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May 25, 2004

Mr. Steven T. Miller, Director
Exempt Organizations Division
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

Re: The California Recovery Team, EIN# 20-0428735

Dear Mr. Miller:

We are writing to express concern that The California Recovery Team (“CRT”), a California nonprofit public benefit corporation founded by Governor Arnold Schwarzenegger, is functioning primarily as a political organization rather than a social welfare entity in violation of its tax-exempt status under Section 501(c)(4) of the Internal Revenue Code. CRT’s activities and representations demonstrate that the organization exists primarily to advance Governor Schwarzenegger’s political career as an elected official and that it has adopted Section 501(c)(4) tax-exempt status solely to avoid tax and disclosure requirements that would be required of a Section 527 political organization. We respectfully request that the Internal Revenue Service investigate this matter.

An organization may be exempt from federal income tax under Section 501(c)(4) of the Internal Revenue Code if it is operated exclusively for the promotion of social welfare. An organization is considered operated exclusively for the promotion of social welfare only if it is primarily engaged in promoting the common good and general welfare of the people of a community.¹ The promotion of social welfare, however, does not include partisan political activity, because such activity promotes the interests of one political faction rather than the common good of the community as a whole.² If CRT primarily benefits a partisan political party and select individuals, it is precluded from qualifying as tax-exempt under Section 501(c)(4).

In American Campaign Academy, the Tax Court held that an organization, a campaign school, conducted its educational activities with the partisan objective of benefiting the interests of the Republican party, thereby resulting in impermissible private benefit.³ The entity’s partisan objective was evidenced by, among other things, the composition of the organization’s board of directors, the failure to counterbalance the Republican focus of its curriculum, and the incorporation by the General

¹ Treas. Reg. 1.501(c)(4)-1(a)(2)(i).

² Treas. Reg. 1.501(c)(4)-1(a)(2)(ii). See also Letter from Edward K. Karcher, Chief of Exempt Organizations Technical Branch 3, to Empower America (Feb. 21, 1997), *reprinted in* Paul Streckfus’ EO Tax J., Dec. 22, 1997 at 28, 33 (“Empower America Feb. 21 Letter”).

³ American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989).

Counsel of the National Republican Congressional Committee, an unincorporated association comprised of Republicans.⁴

The same private benefit activity that prevented the organization in American Campaign Academy from qualifying as tax-exempt under Section 501(c)(3) also cannot be regarded as activity that promotes social welfare under Section 501(c)(4).⁵ In denying Section 501(c)(4) tax-exempt status to an organization called Empower America, the IRS determined that the organization's activities were "designed to promote the electoral interests of the Republican Party and politicians affiliated with the Republican Party."⁶ The IRS found that the organization was biased toward a political party and served politicians' private benefit, because the organization's activities "generate[d] public support and enthusiasm for [the Republican party's] policies and positions... In turn, the public support and enthusiasm could enhance the election or reelection prospects of Republican party politicians (i.e., their political careers) and, thereby, the fortunes of the Republican party."⁷ Although this ruling with respect to Empower America is not binding precedent, the analysis in the letter is strikingly applicable to CRT.

As was the case with American Campaign Academy and Empower America, CRT exists primarily for the benefit of a select group, Governor Schwarzenegger and politicians affiliated with him. CRT's own promotional materials specifically state that its purpose is to "provide the monetary and public support necessary for Governor Arnold Schwarzenegger to achieve his ongoing reform agenda." As further discussed below, CRT exists primarily to serve the Governor and the Republican party's agenda, rather than the social welfare of the entire community.

In denying tax-exempt status to Empower America, the IRS determined that the organization's partisanship was exhibited by the key officers and personnel that founded and operated the organization.⁸ Empower America's directors were all prominent Republicans and "[had] not been expanded to include non-political and non-partisan individuals."⁹ Similarly, CRT's officers and directors are representative of the California Republican party. Governor Schwarzenegger, the founder, has been named Honorary Chairman; CRT sometimes refers to itself as "Governor Schwarzenegger's California Recovery Team." CRT's Board of Directors includes a campaign consultant of Governor Schwarzenegger and several members of the Governor's staff, including Deputy Chief of Staff Donna Lucas. Governor Schwarzenegger's attorney, Tom Hiltachk, serves as executive director. Other key personnel include Mike Murphy, senior strategist for Arnold Schwarzenegger's campaign for governor who also manages two of the Governor's political committees; Jeff Randle, political director of Governor Schwarzenegger's election campaign; and Marty Wilson, Governor Schwarzenegger's campaign and current fundraising director and a former fundraising director for Republican Governor Pete Wilson. These individuals, who both lead CRT and represent Governor Schwarzenegger and the Republican party, clearly reflect the organization's partisan agenda. Board member Bonnie Reiss is the only individual associated with CRT who is identifiable as a non-Republican, yet Reiss is Schwarzenegger's current Chief of Staff.

The IRS eventually recognized Empower America as sufficiently nonpartisan based on its ability to demonstrate that it did not knowingly receive support from political parties or affiliated groups and

⁴ Id. at 1070.

⁵ Empower America Feb. 21 Letter at 34.

⁶ Id. at 33.

⁷ Id. at 34.

⁸ Id. at 33.

⁹ Id.

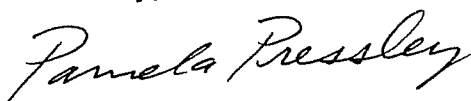
that it selected its advocacy issues independently from and not in coordination with any other organization.¹⁰ In addition, Empower America expanded its board of directors to include individuals unaffiliated with particular political parties or candidates.¹¹

CRT has none of these factors demonstrating nonpartisanship. As discussed above, the CRT Board of Directors is composed of individuals with intimate ties to the Republican party and Governor Schwarzenegger's administration and election campaign. In addition, CRT received financial support directly from Governor Schwarzenegger's campaign committees.¹² Moreover, CRT's advocacy agenda is not only coordinated with the Republican party, it is exclusively driven by it. CRT's promotional materials represent that "The California Recovery Team will be the principal organization supporting the passage of the Arnold Schwarzenegger Economic Recovery Plan." In fact, Governor Schwarzenegger has so closely aligned his personal political success with the success of CRT's efforts, that one is hard pressed to distinguish between support for CRT and support for Governor Schwarzenegger himself.

It appears that CRT has adopted Section 501(c)(4) tax-exempt status merely as a tax shelter for its primarily partisan activities. By exploiting such tax-exempt status, CRT may retain large sums of money in support of Governor Schwarzenegger and earn tax-free interest income that would otherwise be taxable if it were a political organization. Furthermore, CRT also will be able to avoid publicly disclosing the source of its contributors, some of whom may have contributed up to \$500,000 to obtain access to the Governor at one of his fundraising dinners.¹³ In fact, Tom Hiltachk, the Governor's attorney who formed CRT, has explicitly recognized the overtly political nature of the organization. According to Mr. Hiltachk, CRT is identical to an existing Schwarzenegger political action committee known as "Gov. Schwarzenegger's California Recovery Team." The Governor incorporated the political committee in order to allow it to collect donations without paying taxes.¹⁴

We respectfully request that the IRS review the operations and activities of CRT in order to prevent the organization from exploiting its tax-exempt status for purely partisan purposes. Although CRT describes itself as a "legislative advocacy organization," the IRS previously has recognized that an "issues" organization may be no less partisan, as demonstrated by the manner in which it operates and its "extensive party connections."¹⁵ We believe CRT demonstrates the characteristics of a political organization and should be treated accordingly.

Sincerely,



Pamela Pressley



Carmen Balber

¹⁰ Letter from Edward K. Karcher, Chief of Exempt Organizations Technical Branch 3, to Empower America (Nov. 21, 1997), *reprinted in* Paul Streckfus' EO Tax J., Dec. 22, 1997 at 53.

¹¹ *Id.*

¹² Records filed with the California Secretary of State reflect that Governor Schwarzenegger transferred \$100,000 from his Arnold Schwarzenegger's Total Recall Committee to CRT in late 2003 and another \$50,000 to CRT from the Governor Schwarzenegger's California Recovery Team committee in early 2004.

¹³ See CRT invitation to a private dinner with Governor Arnold Schwarzenegger on February 24, 2004, sponsored by Governor George Pataki and Robert Wood Johnson IV.

¹⁴ See "Governor creates private corporation to oversee fund-raising," *Associated Press*, Friday, March 26, 2004.

¹⁵ Empower America Feb. 21 Letter, at 33-34.