Sector Members include significant representation from the tobacco, oil and gas, transportation, insurance, energy, telecommunications, pharmaceutical, private prison, and other industries.<sup>19</sup> These corporations make substantial contributions to ALEC<sup>20</sup>—and also to ALEC's Legislative Members and their political action committees.<sup>21</sup> These industries also are well-represented on ALEC's Private Enterprise Board and its Task Forces.<sup>22</sup> As Task Force members, industry representatives are given an equal vote with ALEC's Legislative Members—and, thanks to ALEC's internal governance policies and procedures, industry representatives also have effective veto power over the Task Force's activities and legislative recommendations.<sup>23</sup> "As a result, meeting minutes show, draft bills that are preferred by a majority of lawmakers are sometimes killed by the corporate members at the table."<sup>24</sup>

Given their ability to direct ALEC's agenda, it is not surprising that the legislative focus of ALEC's Task Forces tracks the ideological and business priorities of the organization's corporate members. Consider the following examples:

- ***Model Legislation to Limit Successor Asbestos-Related Liability for Crown Holdings.*** ALEC helped the asbestos industry, in particular, ALEC member Crown Holdings, Inc. (formerly known as Crown, Cork & Seal), by convincing state legislatures to cap the

<sup>19</sup> See Sullivan, *supra* note 10; AAJ Report at 16 (presenting a list of "Companies and Groups Known to Have Been ALEC Members").

<sup>20</sup> See Mike McIntire, *Conservative Nonprofit Acts as Stealth Business Lobbyist*, N.Y. TIMES, April 21, 2012 available at <http://www.nytimes.com/2012/04/22/us/alec-a-tax-exempt-group-mixes-legislators-and-lobbyists.html?pagewanted=all> (noting that "AT&T, Pfizer and Reynolds American each contributed \$130,000 to \$398,000, according to a copy of ALEC's 2010 tax returns, obtained by The Times, that included donors' names, which are normally withheld from public inspection.").

<sup>21</sup> E.g., Anita Kumar, *Virginia passes bill to limit legal claims on one firm*, Wash. Post, Feb. 10, 2010, at B01, available at <http://www.washingtonpost.com/wp-dyn/content/article/2010/02/09/AR2010020903797.html> (discussing the efforts of ALEC Legislative Members and ALEC corporate member, Crown Holdings, to secure passage of a bill to limit Crown's successor liability for asbestos-related lawsuits in Virginia, where Crown employed 300 workers, and noting that "[s]ince 2007, Crown has donated more than \$100,000 to 46 Virginia legislators or their political action committees.").

<sup>22</sup> According to ALEC's website, its Private Enterprise Board members represent the following organizations: Centerpoint360; Bayer Corporation; GlaxoSmithKline; Reynolds American; Wal-Mart; Energy Future Holdings; Johnson & Johnson; PhRMA; American Bail Coalition; Kraft Foods; Pfizer; Reed Elsevier; DIAGEO; AT&T; Peabody Energy; UPS; Koch Companies Public Sector, LLC; Altria Client Services; ExxonMobil Corp.; Salt River Project; and State Farm Insurance Co.

<sup>23</sup> See ALEC Task Force Operating Procedures (May 2009), para. VIII.F ("A majority vote of legislative members present and voting and a majority vote of private sector members present and voting, *polled separately*, are required to approve any motion offered at a Task Force or Executive Committee Meeting.") (emphasis supplied).

<sup>24</sup> McIntire, *supra* note 20; see also Defenders of Wildlife & NRDC, *Corporate America's Trojan Horse in the States: The Untold Story Behind the American Legislative Exchange Council* (2002), at 8 available at <http://www.alecwatch.org> (hereinafter "Defenders/NRDC Report") ("Nothing can move out of the Task Force without agreement from its private-sector representatives"). For example, "In August, the telecommunications task force met and considered a model resolution regarding online piracy that had been introduced by the U.S. Chamber of Commerce. Although AT&T, Verizon and AOL could not agree on the details, the lawmakers present overwhelmingly supported the resolution in a 17-to-1 vote. However, because the corporate members deadlocked 8 to 8, the bill failed." McIntire, *supra* note 20.

liability of companies that acquire the assets of a business that previously engaged in asbestos-related activities.<sup>25</sup> The stated purpose of the legislation was to exempt successor entities from asbestos-related liabilities assumed or incurred prior to January 1, 1972.<sup>26</sup> The practical effect of the bill—known in some jurisdictions as the “Crown Cork bill”<sup>27</sup>—was to exempt Crown (which had acquired an asbestos manufacturer in 1963, knowing that asbestos-related claims were pending<sup>28</sup>) from these suits<sup>29</sup>—thereby protecting the financial assets of Crown at the expense of the countless victims of asbestos-related diseases and their families. Thanks to the efforts of ALEC’s Legislative Members,<sup>30</sup> legislation providing Crown with immunity was enacted in more than a dozen states, and similar legislation was introduced in other states.<sup>31</sup>

- **Model “Stand Your Ground” Legislation.** In March 2005, the Florida Legislature passed its infamous “Stand Your Ground” law, also known as the “Castle Doctrine” law, which has generated public outcry in the wake of the death of Florida teenager, Trayvon Martin.<sup>32</sup> One

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<sup>25</sup> See Brad Shrade, *Asbestos victims oppose company's push for liability shield in state law*, Minneapolis Star-Tribune, Feb. 14, 2012, at <http://www.startribune.com/politics/state/local/139335403.html>. A copy of the law, as passed by the Michigan Legislature, is available at [http://legislature.mi.gov/\(S\(gavs0v55ai0hagyu1tbbs155\)\)/mileg.aspx?page=getobject&objectname=2011-HB-4601&query=on](http://legislature.mi.gov/(S(gavs0v55ai0hagyu1tbbs155))/mileg.aspx?page=getobject&objectname=2011-HB-4601&query=on).

<sup>26</sup> Kumar, *supra* note 21.

<sup>27</sup> *See id.*

<sup>28</sup> AAJ Report at 8 (“[A]sbestos claims were pending against Mundet Cork at the time it was acquired by Crown, Cork & Seal. This was not news to Crown, but the claims were covered by insurance and Mundet still presented good value, so Crown bought Mundet. Indeed, it continued to produce asbestos for some time.”) (citing Deposition of E.J. Stansbury, pg. 23, U.S. District Court for the Western District of Texas, San Antonio and Austin Divisions, *Hawkins v. Fireboard Corp.*, Jan. 10, 1984).

<sup>29</sup> *See* Kumar, *supra* note 21 (“The 30-minute House Commerce and Labor Committee hearing last week included testimony from representatives of Owens Illinois, a Fortune 500 glass container manufacturer that argued it would pay more in asbestos claims if Crown Cork was no longer held liable. . . . Richard Ottinger, a lawyer representing Owens Illinois, which has two factories in Virginia, employing 350 people, said the bill ‘specifically benefits one company to the detriment of other companies.’”). ALEC’s “Successor Asbestos-Related Liability Fairness Act” capped a successor corporation’s liability at an amount equal to the assets of the acquired company at the time of acquisition, unadjusted for inflation or subsequent growth of the assets and without regard to the number of claims. AAJ Report at 8. A copy of ALEC’s Successor Asbestos-Related Liability Fairness Act is available at [http://www.alecexposed.org/w/images/9/9a/0E2-Successor\\_Asbestos-Related\\_Liability\\_Fairness\\_Act\\_Exposed.pdf](http://www.alecexposed.org/w/images/9/9a/0E2-Successor_Asbestos-Related_Liability_Fairness_Act_Exposed.pdf).

<sup>30</sup> In Virginia, for example, ALEC Virginia Delegate Terry Kilgore, a member of ALEC, and Virginia House Speaker William Howell, ALEC’s former national chairman, went to great lengths to secure passage of the bill. *See* Kumar, *supra* note 21 (The first year, the bill died in committee. Howell directed it to a different committee last year, but it went down in a surprising defeat when five Republicans joined all the Democrats in opposition. *This year, Howell altered the makeup of the 22-member committee—two Democrats were removed and three open seats were filled with Republicans who backed the legislation, which passed 11 to 9.*) (emphasis supplied).

<sup>31</sup> These states include: Florida, Georgia, Indiana, Mississippi, Nebraska, North Dakota, Ohio, Oklahoma, Michigan Pennsylvania, South Carolina, South Dakota, Texas, and Wisconsin. *See also* AAJ Report, at 9.

<sup>32</sup> *See, e.g.*, Mallory Simon & Ann O’Neill, *Unstable Ground: The fine line between self-defense and murder*, CNN, May 2, 2012, at <http://www.cnn.com/2012/04/29/us/stand-your-ground/index.html> (“The controversy has ricocheted from coast to coast ever since unarmed teenager Trayvon Martin was shot to death in Sanford, Florida, on February 26.”). “The Florida measure says any person ‘has the right to stand his or her ground and meet force with force, including deadly force if he or she reasonably believes it is necessary to do so to prevent death or great bodily harm.’” Manuel Roig-Franzia, *NRA plans to push expanded gun law beyond Florida: Measure urges*

of the “chief architects” of the Florida statute was lobbyist and former National Rifle Association (“NRA”) President, Marion Hammer<sup>33</sup>—and, following its enactment, an NRA executive pledged to “mov[e] from state legislature to state legislature” to advocate for passage of the law nationwide.<sup>34</sup> The NRA, a longtime corporate member of ALEC, turned to ALEC to accomplish this goal.<sup>35</sup> According to the NRA, Marion Hammer “presented the ALEC Criminal Justice Task Force with proposed model legislation based on Florida’s landmark ‘Castle Doctrine’ law” in August 2005, and “the task force subsequently adopted the measure unanimously” as ALEC model legislation.<sup>36</sup> The “Castle Doctrine bill” was listed among priority legislation on ALEC’s annual “Legislative Scorecard,”<sup>37</sup> and ALEC broadcasted its “continued success” securing passage of the law in other states.<sup>38</sup> Since 2005, legislation based on ALEC’s Castle Doctrine bill has been enacted in 31 states. However, in the wake of the intense public scrutiny following the Trayvon Martin shooting, ALEC’s Board recently “voted unanimously to disband its [Task Forces] that developed policies on public safety, elections and noneconomic issues,” including the Criminal Justice Task Force.<sup>39</sup>

These examples are by no means unique. A survey of ALEC’s model legislation reveals numerous examples of bills that were crafted by industry representatives to advance their business interests, including:

- ***The Drug Liability Act***, a model bill drafted by ALEC’s Health and Human Services Task Force—whose members include representatives from the Pharmaceutical Research and

*fighters, some say*, Wash. Post, May 1, 2005, available at [http://www.boston.com/news/nation/articles/2005/05/01/nra\\_plans\\_to\\_push\\_expanded\\_gun\\_law\\_beyond\\_florida/](http://www.boston.com/news/nation/articles/2005/05/01/nra_plans_to_push_expanded_gun_law_beyond_florida/).

<sup>33</sup> Ann O’Neill, *NRA’s Marion Hammer stands her ground*, CNN (April 15, 2012), at <http://www.cnn.com/2012/04/15/us/marion-hammer-profile/index.html>.

<sup>34</sup> Roig-Franzia, *supra* note 32 (“Wayne LaPierre, NRA executive vice president, said in an interview that the Florida law is the ‘first step of a multistate strategy’ that he hopes can capitalize on a political climate dominated by conservative opponents of gun control at the state and national levels. ‘There’s a big tailwind we have, moving from state legislature to state legislature,’ LaPierre said. ‘The South, the Midwest, everything they call “flyover land.” If John Kerry held a shotgun in that state, we can pass this law in that state.’”).

<sup>35</sup> McIntire, *supra* note 20 (“ALEC has drawn scrutiny recently for promoting gun rights policies like the Stand Your Ground law at the center of the Trayvon Martin shooting case in Florida, as well as bills to weaken labor unions and tighten voter identification rules.”); see also Krugman, *supra* note 14 (“[L]anguage virtually identical to Florida’s [“Stand Your Ground”] law is featured in a template supplied to legislators in other states by the American Legislative Exchange Council, a corporate-backed organization.”).

<sup>36</sup> NRA Institute for Legislative Action Press Release, *NRA Presents ALEC Model Legislation in Grapevine, Texas* (Aug. 12, 2005), available at <http://www.nraila.org/legislation/state-legislation/2005/8/nra-presents-alec-model-legislation-in.aspx?s=&st=10507&ps=>.

<sup>37</sup> See, e.g., ALEC 2007 Legislative Scorecard, available at [http://web.archive.org/web/20081106040540/http://www.alec.org/AM/Template.cfm?Section=Legislative\\_Scorecard](http://web.archive.org/web/20081106040540/http://www.alec.org/AM/Template.cfm?Section=Legislative_Scorecard) (listing the “Castle Doctrine Act” among the “Model Bill Highlights for 2007” and touting the passage of the legislation in Maine, North Dakota, and Tennessee).

<sup>38</sup> See, e.g., Minutes from the 2006 meeting of ALEC’s Criminal Justice Task Force, available at [http://www.prwatch.org/files/ALEC\\_minutes\\_05.png](http://www.prwatch.org/files/ALEC_minutes_05.png) (“The Task Force heard from Tara Michael, National Rifle Association, on the continuing success of the Castle Doctrine Act throughout the states.”).

<sup>39</sup> Eric Lichtblau, *Martin Death Spurs Group to Readjust Policy Focus*, N.Y. Times, April 17, 2012, at <http://www.nytimes.com/2012/04/18/us/trayvon-martin-death-spurs-group-to-readjust-policy-focus.html>.

Manufacturers of America (PhRMA) and several major pharmaceutical companies—limits liability of pharmaceutical manufacturers for injuries caused by a drug or medical device that was previously approved by the FDA.<sup>40</sup>

- ***The Hydraulic Fracturing Fluid Disclosure Composition Act***, a model bill drafted by ALEC’s Energy, Environment, and Agriculture Task Force, addresses “the public disclosure of chemicals in drilling fluids used to extract natural gas through hydraulic fracturing, or fracking.” The bill, which has been introduced in several states, was sponsored by ExxonMobil, one of the largest practitioners of fracking—“something not explained when ALEC lawmakers introduced their bills back home.” While ALEC has touted the bill “as a victory for consumers’ right to know about potential drinking water contaminants,” a careful review “reveals loopholes that would allow energy companies to withhold the names of certain fluid contents, for reasons including that they have been deemed trade secrets.”<sup>41</sup>
- ***The No Sanctuary Cities for Illegal Immigrants Act***, a model bill drafted by ALEC’s recently-disbanded Public Safety and Elections Task Force, empowers police to detain any person upon “reasonable suspicion” that he might be an illegal alien, and arrest that person if he cannot prove he entered the country legally or, indeed, was born in the United States. The model bill, which reportedly served as the basis for Arizona’s controversial immigration law, was drafted by a group that included several officials from the Corrections Corporation of America (“CCA”), the largest private prison company in the United States.<sup>42</sup> CCA’s support is not surprising, as the company’s “executives believe immigrant detention is their next big market. Last year, they wrote that they expect to bring in ‘a significant portion of our revenues’ from Immigration and Customs Enforcement, the agency that detains illegal immigrants.”<sup>43</sup>

ALEC’s legislative activities are not limited to promoting “model legislation” that is drafted by and intended to advance the interests of its corporate members. The organization also mobilizes its Legislative Members to *prevent* the passage of legislation that threatens the interests of its corporate members. Consider the following example from my clients’ home state of Ohio, which was recently reported in the *New York Times*:

Ohio lawmakers introduced legislation last year that would make it easier to recover money from businesses that defraud the state. It was quickly flagged [by ALEC, which] views such ‘false claims’ laws as encouraging frivolous lawsuits. . . .

[ALEC member] Bill Seitz, a prominent Republican state senator, wrote to a fellow senior lawmaker [and member of ALEC] to relay ALEC’s concerns about ‘the recent upsurge’ in false-claims legislation nationwide. ‘While this is

<sup>40</sup> A copy of ALEC’s Drug Liability Act is available at [http://alecexposed.org/w/images/3/3b/5S2-Drug\\_Liability\\_Act\\_Exposed.pdf](http://alecexposed.org/w/images/3/3b/5S2-Drug_Liability_Act_Exposed.pdf).

<sup>41</sup> McIntire, *supra* note 20; see also Cora Currier, *ALEC and ExxonMobil Push Loopholes in Fracking Chemical Disclosure Rules*, ProPublica, April 24, 2010, at <http://www.propublica.org/article/alec-and-exxonmobil-push-loopholes-in-fracking-chemical-disclosure-rules>.

<sup>42</sup> See Sullivan, *supra* note 10.

<sup>43</sup> Laura Sullivan, *Prison Economics Help Drive Ariz. Immigration Law*, National Public Radio, Oct. 28, 2010, at <http://www.npr.org/2010/10/28/130833741/prison-economics-help-drive-ariz-immigration-law>.



understandable, as states are broke, *the considered advice from our friends at ALEC was that such legislation is not well taken and should not be approved,*' he said in a private memorandum.

The legislation was reworked to ease some of ALEC's concerns, making it one of many bills the group has influenced by mobilizing its lawmaker members, a vast majority of them Republicans.<sup>44</sup>

Incredibly, ALEC reports on its annual information returns that the organization engages in *no lobbying activity*,<sup>45</sup> a position that was recently affirmed by the organization's counsel.<sup>46</sup> However, based on the organization's website and information detailed above, it appears that ALEC's primary activity is to craft the "model legislation" for which it is famous and advocate for its passage nationwide. Indeed, ALEC's Bylaws state that its corporate purposes include "disseminat[ing] model legislation and promot[ing] the introduction of companion bills in Congress and state legislatures."<sup>47</sup> Further, the organization admits on its most recent Form 990 that its two largest program services measured by expenses—"Task Forces" and "Conferences"—involve the formulation of "model legislation."<sup>48</sup> These programs consumed 68% of ALEC's total expenditures in 2010. ALEC's Forms 990 for 2008 and 2009 reflect a similar trend.<sup>49</sup>

ALEC's declaration on its Form 990 filings that it engages in no lobbying activity is contradicted by admissions in at least one state filing by the organization. Specifically, in North Dakota, ALEC registered two of its attorneys as lobbyists for the period of July 1, 2008 through June 30, 2009.<sup>50</sup> However, despite these registrations, its 2008 and 2009 Forms 990 report that the organization did not engage in any lobbying during either year. Moreover, according to one watchdog group, ALEC appears to have broken registration laws in Minnesota, when it hosted an event with lobbyists and state GOP lawmakers without registering its agents as lobbyists.<sup>51</sup>

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<sup>44</sup> McIntire, *supra* note 20 (emphasis supplied). A copy of Senator Seitz's memo appears at Exhibit 16 of the Common Cause complaint. It goes on to state that "anyone can introduce legislation he or she wishes, but when our friends at ALEC caution us against doing so, we should at least carefully consider their sage advice. I know that Representative Mecklenborg feels just as strongly on this subject as I do, and anything you can do to help educate our fellow ALEC members about this proposal would be welcome."

<sup>45</sup> ALEC 2010 Form 990, Part IV, line 4.

<sup>46</sup> Suzanne Perry, *Challenge to Conservative Group's Advocacy Raises Questions about Charity Lobbying*, Chronicle of Philanthropy, April 25, 2012 available at [http://philanthropy.com/article/What-Counts-as-Lobbying-A-New/131676/?sid=pt&utm\\_source=pt&utm\\_medium=en](http://philanthropy.com/article/What-Counts-as-Lobbying-A-New/131676/?sid=pt&utm_source=pt&utm_medium=en) (referencing statements by ALEC's counsel that "the group does no lobbying").

<sup>47</sup> Bylaws, § 2.01.

<sup>48</sup> ALEC 2010 Form 990, Part II, lines 4(a), 4(b).

<sup>49</sup> See ALEC 2009 Form 990, Part II, line 4; 2008 Form 990, Part II, line 4.

<sup>50</sup> See List of Registered Lobbyists for the period of July 1, 2008 through June 30, 2009, at <http://nd.gov/sos/lobbylegislate/lobbying/org-w-loby-2009.html> (listing Mark Behrens and Corey Schaecher as lobbyists for ALEC).

<sup>51</sup> Lee Fang and Scott Keyes, *VIDEO: Corporate Lobbyist Concedes He Does Not Always Register as a Lobbyist for ALEC Bills He Helps Write*, Think Progress, August 17, 2011, available at <http://thinkprogress.org/politics/2011/08/17/290713/alec-lobbyist-disclosure/?mobile=nc>.

ALEC's claim that it engages in no lobbying activity is also undermined by the successful efforts of ALEC members and supporters to secure the passage of legislation exempting ALEC from state disclosure and reporting laws that apply to lobbyists. For example,

- A 2003 South Carolina law exempts ALEC from the requirement to register as a lobbyist or disclose its lobbying expenditures.<sup>52</sup> It also exempts ALEC from the prohibition against paying a legislator more than \$400 a year for lodging, transportation, entertainment, or food—a move that enables South Carolina legislators to participate in ALEC's Task Forces and attend ALEC-funded Task Force meetings.<sup>53</sup> One of the bill's sponsors was a member of ALEC.<sup>54</sup>
- In 1991, an ALEC member successfully introduced a bill to amend the Colorado ethics laws to exempt ALEC from lobbyist status. The bill passed. As a result, for legislators who attend ALEC events, "the expenses of such members for travel, board, and lodging related to such attendance may be paid from appropriations."<sup>55</sup>

Had ALEC not been able to secure these specific legislative carveouts—one of which may be overturned in the near future<sup>56</sup>—its activities would be considered lobbying under the laws of these states. However, it should be noted that the ALEC-developed state law exceptions to lobbying do not affect the federal tax law characterization of the same events. To the contrary, the fact that a specific exception was necessary to avoid classification of ALEC's activities as lobbying under state law likely confirms the characterization of the activity as lobbying for federal tax purposes. Additionally, the state law exceptions do not shield the payment of legislators' personal expenses by corporate members (described below) from federal income tax.

### 3. ALEC's Meetings and Legislative Scholarship Program.

In addition to its regular legislative Task Force meetings, ALEC brings its Legislative and Private Sector Members together to meet and draft model legislation at an Annual Meeting and a State and Nation Policy Summit.<sup>57</sup> These meetings are held in luxury hotels, frequently in vacation-worthy destinations like San Diego, New Orleans, and Scottsdale, and include perks such as meals,

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<sup>52</sup> See S.C. Code § 2-17-90.

<sup>53</sup> See ALEC Scholarship Policy by Meeting (Mar. 7, 2011) (stating that "ALEC Task Force Members are reimbursed by ALEC up to \$350.00 for travel expenses" and that "Task Force Members' rooms and tax fees for up to a two-night stay at the host hotel are covered by ALEC"). A copy of the Scholarship Policy can be found at page 12 of the May 2012 Education Task Force materials that are part of Exhibit 4 to the Common Cause complaint.

<sup>54</sup> Paul Abowd, *Alec Gets a Break From State Lobbying Laws*, Mother Jones Mag., May 8, 2010, at <http://www.motherjones.com/politics/2012/05/alec-lobbyist-exemption>.

<sup>55</sup> See Colo. Rev. Stat. § 2-3-311.

<sup>56</sup> See Corey Hutchins, *Lawmakers Exempted ALEC in S.C. Lobbying Law*, Columbia (SC) FreeTimes, April 26, 2012, available at <http://www.freetimes.com/index.php?cat=1992209084141467&act=post&pid=11862604123541405> ("I am filing a bill tomorrow to remove this section from our code of laws and make ALEC subject to the same standards we expect other special interest groups to follow.") (quoting S.C. Rep. Boyd Brown). A copy of the bill, which was introduced May 1, 2012, is available at [http://www.scstatehouse.gov/sess119\\_2011-2012/bills/5188.htm](http://www.scstatehouse.gov/sess119_2011-2012/bills/5188.htm).

<sup>57</sup> See <http://www.alec.org/meetings/>; AAJ Report at 5.

recreational activities, and subsidized childcare for legislators and their families.<sup>58</sup> For example, ALEC’s meeting agendas generally include events like golf tournaments, open bar parties, and baseball games—all subsidized directly or indirectly by ALEC’s corporate members.<sup>59</sup>

Some legislators pay for ALEC-related trips using state or campaign funds.<sup>60</sup> Indeed, according to one study, “[a]n examination of financial-disclosure forms filed by state legislators in 1999 and 2000 suggests that *taxpayers* foot the bill for at least \$3 million in expenses the lawmakers incur each year in connection with their travel to ALEC-sponsored meetings.”<sup>61</sup> Frequently, however, the state legislators receive industry-funded “legislative scholarships” from ALEC to cover the costs incurred in connection with attending these meetings and events.

ALEC’s legislative scholarships are not “scholarships” in the traditional sense. They are not merit awards. They are not made through a selective or competitive process. And they are not intended to fund educational pursuits. Rather, as ALEC admits on its Form 990 filings, “legislative scholarships” are simple expense reimbursements—*i.e.*, payments made by ALEC to “reimburse [state legislators] for travel expenses incurred” by them—and, at times, their families—in attending ALEC meetings and events.<sup>62</sup>

ALEC’s Bylaws mandate that “[a]ll funds for ALEC State Scholarship Accounts shall be deposited in accounts designated by the ALEC Board of Directors.”<sup>63</sup> The Bylaws also require “legislative scholarship funds” to be raised and collected jointly by each state’s “State Chairman” (a state legislator) and “Private Enterprise State Chair” (a representative from the private sector).<sup>64</sup> And ALEC’s Private Sector Members appear to give quite generously. While we do not have access to records detailing every corporate contribution to ALEC’s scholarship funds, PhRMA, a member of the Private Enterprise Board, reported a \$356,075 grant to the Wisconsin “ALEC

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<sup>58</sup> See Sullivan, *Shaping State Laws With Little Scrutiny*, *supra* note 10 (observing that “[t]ax records show the group spent \$138,000 to keep legislators’ children entertained” at one meeting). For example, the 2012 Annual Meeting will be held in Salt Lake City at the Grand America Hotel—“Salt Lake City’s only AAA Five Diamond Hotel.” See <http://www.grandamerica.com/>.

ALEC’s 2010 Annual meeting was held in San Diego at the Manchester Grand Hyatt, where members’ children were able to participate in an ALEC-subsidized childcare program called “Kids’ Congress” and “see the beautiful beaches, enjoy the perfect weather, and make new friends while having a west coast blast!” See [http://web.archive.org/web/20100623050825/http://www.alec.org/AM/Template.cfm?Section=Kids\\_Congress](http://web.archive.org/web/20100623050825/http://www.alec.org/AM/Template.cfm?Section=Kids_Congress).

<sup>59</sup> Sullivan, *supra* note 10 (“[ALEC] encourages state lawmakers to bring their families [to meetings]. Corporations sponsor golf tournaments on the side and throw parties at night, according to interviews and records obtained by NPR.”).

<sup>60</sup> See Sullivan, *supra*, note 10; Laura Sullivan, NPR, *Prison Economics Help Drive Ariz. Immigration Law* (Oct. 28, 2010), available at <http://www.npr.org/templates/story/story.php?storyId=130833741>.

<sup>61</sup> Defenders/NRDC Report at 26 (emphasis supplied).

<sup>62</sup> ALEC 2010 Form 990, Sch. D, Part IV; see also Defenders/NRDC Report at 6.

<sup>63</sup> See Bylaws § 10.07 (“State Scholarship Accounts”).

<sup>64</sup> See *id.* § 10.03 (“State Chairmen duties shall include recruiting new members, working to ensure introduction of model legislation, suggesting task force membership, establishing state steering committees, planning issue events, and working with the Private Enterprise State Chairman to raise and oversee expenditures of legislative scholarship funds.”).

“Scholarship Fund” on Schedule I of its 2010 Form 990. In Ohio alone, private companies gave more than \$130,000 to ALEC’s Ohio Scholarship Fund between January and August 2011.<sup>65</sup>

We understand that the expense reimbursements through ALEC’s legislative scholarship program range from several hundred to several thousand dollars per legislator, per event. The process for securing this funding is described in ALEC’s “Scholarship Policy” and is quite straightforward.<sup>66</sup> First, the legislator personally pays the costs of travel, event registration, and lodging for the legislator and his or her family. Then, after the meeting concludes, the legislator submits receipts to the State Chairman from the legislator’s home state, and the State Chairman submits a request for repayment to ALEC’s Director of Membership. According to records that were obtained through a Freedom of Information Act Request:

- A \$3,454.36 reimbursement from ALEC’s Ohio Scholarship Fund was approved for Ohio State Representative Seth Morgan following ALEC’s 2009 Annual Meeting. The amounts reimbursed included (1) entertainment and childcare for his three children at ALEC’s “Kid’s Congress”; (2) his wife’s costs to attend the meeting; and (3) travel expenses for the entire family.
- Ohio State Representative Todd Snitchler also attended the 2009 Annual Meeting and received a “scholarship” that covered (1) entertainment and childcare for his two children; (2) his wife’s costs to attend the conference; and (3) airfare for him and one of his children.
- Ohio State Senator Kris Jordan and State Representative John Adams also received “scholarships” for their spouses to attend the Annual Meeting in 2009.<sup>67</sup>

Significantly, none of the legislators reported the payments for family travel and entertainment on state disclosure forms.<sup>68</sup> While my clients are, understandably, particularly concerned with ALEC’s activities in their home state of Ohio, where the scholarship payments arguably violate state ethics laws,<sup>69</sup> it bears emphasis that this practice appears to be replicated in other states.

<sup>65</sup> See Exhibit 18 to the Common Cause complaint. The “thank you note” from the ALEC State Chair in Ohio to the corporate contributors to the Ohio ALEC scholarship fund implies that the corporate contributions might motivate legislators to introduce ALEC model legislation favorable to the donors’ interests: “Because of your help and others like you, the trip to ALEC was made possible for our legislators. [...] With information that is disseminated at these meetings, my desire is that the Ohio Legislature will pass and repeal laws to make Ohio a much more business friendly state.” See Source Documents #11, at <http://alecexposed.org/wiki/File:Ohio-ALEC-11.pdf> (page 1).

<sup>66</sup> A copy of the Scholarship Policy can be found at page 12 of the May 2012 Education Task Force materials that are part of Exhibit 4 to the Common Cause complaint.

<sup>67</sup> See Source Documents #29, at <http://alecexposed.org/w/images/1/1d/Ohio-ALEC-29.pdf> (pages, 32, 49–52); Source Documents #28, at <http://alecexposed.org/w/images/8/84/Ohio-ALEC-28.pdf> (pages 53, 55).

<sup>68</sup> Ohio legislators were not required to report payments received to cover the *legislator’s* expenses for travel and meals, incurred in connection with the *legislator’s* official duties, at “at a meeting or convention of a national or state organization to which any state agency . . . pays membership dues,” including ALEC. See, e.g., Ohio Joint Legislative Ethics Committee, 2009 Financial Disclosure Statement, §§ 8, 10.

<sup>69</sup> Specifically, Ohio’s ethics laws prohibit “member[s] of the general assembly . . . [from] accept[ing] anything of value which would result in a substantial and improper influence upon the member . . . with respect to his or her duties.” *Legislative Code of Ethics for Members and Employees of the 129<sup>th</sup> Ohio General Assembly, Employees of any Legislative Agency, and Candidates for the 130<sup>th</sup> General Assembly*, §7(B). The Ohio Joint Legislative Ethics Committee has stated that a benefit “result[s] in substantial and improper influence” on a legislator if it

ALEC's Bylaws provide that the duties of each state's State Chair and Private Enterprise State Chair include (1) soliciting funds for legislative scholarships; (2) depositing these funds in accounts designated by ALEC's Board; and (3) overseeing the payment of scholarships to legislators. In other words, these officials act on behalf of ALEC in executing the organization's legislative scholarship program and depositing the funds in ALEC-owned accounts. Further, ALEC's Scholarship Policy makes clear that State Chairs do not "select" scholarship recipients; rather, any legislator who provides proper documentation will have their expenses reimbursed. Despite this, ALEC takes the incredible position that *the scholarship funds are not revenues or expenses of ALEC*.

Instead, ALEC reports the combined scholarship fund balance as a liability on its balance sheet. On its 2007 through 2009 Form 990 filings, ALEC reported the scholarship funds to the IRS as an "Other liability" for "Scholarship funds held as an agent." On its 2010 Form 990, ALEC refined its position, reporting the scholarship fund balance as an "Escrow or custodial account liability" on Part X, line 21 and providing the following explanation:

ALEC is the recipient of funds from various outside organizations and individuals which are to be used exclusively for scholarships on behalf of state legislators. Scholarships are payable, upon approval by the relevant State Chair, to State Legislators to reimburse them for travel expenses incurred attending meetings of ALEC. The amounts received and disbursed by ALEC for such purposes are not considered revenue and expenses of ALEC as the State Chair retains the exclusive right to determine the expenditures. The cash held and related liability are reported in the financial statements of ALEC.<sup>70</sup>

ALEC's financial statements similarly provide:

Funds for scholarships received by ALEC on behalf of State Legislators in agency transactions are reported as scholarship funds held as agent. Scholarships are payable, upon approval by the relevant State Chair, to State Legislators to reimburse them for expenses incurred attending meetings of ALEC. The amounts received and disbursed for this scholarship program are not considered revenue and expenses of ALEC as the State Chair retains the exclusive right to approve scholarships.<sup>71</sup>

According to ALEC's financial statements and information returns, the total amount held in ALEC's state scholarship funds ranges from \$1 million to \$2 million each year, a significant sum

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"impair[s] his objectivity and independence of judgment as a public official." See Ohio Joint Legislative Ethics Committee Advisory Opinions 95-006 and 00-003. By ensuring the participation of the Ohio legislators in closed-door meetings with representatives (including lobbyists) from ALEC's corporate members—corporations that, we understand, contribute to the legislators' campaigns and political action committees—to draft legislation that is intended to advance those corporations' interests, ALEC's legislative scholarships arguably "results in a substantial and improper influence" on the legislator.

<sup>70</sup> 2010 Form 990, Schedule D (Supplemental Financial Statements), Part XIV (Supplemental Information).

<sup>71</sup> Note 1 to ALEC's audited financial statements for the years ended December 31, 2010 and 2009.

given the size of the organization.<sup>72</sup> Claiming that these funds do not belong to ALEC facilitates other helpful reporting positions taken by the organization. For example:

- On Part IX, line 18 of its 2008 and 2009 information returns, ALEC reported that it made *no expenditures* for “travel or entertainment expenses of any federal, state, or local public officials,” and reported spending only \$49,499 for government official travel in 2010.
- On Schedule J, Part I of its 2008, 2009, and 2010 information returns, ALEC reported that it *did not fund any* “travel for companions” for any of its officers or directors.

Relatedly, it appears that ALEC does not treat amounts related to spousal and family travel as compensation, where appropriate, or issue Form 1099 information returns to the parties receiving this benefit.

## DISCUSSION

### **1. ALEC Operates for the Private Benefit of its Corporate Donors, Legislative Members, and the Republican Party, in Violation of Section 501(c)(3).**

As you are well-aware, organizations that are exempt from federal income tax under section 501(c)(3) must be organized and operated exclusively for charitable, educational, or other exempt purposes. Indeed, the Supreme Court has held that “the presence of a single non-exempt purpose, if substantial in nature, will disqualify an organization from tax-exempt status, even if the organization also conducts charitable activities.”<sup>73</sup> The Treasury Regulations further clarify that an organization is not operated exclusively for exempt purposes unless it “serves a public rather than a private interest.”<sup>74</sup> Courts have interpreted this regulation to create a “private benefit test” that prohibits tax-exempt organizations from conducting more than insubstantial activities that confer “nonincidental benefits . . . on disinterested persons [*i.e.*, people who do not control the organization] that serve private interests.”<sup>75</sup>

In other words, if an organization serves private interests other than incidentally, it will not meet the standard for tax-exemption, even if it otherwise appears to conduct charitable activities.<sup>76</sup> Based on the foregoing, this appears to be precisely ALEC’s situation.

#### **A. *Contours of the Private Benefit Doctrine.***

While the most common examples of impermissible private benefit involve a charity conferring financial benefits to individuals, the doctrine is substantially broader than this paradigm.

<sup>72</sup> For example, in 2010, ALEC reported contributions of \$5,997,347, membership fees of \$1,166,804, end-of-year assets of \$4,047,129 and a scholarship fund liability of \$1,023,761. In 2009, ALEC reported contributions \$5,302,779, membership fees of \$961,104, \$3,306,976, and a scholarship fund liability of \$1,042,629.

<sup>73</sup> See *Better Business Bureau v. United States*, 326 U.S. 279 (1945).

<sup>74</sup> Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

<sup>75</sup> *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053, 1069 (1989); Rev. Rul. 2006-27, 2006-21 I.R.B. 915.

<sup>76</sup> See *Columbia Park & Recreation Ass’n v. Comm’r*, 88 T.C. 1, 25 (1987) (explaining that under the section 501(c)(3) Regulations, “a private interest exists if any person having a private or personal interest in [the organization’s] activities is the focus of [the organization’s] benefit.”).

Significantly, for purposes of our analysis, the IRS and courts have long recognized that a charity may create an impermissible private benefit—and, accordingly, jeopardize its exempt status—if it has a substantial purpose of generating business or providing pecuniary support for one or more nonexempt entities.<sup>77</sup> In one case, for example, the Tax Court upheld the IRS’s revocation of the section 501(c)(3) status of the International Postgraduate Medical Foundation because a substantial purpose of its operations was to benefit a for-profit company owned by an officer of the charity.<sup>78</sup> In its decision, the court explained: “When a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.”<sup>79</sup>

Moreover, impermissible private benefit exists where a charity allows private interests to dictate the charity’s internal operations and policies. Thus, in *Columbia Park & Recreation Association v. Commissioner*, the Tax Court ruled that a nonprofit civic association created to provide park, recreation, and other services to a planned community failed to qualify for exemption because it was operated principally to promote the private interests of the homeowners residing in the community. The court rejected the argument that this benefit was incidental to a greater benefit to the public at large, which had access to some of the development’s facilities and amenities, stating:

We find it difficult to accept petitioner’s contention that the residents and property owners do not have a personal interest in petitioner. . . . Petitioner’s operations are controlled by the residents and property owners . . . . In addition, residents’ advisory committees participate in formulating petitioner’s budget and defining its goals and policies. Moreover, a substantial number of petitioner’s activities are solely for the purpose of providing the “new life style” promised to the residents of the development. We, therefore, find that the residents and property owners of Columbia are the intended beneficiaries of petitioner’s facilities and services and that they have a personal interest in petitioner’s activities.<sup>80</sup>

Finally, the private benefit doctrine also has been applied in the political and public policy arena to deny tax-exempt status to organizations that provide direct or indirect benefits to political parties, candidates, or officeholders. These cases and decisions establish that advancing the political fortunes of a particular party or group of candidates is not a permissible public benefit purpose and, thus, constitutes grounds for revocation. In the leading case, *American Campaign Academy v. Commissioner*, the Tax Court applied this doctrine to deny exempt status to an organization that operated a school for campaign workers.<sup>81</sup> While the school was ostensibly open

<sup>77</sup> *E.g.*, *International Postgraduate Med. Found.*, T.C. Memo 1989-36; *KJ’s Fund Raisers Inc.*, T.C. Memo 1997-424, *aff’d*, 166 F.3d 1200 (2d Cir. 1998); Rev. Rul. 76-206, 1976-1 C.B. 154.

<sup>78</sup> *Int’l Postgraduate Med. Found.*, T.C. Memo 1989-36. While private benefit is more commonly found when the for-profit entity or its owners have formal or effective control of the charity, such control is not essential. For example, the IRS denied exemption to an organization dedicated to generating support for a failing for-profit classical radio station even though the charity did not appear to have any relationship with the for-profit. Rev. Rul. 76-206, 1976-1 C.B. 154.

<sup>79</sup> *Int’l Postgraduate Med. Found.*, T.C. Memo 1989-36.

<sup>80</sup> *Columbia Park & Recreation Ass’n*, 88 T.C. at 25–26.

<sup>81</sup> *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053 (1989).

to all individuals, it had a decidedly Republican focus, and, in fact, all or nearly all of the graduates went on to become Republican campaign workers. Because the secondary benefits of the organization's educational activity—a cadre of well-trained campaign workers—redounded nearly exclusively to the Republican Party and its candidates, the court applied the private benefit doctrine to find the organization ineligible for 501(c)(3) status.<sup>82</sup>

In *Fund for the Study of Economic Growth & Tax Reform v. Internal Revenue Service*,<sup>83</sup> a federal court agreed with the Service that an organization was not described in section 501(c)(3) because it had a substantial nonexempt purpose of advancing the interests of the Republican Party. The organization was a charitable trust established to fund the work of an all-Republican Commission on Economic Growth and Tax Reform (the “Kemp Commission”), namely producing a report on the advantages of a flat tax and educating the public about those advantages through public hearings. The Kemp Commission was established by the Republican leadership in Congress, Newt Gingrich and Bob Dole, and headed by Republican Senator Jack Kemp. Although the organization argued that producing reports and educating the public on the merits of a particular policy (the flat tax) were exempt activities, the court found the organization nonexempt because its funded activities “were conducted to advance a particular political message and to [garner] support for a cornerstone of the Republican agenda in the 1996 elections.”<sup>84</sup>

As these examples demonstrate, an organization can run afoul of the private benefit test even without providing direct economic benefits to an individual, or supporting or opposing candidates in an election. The IRS did not allege that either the campaign schools in *American Campaign Academy* or the tax reform work in *Fund for the Study of Economic Growth* violated the 501(c)(3) prohibition on political campaign intervention by endorsing candidates or otherwise intervening in an election. Nevertheless, both the IRS and the courts determined these organizations provided substantial private benefit by advancing one particular political party's interests and, therefore, neither organization was entitled to tax-exempt status.

## **B. Application of the Private Benefit Doctrine to ALEC.**

The fact that ALEC provides significant benefits to its corporate donors and Legislative Members is incontrovertible. The benefits conferred on either group would alone be sufficient to jeopardize ALEC's tax-exempt status. Moreover, based on the political orientation of the organization's corporate members and its Legislative Members' strong ties to the Republican Party, ALEC's operations appear to benefit one particular segment of the political spectrum. In light of this, it is appropriate—indeed, necessary—for the IRS to investigate ALEC's activities.

### **i. ALEC is Operated Primarily for the Benefit of its Corporate Members.**

Based on the facts detailed above, ALEC appears to be operated to benefit the private interests of its corporate donors. By paying substantial fees to “join” ALEC, corporations gain not only unprecedented access to state lawmakers—the very individuals who introduce and support the state laws that positively impact the corporations' bottom lines—but also the opportunity to draft those laws.

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<sup>82</sup> See *id.* at 1070-72.

<sup>83</sup> 997 F. Supp. 15 (D.D.C. 1998), *aff'd on other grounds*, 161 F.3d 755 (D.C. Cir. 1998).

<sup>84</sup> *Id.* at 21.



As the Drug Liability Fairness Act and the “Crown Cork bill” illustrate quite plainly, the magnitude of this benefit cannot be understated. It is hardly, however, the only benefit ALEC confers on its Private Sector Members. ALEC’s operating procedures give its corporate donors authority to approve or veto every legislative and policy proposal developed by ALEC’s Task Forces,<sup>85</sup> and the organization’s Bylaws give corporate members disproportionate authority to appoint and remove legislators from the Task Forces. This effectively ensures that the only model laws distributed to ALEC’s Legislative Members and disseminated nationwide are those that have been co-drafted and subsequently blessed by ALEC’s corporate donors.

Further, the legislative proposals that clear this process appear to be motivated substantially, if not primarily, by the pecuniary interests of ALEC’s corporate members. In this regard, ALEC’s activities differ little from those that were found by the Service and the Tax Court to constitute private benefit in the authorities discussed above. Just as the International Postgraduate Medical Foundation was operated to profit its founder’s private interests, ALEC appears to be operated to advance the bottom lines of its corporate members. Further, as in the *Columbia Park and Recreation Association* case, ALEC’s “operations are controlled by” its corporate members; ALEC’s “goals and policies” are “defin[ed]” by its corporate members; and “a substantial number of [ALEC’s] activities are solely for the purpose of providing” a financial benefit to its corporate members.<sup>86</sup>

While ALEC’s policies may, at times, arguably benefit the community at large—just as the continuing education programs and recreational facilities arguably benefited the community at large in the in the *International Postgraduate Medical Foundation* and *Columbia Park and Recreation Association* cases—the motivation behind these policies is undeniably private in nature. Furthermore, the overwhelming success of many of ALEC’s proposals confirms that the benefits ALEC confers on its corporate members are hardly “nonincidental.” They are substantial and quite valuable. Indeed, many corporations may find them invaluable. Because ALEC is operated to further the private interests of its corporate members, it is not entitled to exemption from tax under section 501(c)(3).

ii. ALEC Also Confers Substantial Private Benefits on its Legislative Members.

In addition to operating for the benefit of its corporate members, the evidence strongly suggests that ALEC is operated for the benefit of its Legislative Members. The organization’s legislative scholarship program provides direct financial benefits to the Legislative Members and their families—covering expenses for travel, lodging, meals and entertainment—without advancing any legitimate charitable purpose. Further, this benefit is substantial. According to ALEC’s financial statements and information returns, the total amount held in ALEC’s scholarship funds each year ranges from \$1 million to \$2 million each year.<sup>87</sup> Indeed, the organization admits these

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<sup>85</sup> ALEC Task Force Operating Procedures (May 2009), para. VIII.F (“A majority . . . private sector members present and voting . . . [is] required to approve any motion offered at a Task Force or Executive Committee Meeting.”).

<sup>86</sup> Compare 88 T.C. at 25–26.

<sup>87</sup> For example, in 2010, ALEC reported contributions of \$5,997,347, membership fees of \$1,166,804, end-of-year assets of \$4,047,129 and a scholarship fund liability of \$1,023,761. In 2009, ALEC reported contributions \$5,302,779, membership fees of \$961,104, \$3,306,976, and a scholarship fund liability of \$1,042,629.

funds are “held for the benefit of” its Legislative Members<sup>88</sup> and the evidence cited above demonstrates that these funds are used to pay for expenses incurred by legislators’ entire family as well. Providing this sort of pecuniary benefit to private individuals violates the private benefit doctrine in its most classic sense.<sup>89</sup>

iii. ALEC is Operated to Advance the Interests of One Political Party.

The private benefit analysis does not end with ALEC’s members, however. ALEC’s activities strongly resemble those that troubled the Service and the courts in the *American Campaign Academy* and *Fund for the Study of Economic Growth and Tax Reform* cases. In both cases, the IRS determined, and the courts confirmed, that an organization was not entitled to exemption from federal income tax under section 501(c)(3) because it was operated to benefit one particular political agenda. Similarly, ALEC’s activities advance the cause of conservative-leaning corporations and Republican lawmakers that share their priorities.

Although ALEC professes to be “nonpartisan,” the majority of its Legislative Members—and nearly 100% of its officers, directors, and other leaders—are Republican. Further, ALEC’s corporate members favor policies that advance traditionally conservative causes and the private interests of its members. These policies, which are embodied in ALEC’s model legislation, include limiting tort liability for corporations; relaxing gun control laws; limiting the activities of unions; and privatizing government programs and services like Medicare, public education, foster care, water and sewer systems, and the corrections system. If supporting the Republican Party constitutes private benefit—as courts and the IRS have determined it does—then surely supporting the big business segment of the Republican Party is equally impermissible.

**2. ALEC Engages in Substantial Lobbying, in Violation of Section 501(c)(3).**

As you know, federal tax law limits the lobbying activities of organizations exempt from tax under section 501(c)(3). This limitation “stem[s] from congressional policy that the United States Treasury should be neutral in political affairs and that substantial activities directed to attempts to influence legislation . . . should not be subsidized.”<sup>90</sup> As the Supreme Court explained, the limitation on lobbying in section 501(c)(3) came about because “Congress was concerned that exempt organizations might use tax-deductible contributions to lobby to promote the private interests of their members.”<sup>91</sup>

Public charities have the option of choosing between two quite different methods of complying with the lobbying restriction. Under the default regime, a charity is subject to the so-

<sup>88</sup> See, e.g., Form 990 Schedule D, Part IV.

<sup>89</sup> E.g., Rev. Rul. 71-395, 1971-2 C.B. 228 (a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting and selling their works does not qualify under section 501(c)(3) of the Code because it provides a private benefit—i.e., the sales proceeds—to the artists); Rev. Rul. 76-152, 1976-1 C.B. 151 (same).

<sup>90</sup> *Christian Echoes Nat’l Ministry v. United States*, 470 F.2d 849, 854 (10th Cir. 1972); See also *Taxation With Representation v. Regan*, 461 U.S. 540, 544 (1983) (“In short, Congress chose not to subsidize lobbying as extensively as it chose to subsidize other activities that nonprofit organizations undertake to promote the public welfare.”); *id.* at 550 (“It is not irrational for Congress to decide that tax-exempt charities . . . should not further benefit at the expense of taxpayers at large by obtaining a further subsidy for lobbying.”).

<sup>91</sup> *Taxation With Representation*, 461 U.S. at 550 (citing 78 Cong. Rec. 5861 (remarks of Sen. Reed), 5959 (remarks of Sen. La Follette) (1934)).

called “no substantial part test” of section 501(c)(3), which provides simply that no substantial part of an organization’s activities may be “carrying on propaganda, or otherwise attempting, to influence legislation.” Alternatively, certain public charities can make an election under section 501(h) to be subject to clear, bright-line rules defining the portion of its charitable expenditures that can be devoted to lobbying activities.

Based on recently-reported statements from ALEC’s counsel, we understand that the organization has made an affirmative election under section 501(h) of the Code.<sup>92</sup> While we believe that ALEC’s activities violate the rules under both the “no substantial part” test and the expenditure-based test set forth in section 501(h), we focus our analysis on the latter framework in light of these statements.

**A. Overview of the Section 501(h) Lobbying Rules.**

Under the section 501(h) rules, an organization has engaged in lobbying if it makes either a “direct” or a “grassroots” lobbying communication. An organization makes a *direct lobbying communication* when it:

- communicates directly with a legislator or a legislator’s staff;
- refers to “specific legislation”—a term that includes “both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes”<sup>93</sup>; and
- expresses a point of view on that legislation or legislative proposal.<sup>94</sup>

An organization generally makes a *grassroots lobbying communication* only if in a communication with the public it refers to a specific legislation or a specific legislative proposal, expresses a point of view on that legislation or legislative proposal, and makes a “call to action” for the recipients to communicate their views to legislators.<sup>95</sup>

There are four significant exceptions to the definition of lobbying:

- Responding to oral or written requests for technical assistance from a legislative committee, subcommittee or governmental body;<sup>96</sup>
- Presenting examinations and discussions of broad social, economic, and similar problems that do not address the merits of a specific legislative proposal or encourage recipients to take action with respect to legislation;<sup>97</sup>

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<sup>92</sup> Perry, *supra* note 46 (“[ALEC] maintains that its activities are allowed under tax rules governing charities that choose to limit their lobbying activities to a percentage of their expenses instead of trying to determine what “no substantial part” means. Alan P. Dye, a lawyer for ALEC, said that even though the group does no lobbying, it has requested tax-status consideration under those rules because they offer a ‘relatively clear’ definition of what constitutes lobbying.”).

<sup>93</sup> Treas. Reg. § 56.4911-2(d)(1)(ii).

<sup>94</sup> I.R.C. § 4911(d)(1)(B); Treas. Reg. § 56.4911-2(b)(1).

<sup>95</sup> I.R.C. § 4911(d)(1)(A); Treas. Reg. § 56.4911-2(b)(2).

<sup>96</sup> I.R.C. § 4911(d)(2)(B).

- Communicating with legislators concerning legislation that could affect the organization's existence, powers, duties, tax-exempt status, or right to receive tax-deductible contributions (so-called "self-defense" lobbying);<sup>98</sup> and
- Making available the results of "nonpartisan analysis, study, or research" available to the general public or a segment thereof, or to governmental bodies, officials, or employees.<sup>99</sup>

With regard to the last exception, the Regulations clarify that:

"nonpartisan analysis, study, or research" means an independent and objective exposition of a particular subject matter, including any activity that is 'educational' within the meaning of § 1.501(c)(3)-1(d)(3). Thus, "nonpartisan analysis, study, or research" may advocate a particular position or viewpoint so long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion.<sup>100</sup>

Examples of "nonpartisan analysis, study, or research . . . include distribution of reprints of speeches, articles and reports; presentation of information through conferences, meetings and discussions; and dissemination to the news media, including radio, television and newspapers, and to other public forums."<sup>101</sup>

To qualify for the "nonpartisan analysis" exception, this material must not (i) explicitly encourage recipients to contact legislators, (ii) be distributed only to persons interested in one side of the issue addressed, or (iii) reflect a view on specific legislation and directly encourage the recipient to take action with respect to such legislation.<sup>102</sup> In the words of the Service, an organization that "does not direct its efforts or expend funds in making any legislative recommendations, preparing prospective legislation, or contacting legislators for the purpose of influencing legislation" may qualify for this exception.<sup>103</sup> However, an organization that "advocate[s] the adoption of any legislation or legislative action to implement [its] findings" will not.<sup>104</sup>

Finally, section 501(h) prescribes specific limits on the amount an organization may spend on lobbying activities. These limits are determined in accordance with a mathematical calculation based on the size of the organization's charitable programming. Specifically, the overall lobbying expenditure ceiling equals 20% of the first \$500,000 of the organization's charitable budget and declines as exempt expenditures rise, reaching a maximum allowance of \$1 million per year. Further, only 25% of this amount may be devoted to the so-called "grassroots" lobbying efforts described above. All expenses incurred in researching, drafting and reviewing a lobbying

<sup>97</sup> Treas. Reg. § 56.4911-2(c)(2).

<sup>98</sup> I.R.C. § 4911(d)(2)(C).

<sup>99</sup> Section 4911(d)(2)(A).

<sup>100</sup> Treas. Reg. § 56.4911-2(c)(1)(ii).

<sup>101</sup> Treas. Reg. § 56.4911-2(c)(1)(iv).

<sup>102</sup> Treas. Reg. § 56.4911-2(c)(1)(iv), (vi).

<sup>103</sup> Rev. Rul. 70-79, 1970-1 C.B. 127.

<sup>104</sup> *Id.*

communication count towards this ceiling.<sup>105</sup> If an organization exceeds either the overall lobbying expenditure ceiling or the grassroots lobbying ceiling during any tax year, it is subject to a penalty tax of 25% of the excess expenditures.<sup>106</sup> Moreover, an organization will lose its tax-exempt status if it exceeds either the overall or the grassroots lobbying expenditure ceiling by more than 50% over a four-year period.<sup>107</sup>

### **B. Application of the Lobbying Rules to ALEC**

Based on our review of ALEC’s activities and the facts set forth above, it appears that ALEC dedicates the bulk of its time, energy, and resources to formulating, disseminating and supporting its “model legislation.” Each piece of model legislation constitutes a “specific legislative proposal that the organization supports” and thus qualifies as “specific legislation” under section 4911.<sup>108</sup> Accordingly, the expenses incurred by ALEC in researching, drafting and promoting each piece of its model legislation are all lobbying expenditures.

We understand that, in response to the Common Cause complaint, ALEC claimed, through counsel, that its activities fall within the exception from lobbying for “nonpartisan analysis, study, or research”<sup>109</sup> According to counsel, “[w]hile the group often expresses a point of view on model legislation, it also provides background on the issues involved, for example, by including a link to ‘substantive studies’ when it sends e-mail communications to legislators.”<sup>110</sup> Admittedly, we have not reviewed all of ALEC’s model legislation and related communications—indeed, many have never been made available to the public. However, the legislative proposals and related communications we have reviewed do not satisfy any of the requirements for the exception from lobbying for nonpartisan analysis, study or research.

- The proposals do not appear to contain “a sufficiently full and fair exposition” of the public policy issue underlying the legislative proposal.<sup>111</sup> To the contrary, they promote the ideological views and business interests of ALEC’s Private Sector Members—the corporate funders who help draft the model legislation and fund its creation.
- The very nature of ALEC’s work product—*i.e.*, “model legislation” and related communications recommending the passage of its legislative proposals—demonstrates that the organization “direct[s] its efforts [and] expend[s] funds in making . . . legislative recommendations [and] preparing prospective legislation.”<sup>112</sup>

<sup>105</sup> Treas. Reg. § 56.4911-3(a).

<sup>106</sup> I.R.C. § 4911(a).

<sup>107</sup> See Treas. Reg. § 1.501(h)-3(b). “The organization thereafter shall not be exempt from tax under section 501(a) as an organization described in section 501(c)(3) unless . . . the organization reapplies for recognition of exemption and is recognized as exempt.” *Id.*

<sup>108</sup> Compare Treas. Reg. § 56.4911-2(d)(1)(ii).

<sup>109</sup> Perry, *supra* note 46.

<sup>110</sup> *Id.*

<sup>111</sup> *Contra* Treas. Reg. § 56.4911-2(c)(1)(ii) (a communication that presents “a sufficiently full and fair exposition of the pertinent facts” may fit within the exception from the definition of lobbying for “nonpartisan analysis, study, or research”).

<sup>112</sup> *Contra* Rev. Rul. 70-79, 1970-1 C.B. 127 (a communication that “does not direct its efforts or expend funds in making any legislative recommendations, preparing prospective legislation, or contacting legislators for the

- Further, it appears that ALEC’s model legislation and any related communications are distributed only to ALEC’s Legislative Members, the vast majority of whom are Republican legislators.<sup>113</sup>
- Finally, the efforts undertaken by ALEC’s members in state houses nationwide, and its publication of “scorecards” tracking the adoption of its model legislation, strongly suggests that the organization also “advocate[s] the adoption of any legislation or legislative action to implement [its] findings.”<sup>114</sup>

Based on the materials we reviewed, it appears to us that all work related to researching, preparing, and disseminating ALEC’s legislative proposals could constitute lobbying—and none would constitute nonpartisan analysis, study, or research, as ALEC contends.

If the Service finds (and we believe it will) that ALEC’s activities related to its model legislation constitute lobbying, the expenditures made in connection with formulating and disseminating that legislation would, at best, be subject to excise tax imposed by section 4911(a). At worst, they could cost ALEC its tax-exempt status.

These expenditures are substantial. According to ALEC’s Form 990 its two largest program areas, measured by expenditures, are (1) its legislative Task Forces, which “provide a forum for legislators and the private sector to discuss issues, develop policy, and draft model legislation”;<sup>115</sup> and (2) its Conferences, where it brings state legislators and private company representatives together to draft and adopt “model legislation and policy”<sup>116</sup> ALEC’s expenditures for these programs are documented in the table below.

**Form 990 Reporting of Expenditures**

	2007	2008	2009	2010
<b>Task Force Expenditures</b>	\$2,459,483	\$2,977,527	\$2,634,723	\$2,125,791
<b>Conference Expenditures</b>	\$2,204,995	\$1,955,040	\$1,955,457	\$1,867,332
<b>TOTAL</b>	<b>\$4,664,478</b>	<b>\$4,932,567</b>	<b>\$4,590,180</b>	<b>\$3,993,123</b>
<b>Other Program Expenditures</b>	\$1,044,236	\$1,025,118	\$959,467	\$780,688

Thus, in each of the past four years, ALEC spent between \$3.9 and \$4.9 million on programs related to “model legislation” and \$1 million or less on its other exempt program services (the majority of these expenses were for its membership recruitment program<sup>117</sup>). Even assuming very conservatively that only half of ALEC’s expenditures for its Task Force and conferences were attributable to lobbying activities—and we believe the percentage is likely much higher—ALEC’s

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purpose of influencing legislation” may fit within the exception from the definition of lobbying for “nonpartisan analysis, study, or research”).

<sup>113</sup> *Contra* Treas. Reg. § 53.4911-2(c)(1)(iv) (a communication that is not “limited to, or . . . directed toward, persons who are interested solely in one side of a particular issue” may fit within the exception from the definition of lobbying for “nonpartisan analysis, study, or research”).

<sup>114</sup> *Contra* Rev. Rul. 70-79, 1970-1 C.B. 127 (a communication that does not advocate the adoption of any legislation or legislative action to implement these findings” may fit within the exception from the definition of lobbying for “nonpartisan analysis, study, or research”).

<sup>115</sup> ALEC 2010 Form 990, Part III, line 4(a).

<sup>116</sup> *Id.*, Part III, line 4(b).

<sup>117</sup> *E.g.*, 2010 Form 990, Part III, line 4(c).

lobbying expenditures would have been double the \$1 million *maximum* ceiling permitted under section 501(h)<sup>118</sup> and the organization would face revocation of its tax-exempt status.<sup>119</sup> These numbers underscore the extent to which ALEC's Private Sector Members use the organization to advance their pecuniary agendas through legislative means, often at the expense of the less fortunate and well-connected. Clergy VOICE urges the Service to investigate immediately.

### 3. The Filing of Inaccurate Information Returns Should Subject ALEC to Penalties, Interest, and Extended Statutes of Limitations.

The public record suggests that there may be a number of inconsistencies, and potentially significant inaccuracies, in the Form 990s that were filed by ALEC under penalties of perjury. First, on Part IV, line 4 of its 2008, 2009, and 2010 Forms 990, ALEC reported that it did not “engage in lobbying activities” (and reported in 2010 that it did not “have a section 501(h) election in effect during the tax year”) and, thus, was not required to complete Schedule C of the Form 990. At the same time, ALEC registered its attorneys as lobbyists in at least one state, and it has consistently admitted on its Form 990 that its core activities is drafting and adopting model legislation<sup>120</sup>—an activity that, for the reasons above, constitutes lobbying. Thus, its statement on the Form 990 that it did not engage in *any* lobbying seems incredible. Further, ALEC has admitted through counsel that the organization is a section 501(h)-electing charity; therefore, its statement that it did not have a section 501(h) election in effect in 2010 was patently false.

Second, on Schedule D of its 2008, 2009, and 2010 Form 990 information returns, ALEC took the position that funds collected and disbursed for its “legislative scholarships” are “not revenues and expenses of ALEC as the State Chair retains the *exclusive right to determine* the expenditures.”<sup>121</sup> However, as ALEC's Scholarship Policy makes clear, the State Chair does not exercise discretion over how scholarship funds are expended or awarded. Rather, this policy—an ALEC policy—provides that the legislators' travel and entertainment expenses will be reimbursed if the legislator submits receipts to the State Chair (who, in turn, “will submit the appropriate signed form to [ALEC's] Director of Membership). Thus, as ALEC's Bylaws state quite plainly, the State

<sup>118</sup> It bears emphasis, however, that ALEC's lobbying expenditure ceiling under section 501(h) would be significantly lower than the maximum. Specifically, if half of ALEC's Task Force and conference-related expenses were not lobbying expenditures (which, again, we believe is a very conservative assumption), the organization's lobbying expenditure ceiling for 2007 through 2010 would have been \$318,824; \$324,570; \$312,728; and \$288,862 respectively—and *ALEC's lobbying expenditures would have been 6.9 to 7.5 times the maximum the organization is allowed under section 501(h).*

<sup>119</sup> See Treas. Reg. § 1.501(h)-3(b).

We have seen press reports suggesting that ALEC could be treated as a section 501(c)(4) organization if its section 501(c)(3) status were revoked for excessive lobbying. The Internal Revenue Code expressly prevents this. Specifically, Section 504(a) provides that if the tax-exempt status of a section 501(c)(3) organization is revoked for engaging in political campaign activity or excessive lobbying, the organization “shall not at any time thereafter be treated as an organization described in section 501(c)(4).” See also Treas. Reg. 1.504-1 (“Section 504(a) and this section apply to an organization that is exempt from taxation . . . as an organization described in section 501(c)(3), and that ceases to be described in that section because it . . . [i]s denied exemption under the provisions of section 501(h) (see § 1.501(h)-3 or § 56.4911-9).”).

<sup>120</sup> See Form 990, Part III (“Statement of Program Service Accomplishments,” lines 4(a) and 4(b).

<sup>121</sup> See Form 990, Sch. D (“Supplemental Financial Statements”) (emphasis supplied), Part IV (referencing Form 990, Part IX (“Balance Sheet”), line 21).

Chair merely “oversee[s] expenditures of legislative scholarship funds”<sup>122</sup>; approving these reimbursements is one of his duties set forth in the Bylaws. Further, ALEC admits on its Form 990 that its “Membership” program—one of its three largest program services by expenditures—“provides assistance to ALEC State Chairs in raising scholarship funds [and] tracking the expenditures of these funds.”<sup>123</sup> There simply is no legitimate basis for ALEC’s position that the legislative scholarship funds do not belong to the organization.

ALEC’s position that legislative scholarship funds do not belong to the organization is not only untenable, but also provides the basis for several other return positions that are helpful to the organization. For example:

- On Part IX, line 18 of the Form 990, charities must report the amount of any “[p]ayments of travel or entertainment expenses for any federal, state, or local public officials.” ALEC did not report any of its travel reimbursements through the “legislative scholarship” program on Part IX, line 18—and, indeed, reported that it made *no payments* for public official travel in 2008 or 2009.
- On Schedule J, Part I of the Form 990, charities must disclose whether they provide “travel for companions” to their officers, directors, and trustees. Although publicly-available documents confirm that ALEC awarded “legislative scholarship” reimbursements to cover the travel expenses for legislators’ spouses and children—including, presumably, the spouses and children of legislators serving on ALEC’s Board—the organization indicated on Schedule J that it did not pay for any companion travel.
- On Part IV, line 25, and Schedule L, Part I of the Form 990, charities must disclose their participation in any “excess benefit transactions” involving their officers, directors, and other “disqualified persons,” which occurred or were discovered during the tax year. The reimbursement of spousal and family travel for legislators serving as officers or Board members of ALEC would very likely constitute “automatic excess benefit transactions” under section 4958.<sup>124</sup>
- Because ALEC does not treat legislative scholarship funds as funds belonging to the organization, it follows that ALEC does not treat amounts reimbursed for spousal and family travel as compensation to the legislator,<sup>125</sup> or issue Form 1099 information returns to the legislators in cases where the amounts reimburse exceed \$600.<sup>126</sup>

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<sup>122</sup> Bylaws, § 10.03.

<sup>123</sup> See Form 990, Part III, line 4(c).

<sup>124</sup> See Treas. Reg. § 53.4958-4(c).

<sup>125</sup> See Treas. Reg. § 1.132-5(t) (amounts paid for spousal and family travel will not qualify as a “working condition fringe benefit” unless “it can be adequately shown that the spouse’s, dependent’s, or other accompanying individual’s presence on the employee’s business trip has a bona fide business purpose.”).

<sup>126</sup> I.R.C. § 6041(a); *United States v. Gotcher*, 401 F.2d 118 (5th Cir. 1968) (holding that a spouse’s expenses incurred in accompanying her husband on a business trip were taxable to her husband); *Acacia Mut. Life Ins. Co. v. United States*, 272 F. Supp. 188 (D. Md. 1967) (same).



The misstatements on ALEC's information returns are serious and may subject the organization, and the individuals who signed the return under penalties of perjury, to the civil and criminal penalties described below.

**A. ALEC Faces Potential Civil Penalties for Failing to File a Complete or Correct Information Return.**

Section 6652 of the Code imposes penalties for failing “to file a return required under [section] 6033(a)(1)”—*e.g.*, a Form 990—or for failing to provide complete or correct information on a required return.<sup>127</sup> For purposes of section 6652, a return is considered “incomplete” if “*material* information” has been omitted.<sup>128</sup> Although “materiality” is not defined in section 6652 or the accompanying Regulations, the IRS has explained that materiality is

both a qualitative and quantitative assessment used in identifying those items that are most relevant and consequential in determining (a) *continued tax exempt status*; (b) the overall accuracy and completeness of the information return (Form 990, 990 PF, etc.); and (c) the correct tax liability (income, employment, excise).<sup>129</sup>

Information is material in the qualitative sense if it affects the ability of the IRS “to perform the duties and responsibilities placed upon it by Congress for proper administration of the revenue laws.”<sup>130</sup> Significantly, the IRS stated that the Form 990 and instructions

request information that is necessary in order for the Service to perform the duties and responsibilities placed upon it by Congress for proper administration of the revenue laws . . . [which include] conducting audits of exempt organizations to determine their compliance with statutory provisions. When a return is submitted that has not been satisfactorily completed, the Service's ability to perform its duties is seriously hindered . . . . Thus, when material information is omitted, a return is not completed in the manner prescribed by the form and instructions and the organization has not met the filing requirements of section 6033(a)(1) of the Code.<sup>131</sup>

For this reason, the IRS takes the position that when material information has been omitted from a Form 990, the return “is treated in the same manner as if no return had been filed when considering whether to impose penalties.”<sup>132</sup> For example, “the organization is considered to have failed to file

<sup>127</sup> I.R.C. § 6652(c)(1)(A)(ii).

<sup>128</sup> Internal Revenue Manual (“I.R.M.”) § 4.75.21.2(3) (“Incomplete Returns”) (emphasis supplied).

<sup>129</sup> I.R.M. § 4.75.29.11.2.4 (defining “materiality” for purposes of the Exempt Organizations Team Examination Program Procedures) (emphasis supplied).

<sup>130</sup> Rev. Rul. 77-162, 1977-1 C.B. 400.

<sup>131</sup> *Id.*

<sup>132</sup> I.R.M. § 4.75.21.2(3); *see also* Gen. Couns. Mem. 36506 (Dec 8, 1975) (“the filing of an incomplete return does constitute ‘failure to file a return’ . . . if, absent reasonable cause, the incompleteness of the return is due to the omission of material information that would hinder or preclude the Service from being able to perform the duties and responsibilities placed upon it by Congress.”).

any return at all, thereby preventing the commencing of the statute of limitations under Code § 6501(c)(3).”<sup>133</sup>

In this case, it appears that the Form 990s filed by ALEC contained incorrect information about its scholarship program and payments to legislators for travel and entertainment. Even more troubling, ALEC’s information returns omitted critical information regarding the nature and extent of its lobbying activities. These misstatements and omissions are “material” within the meaning of section 6652—*i.e.*, they are unquestionably “relevant and consequential” in determining (a) the accuracy and completeness of ALEC’s return, (b) its liability for excise tax under sections 4911 and 4958, and (c) its continued exemption from federal income tax. Properly reporting the “scholarship” funds as revenues and expenditures of ALEC, and properly disclosing ALEC’s lobbying expenditures would have provided the IRS with proper notice and an opportunity to inquire into the scope of ALEC’s legislative activities and—significantly—its continued exemption from tax. ALEC’s reporting of its “scholarship program” and legislative activities ensured that the IRS would not be in a position to conduct this sort of analysis and, accordingly, interfered with the agency’s ability to properly administer the internal revenue laws and “determine [ALEC’s] compliance with” the requirements of section 501(c)(3).<sup>134</sup>

In sum, it appears that ALEC filed multiple Forms 990 that not only reported incorrect information, but also omitted of material information. As a result, the organization may be subject to civil penalties under section 6652 of the Internal Revenue Code.<sup>135</sup>

**B. *ALEC, and Persons Who Helped Prepare its Form 990, May Face Criminal Tax Penalties for Failing to File a Complete or Correct Information Return.***

The misstatements and omissions on ALEC’s Form 990 may expose the organization to far more than civil penalties. If the misstatements or omissions were made knowingly or willfully, ALEC, and any person who willfully assisted or advised ALEC in connection with the preparation of its information returns, could face criminal penalties as well. In light of the widespread reports of ALEC’s activities and their apparent incompatibility with section 501(c)(3)—and, at times, with statements made by the organization on its Form 990—we would be remiss if we did not bring these potential criminal violations to your attention. For instance, based on the fact that at least one member of ALEC’s staff registered as a lobbyist, the organization seems to be on notice that it engaged in lobbying activity reportable on the Form 990, and a statement to the contrary would appear to be deliberately made. Even if ALEC’s lobbying activities were otherwise permissible under section 501(c)(3), its deliberate failure to report them, the Form 990 could still subject the organization or its personnel to penalties.

Specifically, the following criminal tax penalties may be implicated in this case:

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<sup>133</sup> Gen. Couns. Mem. 36506 (Dec. 8, 1975).

<sup>134</sup> See Rev. Rul. 77-162, 1977-1 C.B. 400; compare I.R.M. § 4.75.10.4 (“The primary objectives for examination of an exempt organization are to determine if: (a) The organization is organized and operated in accordance with its exempt purpose(s) and should continue to be recognized as exempt from Federal income taxes[, and] (b) The Form 990 . . . is complete, correct, and contains all public information required by I.R.C. § 6033.”).

<sup>135</sup> In addition, if ALEC failed to report its lobbying expenditures on its Form 990, in “negligent disregard of the rules or regulations,” it could be liable for a “substantial understatement” penalty of 20% of the understatement of any tax it owes under section 4911 for exceeding its section 501(h) expenditure limits. I.R.C. § 6662(a). If the understatement is found to be attributable to fraud, the penalty would increase to 75%. See I.R.C. § 6663(a).

i. Penalties for Fraud and False Statements.

Section 7206(1) of the Code provides that any person who, under penalties of perjury, signs a document that “he does not believe to be true and correct as to every material matter,” is guilty of a felony and is subject to a \$100,000 fine and up to three years’ imprisonment.<sup>136</sup> Section 7206(2) of the Code provides that any person—including a legal or tax advisor, trustee, officer, or chief financial officer of an organization—who willfully aids or assists in the preparation of a return that is false or fraudulent as to any material matter is subject to these same penalties.<sup>137</sup>

As with the civil penalties imposed by section 6652, “materiality” is not defined for purposes of section 7206. However, courts have found a misstatement to be “material” for purposes of section 7206 if “it has the potential [to] hinder[] the IRS’s efforts to monitor and verify the tax liability” of the taxpayer, or if it results in the underpayment of tax.<sup>138</sup> ALEC’s failure to report its lobbying expenditures (which very likely expose the organization to section 4911 excise tax liability)—and, to the extent it gives rise to section 4958 excise tax liability, its failure to properly report the “legislative scholarship” payments—are arguably material under this definition. It bears emphasis that the government need not prove that the misstatement resulted in an actual tax deficiency to obtain a conviction under this section. In other words, it is irrelevant if the misstatement affected the ultimate tax liability of the organization. Rather the government must prove only that the tax return was false as to a material matter.

ii. Penalties for Willful Failure to Provide Required Information.

Section 7203 of the Code provides for a fine not to exceed \$25,000, plus the costs of prosecution, and imprisonment of not more than one year, for a willful failure to provide information required under the Internal Revenue Code. Thus, if the government were to establish that ALEC willfully failed to provide any information required by the Instructions to the Form 990—as appears to be the case—these penalties would be applicable as well.

***C. ALEC, and Persons Who Helped Prepare its Form 990, Also May Face Liability Under the Federal Criminal Code for Failing to File a Complete or Correct Information Return.***

In addition to the penalties imposed by the Internal Revenue Code, Title 18 of the United States Code (the “Federal Criminal Code”) sets forth criminal penalties for certain conduct relating to filing required tax or information returns with the IRS. “In recent years, the Department of Justice has indicated a greater willingness to seek criminal prosecutions of individuals [associated with charities] who falsify information . . . on their Forms 990” under these provisions.<sup>139</sup> Specifically, the government could assert that the following provisions are applicable:

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<sup>136</sup> I.R.C. § 7206(1).

<sup>137</sup> I.R.C. § 7206(2).

<sup>138</sup> United States v. Presbitero, 569 F.3d 691, 700–01 (7th Cir. 2009).

<sup>139</sup> Frances R. Hill & Douglas M. Mancino, Taxation of Exempt Organizations ¶ 33.13[3][e] (“Criminalization of Form 1023 and Form 990 Filings”).

i. Conspiracy to Defraud the United States Government.

Section 371 of the Federal Criminal Code proscribes two types of conspiracies: a conspiracy to violate any federal criminal statute, or a conspiracy to “defraud the United States.” The latter clause gives wide leeway to federal prosecutors to charge criminal offenses. Specifically, the alleged fraudulent conduct underlying a conspiracy to defraud the United States need not constitute a substantive tax crime. To that end, courts have held that a charge of conspiracy to defraud the United States can be predicated upon any agreement to obstruct or impede the Internal Revenue Service in the determination, assessment or collection of tax.<sup>140</sup>

Under the “conspiracy to defraud” prong of section 371 of the Federal Criminal Code, courts will sustain prosecutions where the government can demonstrate two things: (1) an agreement by two or more persons to obstruct, impair or impede the IRS in performing *any* of its lawful functions, and (2) a single “overt act”—which by itself need not be criminal—in furtherance of that agreement. The conspiracy need not have been successful and an IRS examination need not have occurred. All the government need show is that two or more people conspired to take any step (such as reporting that ALEC engaged in no lobbying activities, or that it did not pay travel or entertainment expenses for any public officials), which, had an IRS auditor examined the books, might have misled him or her in any way.

In recent years, the Department of Justice has convicted officers of a charity for conspiring to defraud the United States for knowingly signing a false Form 990. For example,

- In one case, the officer of a tax-exempt charity was convicted for conspiracy to defraud the United States (18 U.S.C. § 371) and making false statements on tax returns (I.R.C. § 7206(1)) when the charity’s Form 990 undervalued a building and did not disclose that it had received a contribution that was earmarked for another organization.<sup>141</sup>
- In another case, the officers of a tax-exempt charity were convicted of the same crimes when the charity’s Form 990 did not disclose that the charity published a fund-raising newsletter and that the officers had formerly been volunteers for another organization. There were no allegations in this case that the charity’s resources had been diverted for an improper purpose.<sup>142</sup>

Most recently, the Department of Justice secured a guilty plea from the Ex-Chief of the Fiesta Bowl to conspiracy charges for knowingly filing a false Form 990. Specifically—and significantly for ALEC—the Fiesta Bowl’s Form 990 declared, falsely, that it engaged in no lobbying or political campaign activity.<sup>143</sup>

<sup>140</sup> See *United States v. Klein*, 247 F.2d 908, 915 (2d Cir. 1957); *cf. Hammerschmidt v. United States*, 265 U.S. 182, 188 (1924).

<sup>141</sup> *United States v. Sedaghaty*, No. CR 05-60008 (D. Ore.).

<sup>142</sup> *United States v. Mubayyid et al.*, 476 F Supp 2d 46 (D. Mass. 2007), *aff’d* 658 F3d 35 (1st Cir. 2011).

<sup>143</sup> [http://www.justice.gov/usao/az/press\\_releases/2012/JAN/PR\\_03142012\\_Junker.html](http://www.justice.gov/usao/az/press_releases/2012/JAN/PR_03142012_Junker.html).

ii. Aiding and Abetting.

Section 2 of the Federal Criminal Code provides that anyone who aids, abets, counsels, commands or induces or procures the commission of a crime against the United States is punishable as a principal.<sup>144</sup> The statute also provides that anyone who willfully causes an act to be done which if directly performed by him or another would be an offense against the United States is also punishable as a principal.<sup>145</sup> While this statutory provision may appear to criminalize the same conduct as that covered by section 7206(2) of the Code,<sup>146</sup> discussed above, the scope of the general aiding and abetting statute can extend to non-tax crimes, like those discussed below. It is important to note that the acquittal of the principal will not relieve the person that aids and abets of criminal liability.<sup>147</sup>

#### 4. The Actions of ALEC and its Members May Violate Other Criminal Laws.

Finally, while certainly not the primary focus of this submission, we believe that that in addition to the violations detailed above, the activities of ALEC and its members may run afoul of other federal and state criminal statutes. For example,

- **“Honest Services Fraud.”** Section 1346 of the Criminal Code, expands the federal mail fraud statute (18 U.S.C. § 1341) and the federal wire fraud statute (18 U.S.C. § 1343) to prohibit any “scheme or artifice to deprive another of the intangible right of honest services.” In *Skilling v. United States*,<sup>148</sup> the Supreme Court held that section 1346 criminalizes fraudulent schemes to deprive another of honest services through bribes or kickbacks supplied by a third party who has not been deceived. It appears that participants in ALEC’s “legislative scholarship program” (*i.e.*, the corporations that fund the payments to legislators, the legislators who receive the payments, and ALEC itself) could potentially be subject to sanctions under this provision.
- **“Pay-to-Play” prohibition.** Those corporate members of ALEC who are involved in the tax-exempt bond market may find that any payments they make to cover state legislators’ personal expenses may implicate the pay-to-play restrictions under federal securities laws. Specifically, Municipal Securities Rulemaking Board (MSRB) Rule G-37, generally prohibits firms from underwriting municipal bonds for an issuer for two years after a municipal finance professional involved with that firm makes a campaign contribution to an elected official of that municipality.
- ***Racketeer Influenced and Corrupt Organizations Act (RICO)*.** Sections 1961–1968 of the Federal Criminal Code applies an additional federal criminal penalty in the case of multiple

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<sup>144</sup> 18 U.S.C. § 2(a).

<sup>145</sup> 18 U.S.C. § 2(b).

<sup>146</sup> I.R.C. § 7206(2) has been referred to as the Tax Code’s aiding and abetting statute. *See* *United States v. Williams*, 644 F.2d 696, 701 (8th Cir. 1981).

<sup>147</sup> *United States v. Standefer*, 447 U.S. 10, 18-19 (1980) (explaining that 18 U.S.C. § 2 “evinces a clear intent to permit the conviction of accessories to federal criminal offenses despite the prior acquittal of the actual perpetrator of the offense.”).

<sup>148</sup> *Skilling v. United States*, 130 S.Ct. 2896 (2010).

criminal acts, such as violations of the Honest Services Fraud statute and mail and wire fraud statutes.

- ***Widespread filing of inaccurate Forms 990 with the states.*** The Form 990 generally comprises a part of the state law reporting requirements for organizations exempt under section 501(c)(3). ALEC’s failure to disclose any lobbying expenditures on its Forms 990, even in those years in which its personnel were registered as lobbyists; its failure to report payments to government officials; and its failure to properly report its “legislative scholarship” program means that inaccurate returns likely were filed under penalties of perjury with the various states, implicating state civil and criminal statutes.

We do not have enough information to fully analyze these claims. Nor have we attempted to evaluate the extent to which members of ALEC might be complicit under state or federal statutes. However, we are compelled to emphasize that *any* violation by ALEC of these criminal statutes—or, for that matter, the criminal tax statutes discussed above—would raise potentially significant issues under section 501(c)(3) and provide independent grounds for revoking ALEC’s tax-exempt status.<sup>149</sup>

## CONCLUSION

This submission, together with the IRS complaint filed by Common Cause and media accounts regarding ALEC’s activities, raise a number of complicated and significant questions regarding the organization’s continued qualification for exemption from tax. Given the influence wielded by ALEC and its members, the nature of the violations, and the fact that they are ongoing, we urge you to take immediate action to investigate ALEC and, if appropriate, assess penalties and other sanctions—including revocation—to ensure that these abuses do not continue to occur.

Thank you for allowing Clergy VOICE to bring these important issues to your attention.

Respectfully submitted,



Marcus S. Owens

Enclosure

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<sup>149</sup> *E.g.*, Rev. Rul. 97-21, 1997-1 C.B. 121, Situation 5 (“[a]n organization that engages in substantial unlawful activities . . . does not qualify as an organization described in section 501(c)(3)”) (citing Rev. Rul. 75-384, 1975-2 C.B. 204); *see also Activities that are Illegal or Contrary to Public Policy*, IRS Exempt Organizations Continuing Professional Education Text, at 109 (1985) (“Violation of constitutionally valid laws is inconsistent with exemption under IRC 501(c)(3).”); Jean Wright and Jay H. Rotz, *Illegality and Public Policy Considerations*, IRS Exempt Organizations Continuing Professional Education Text (1994) (“[I]n most cases, if an organization has engaged in substantial illegal activity, it has also run afoul of other basic principles of tax exemption and may be subject to revocation on those grounds, independent of the illegality issues.”).