John Pomeranz <jpomeranz@harmoncurran.com> on 04/05/2004 08:37:47 PM

To: pcstestify@fec.gov
cc:

Subject: Comments and Request to Testify

Attached (in MS Word format) please find comments on Notice of Proposed Rulemaking 2004-6, including a request to testify at the Commission's upcoming hearing on the matter.

<<Harmon Curran Comments - FEC NPRM 2004-6.doc>>

John Pomeranz
Harmon, Curran, Spielberg & Eisenberg, LLP
1726 M Street, NW, Suite 600
Washington, DC 20036
p: 202.328.3500
f: 202-328-6918
e: jpomeranz@harmoncurran.com

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HARMON, CURRAN, SPIELBERG & EISENBERG LLP

1726 M Street, NW, Suite 600 Washington, DC 20036 (202) 328-3500 (202) 328-6918 fax

April 5, 2004

Ms. Mai T. Dinh, Acting Assistant General Counsel
Federal Election Commission
999 E Street, NW
Washington, DC 20463
BY ELECTRONIC MAIL

Re: Treatment of IRC Section 527 Organizations in Notice of Proposed Rulemaking on Political Committee Status (Notice 2004-6)

Dear Ms. Dinh:

The law firm of Harmon, Curran, Spielberg & Eisenberg, LLP, submits these comments in response to the Commission's proposed rules related to political committees.[1] We have many concerns about these proposed rules and their potential consequences for the democratic process. However, others – including a number of our firm's clients – are filing comments detailing the many issues raised by the NPRM.[2] Instead, our comments focus on a more specific issue: the proposal's attempt to regulate the entire class of organizations that are exempt from federal tax under Section 527 of the Internal Revenue Code (IRC). There is a great deal of confusion about these organizations that undermines the foundations of this rulemaking. We write today to offer the Commission a better understanding of the nature and obligations of Section 527 organizations and to identify some of the problems associated with any attempt to use the tax code as a template for election law regulation and enforcement.

Harmon, Curran, Spielberg & Eisenberg, LLP specializes in providing legal advice to nonprofit organizations and individuals in the areas of nonprofit organization tax law, election law, employment law, and environmental law. For more than 25 years, we have successfully served the legal needs of a wide variety of nonprofit organizations, citizen groups, political action committees, and individuals. Our clients engage in a variety of activities – some election-related, some not. Frequently we have had to guide our clients through the often confusing intersection of tax and election law, a crossroads created where the two roads – tax law and election law – begin from different policy rationales, meet in seemingly similar concepts, but then proceed to wildly different legal destinations.

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[1] Federal Election Commission Notice of Proposed Rulemaking on Political Committee Status, Notice 2004-6, 69 Fed. Reg. 11736 (March 11, 2004) (NPRM).

[2] In addition to the concerns we raise here, we express our general agreement with other comments that question this proposal's constitutionality, statutory authority, and timing. The Commission should not read our focus here on 527 organizations as an assent to regulation of 501(c)s and other independent organizations.

We hope that our experience in helping our clients with these issues will be of some aid to the Commission as well. Because we believe that the Commission should have a full understanding of the underlying tax law in this area, we request an opportunity for John Pomeranz, an attorney with our firm, to present testimony on this point at the Commission's planned hearing on this rulemaking.

COMMISSION REGULATION OF ALL 527S IS UNCONSTITUTIONAL

Laws governing electoral activity must survive a significantly higher constitutional standard of review than the law governing tax-exempt organizations

Government restrictions on speech, particularly core political speech, face a far more stringent constitutional standard than the standard that applies to restrictions on political activities of tax-exempt organizations.

As this Commission certainly knows, the courts have often been reluctant to approve restrictions on core political speech under federal election law. In general, any such government restrictions must survive strict scrutiny by the courts – they must be necessary to achieve a compelling government interest. Hence in *FEC v. Massachusetts Citizens for Life* ("MCFL") the Supreme Court held that a tax-exempt organization was exempt from the Federal Election Campaign Act (FECA) restrictions on express advocacy communications because "government must curtail speech only to the degree necessary to meet the particular problem at hand, and must avoid infringing on speech that does not pose the danger that has prompted regulation."[3] The Court has been similarly protective of political speech on numerous occasions. In *Buckley v. Valeo* ("Buckley") the Court reminded us that "[d]iscussion of public issues and debate on the qualifications of candidates are integral to the operation of the system of government established by our Constitution. The First Amendment affords the broadest protection to such political expression in order 'to assure [the] unfettered interchange of ideas for the bringing about of political and social changes desired by the people.'"[4] The Buckley Court went on to cite other cases in which the Supreme Court viewed restrictions on political speech with a skeptical eye.[5]

In contrast, tax-exempt organizations voluntarily assume restrictions far more onerous than those that the government may generally impose because the organizations accept these restrictions in exchange for the grant of certain tax benefits. As explained in a key case upholding the restriction on political activities by 501(c)(3)s:

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[3] 479 U.S. 238, 265 (1986).

[4] 424 U.S.1, 14 (1976), *citing* Roth v. United States, 354 U.S. 476, 484 (1957).

[5] *Id.* at 14-15 ("[T]here is practically universal agreement that a major purpose of that Amendment was to protect the free discussion of governmental affairs, . . . of course includ[ing] discussions of candidates . . . ." Mills v. Alabama, 384 U.S. 214, 218 (1966); "debate on public issues should be uninhibited, robust, and wide-open," New York Times Co. v. Sullivan, 376 U.S. 254, 270 (1964); "it can hardly be doubted that the constitutional guarantee has its fullest and most urgent application precisely to the conduct of campaigns for political office," Monitor Patriot Co. v. Roy, 401 U.S. 265, 272 (1971)).

> In light of the fact that tax exemption is a privilege, a matter of grace rather than right, we hold that the limitations contained in Section 501(c) (3) withholding exemption from nonprofit corporations do not deprive [the organization] of its constitutionally guaranteed right of free speech. The taxpayer may engage in all such activities without restraint, subject, however, to withholding of the exemption or, in the alternative, the taxpayer may refrain from such activities and obtain the privilege of exemption.[6]

There are, of course, limits on the ability of the government to impose restrictions on constitutionally protected activities as a condition of a grant of tax benefits,[7] but generally the courts have been willing to allow limits on the otherwise-protected activities of tax-exempt organizations.[8]

The tax-law definitions of political activity are too vague to survive constitutional review as standards under federal election law.

The Internal Revenue Code (IRC) and its accompanying regulations offer several different tests for what constitutes political activity for tax-exempt organizations (including 527 organizations), but all of these tests boil down to a vague "facts and circumstances" standard. While constitutionally adequate (although by no means ideal) for the enforcement of tax laws, the inherent uncertainty created by such a contextual, subjective standard renders it wholly inadequate to the task of providing a predictable standard for those required to comply with federal election law.

IRC Section 527(e) and the Concept of "Exempt Function"

Section 527 governs taxation of organizations that exist primarily for the purpose of "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization..."[9] Section 527 refers to these activities as "exempt functions" – a term that creates a great deal of confusion because it describes as "exempt" political activities that are prohibited or limited for most types of tax-exempt organizations. Organizations primarily engaged in these political

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[6] Christian Echoes National Ministry v. U.S., 470 F.2d 849, 857 (10th Cir. 1972).

[7] *See, e.g.*, Speiser v. Randall, 357 U.S. 513 (1958) (overturning a law requiring anyone seeking a property tax exemption to declare that he or she did not advocate the forcible overthrow of the Government of the United States).

[8] *See, e.g.*, Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983) (upholding restrictions on lobbying by 501(c)(3)s).

[9] 26 U.S.C. § 527(e)(2). Congress passed Section 527 in 1975 to address a concern raised by the IRS. Until that time, no section of the IRC explicitly exempted political parties, candidate campaign organizations, and political committees from taxation on the funds they received. Judith E. Kindell & John Francis Reilly, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 2002, "Election-Year Issues" 387 (2002) (hereafter "Election-Year Issues"). In light of this legislative silence, the IRS proposed a solution in 1973 to exempt contributions to political organizations from taxation but to subject their investment income to taxation. Announcement 73-84, 1973-2 C.B. 461, restated in Rev. Rul. 74-21, 1974-1 C.B. 14, (modified and clarified in Rev. Rul. 74-475, 1974-2 C.B. 22). However, the IRS indicated that it would not enforce this policy until Congress had time to consider this issue. Congress acted by passing Section 527.

"exempt functions" – including not only political committees, but also political parties and candidate campaigns – pay federal income tax any investment income but not on contributions they receive. Furthermore, contributions to 527 organizations are exempt from the federal gift tax usually imposed on donors that that make gifts in excess of an indexed annual threshold (currently $11,000).[10]

Not only does the IRC definition of political "exempt function" determine which organizations qualify for this tax treatment under Section 527, but it also determines which activities of other organizations are subject to tax on political activities under Section 527(f). Section 527(f) makes 501(c) organizations subject to federal income tax on an amount equal to the lesser of expenditures they make for "exempt functions" defined under Section 527(e) and the amount of investment income the 501(c) organization has received in that year.[11]

501(c) "Campaign Intervention" Standard: "Exempt Function" by Another Name[12]

Organizations operating under Section 501(c)(3) of the IRC are prohibited from "participat[ing] in, or interven[ing] in ... any political campaign on behalf of (or in opposition to) any candidate for public office."[13] The IRS evaluates each possible instance of 501(c)(3) electoral intervention based on a review of all of the "facts and circumstances."[14] A small number of revenue rulings as well as non-precedential guidance such as private letter rulings, indicate that relevant facts include the content and timing of any message, the breadth of the issues addressed in a communication, the organization's history of engaging in similar activities, the intended audience for any message, and many other factors.[15]

501(c) organizations other than 501(c)(3)s may engage in political activities under federal tax law, but these organization do face limits on such activities, and they use the same definition of political activity that applies to 501(c)(3)s. 501(c)s other than 501(c)(3)s must be primarily engaged in the activities that justify their tax-exempt status – the "social welfare" activities of 501(c)(4)s, the efforts on behalf of laborers of 501(c)(5)s, the efforts of 501(c)(6)s to promote a trade or profession, and so on. IRS regulations indicate that partisan political activity does not

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[10] 25 U.S.C. § 2501(a)(5).

[11] This terminology often creates confusion: 501(c) organizations are subject to *taxation* on so-called "*exempt* function" expenditures. 501(c)s face increased tax liability the more they engage in "exempt functions." It is important to remember that the exemption referred to is the exemption for political committees, not 501(c) organizations.

[12] Much of the following analysis is distilled from the draft report of the Task Force on Section 501(c)(4) and Politics, produced by the Subcommittee on Political and Lobbying Organizations and Activities of the American Bar Association's Section on Taxation Exempt Organizations Subcommittee. This report is available from the Task Force co-chair Greg Colvin of the San Francisco law firm of Silk, Adler and Colvin. As a draft, this report should not be read to reflect the final thinking of the Task Force. Furthermore, the American Bar Association has not approved the report, its analysis, or any of its recommendations.

[13] 26 U.S.C. § 501(c)(3).

[14] Election-Year Issues at 339.

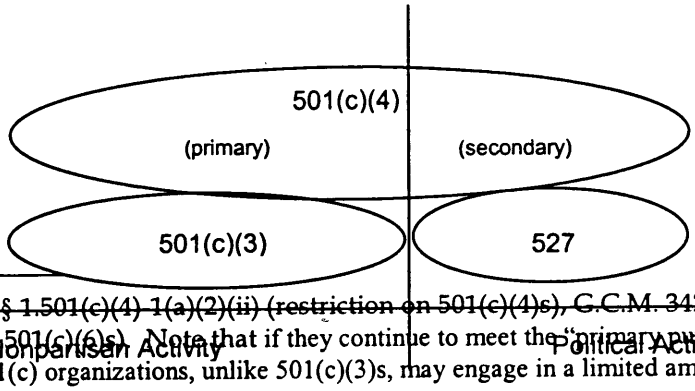
[15] *See* Rev. Rul 78-248, 1978-1 C.B. 154, Rev. Rul. 80-282, 1980-2 C.B. 178.

promote these tax-exempt purposes.[16] For example, the regulations governing 501(c)(4) organizations provide that "the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office"[17]

As indicated by the similar language prohibiting 501(c)(3) and restricting 501(c)(4) political activity, the IRS has made clear that the activities that would be considered prohibited campaign intervention for 501(c)(3) organization are the same as activities that constitute political activity for 501(c)(4) organizations. In at least one revenue ruling, the IRS has cited existing revenue rulings on 501(c)(3) political activity to describe activities that would constitute political activities for a 501(c)(4).[18] Non-precedential guidance from the IRS has been more explicit that the line for political activities by 501(c)(3)s is the same as that for other 501(c)s.[19]

The IRS has likewise linked the definition of political activities for 501(c)s to the definition of "exempt function" activities under Section 527. In particular, a series of private letter rulings from the late 1990s addressed organizations seeking to have activities declared "exempt function" activities under Section 527. In these rulings, the organizations that sought be qualify as 527 political organizations echoed language used to describe activities held to be prohibited 501(c)(3) political activity. For example, one of these rulings described a proposed voter guide highlighting the candidates' positions on issues selected not based "their importance and interest to the electorate as a whole" but on "their expected resonance with the public."[20] Furthermore, the voter guide that would be targeted geographically based on the organization's political interests and timed to coincide with political campaigns.[21]

There are some areas in which the definitions of "exempt function" under 527 is not perfectly congruent with the definitions of political activities for 501(c)(3)s or other 501(c) organizations.[22] However, it is in large part true that the IRS regulation of political activities by tax-exempt organizations can be summarized by the following simple illustration:



[16] *See,* Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (restriction on 501(c)(4)s), G.C.M. 34233 (Dec. 3, 1969) (restriction on 501(c)(5)s and 501(c)(6)s). Note that if they continue to meet the "primary purpose test" through their core activities, these 501(c) organizations, unlike 501(c)(3)s, may engage in a limited amount of political activity.

[17] Treas. reg. § 1.501(c)(4)-1(a)(2)(ii).

[18] Rev. Rul. 81-95, 1981-1 C.B. 332.

[19] *See, e.g.,* PLR 9652026 (October 1, 1996). *See also,* Election-Year Activities at 433 (treating as similar the definition of political activities for 501(c)(3) and other 501(c) organizations).

[20] *Compare* Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 2 *with* PLR 9652026 (Oct. 1, 1996).

[21] PLR 9652026 (Oct. 1, 1996).

[22] See, e.g., GCM 39694 (Feb. 1, 1988) (expenditures to oppose federal judicial nominee are both "exempt function" under 527 and permissible lobbying activity for 501(c) organization).

The Vagueness of the Tax Standard as Applied for FECA Purposes

The apparent simplicity of the tax law's definition of political activity and the seeming consistency of the regulatory scheme encompassing different types of tax-exempt organizations masks the fundamental problem with the system: its inherent vagueness and subjectivity.

FECA regulates core political speech and imposes criminal penalties for violations. Thus, FECA is especially intolerant of vague standards. As the Court explained in Buckley:

> Due process requires that a criminal statute provide adequate notice to a person of ordinary intelligence that his contemplated conduct is illegal, for 'no man shall be held criminally responsible for conduct which he could not reasonably understand to be proscribed. Where First Amendment rights are involved, an even 'greater degree of specificity' is required.[23]

Even in the context of the tax law, the "facts and circumstances" test employed by the IRS creates vast uncertainty for tax-exempt organizations seeking to comply with the law.[24] The IRS has consistently refused to provide a comprehensive list of the criteria it will use to evaluate political activities.

The problem is exacerbated by the relative lack of guidance from the IRS (particularly precedential guidance) to help tax-exempt groups.[25] The IRS Private Letter Ruling process (unlike the Commission's own Advisory Opinion process) does not permit similarly situated organizations cite previous letter rulings as precedent.[26] When the IRS does release precedential guidance in the form of a Revenue Ruling, it often enumerates an explicitly non-exhaustive list of facts and circumstances and then provides discreet examples rather then generally applicable rules.[27]

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[23] Buckley at 77, *citing* United States v. Harriss, 347 U.S. 612, 617 (1954) and Smith v. Goguen, 415 U.S. 566, 573 (1974).

[24] *Cf.* United Cancer Council v. Commissioner, 165 F.3d 1173, 1179 (7th Cir. 1999) (Judge Posner, considering use of the "facts and circumstances" standard to evaluate appropriate costs of fundraising for 501(c)(3)s: "'facts and circumstances'... is no standard at all, and makes the tax status of charitable organizations and their donors a matter of the whim of the IRS").

[25] On several occasions, the American Bar Association Section on Taxation and its various committees and subcommittees have urged the IRS to address the lack of guidance in this area. *See, e.g., Commentary on IRS 1993 Exempt Organizations Continuing Professional Education Technical Instruction Program Article on 'Election Year Issues,' prepared by individual members of the Subcommittee on Political and Lobbying Activities and Organizations of the Committee on Exempt Organizations of the Section on Taxation, American Bar Association*" (Feb. 21, 1995), reprinted in 11 EXEMPT ORGANIZATION TAX REVIEW 854 (Apr. 1995). While the IRS has provided some welcome additional guidance in recent months (see, e.g., Rev. Rul. 2004-6), tax-exempt organizations and those who represent them continue to engage in what is little more than an educated guessing game in this area.

[26] Compare 26 U.S.C. 6110(k)(3) ("may not be used or cited as precedent") with 11 C.F.R. § 112.5(a) (an AO may be relied upon by any person engaged in an activity materially indistinguishable from that described in the AO).

[27] An analogy may help the Commission to understand the inadequacy of the available guidance on the tax-law definitions of political activity: If the Commission provided guidance on FECA at a level equivalent to the level of guidance the IRS has provided on political activities under the IRC, the Commission would have issued no new regulations and perhaps half a dozen Advisory Opinions in the past twenty years. While such an output would

Given the strict scrutiny with which the courts would view any general restriction on political activity, no court could possibly find that the IRS definition of political exempt-function activities for 527 organizations would provide the necessary "adequate notice" to survive a constitutional challenge for vagueness.

Treating all 527s as political committees would be unconstitutionally overbroad.

An effort to bring all 527 organizations under FECA's restrictions on political committees, as suggested in the NPRM and by some submitting comments,[28] would regulate a wide range of activities protected under the First Amendment and, at least until now, exempted from regulation by the Commission. The IRS has long recognized that its standards for identifying political activity by tax-exempt organizations captures far more activity than is regulated under federal election law.[29] Many examples exist of legitimate activities that would be swept into the Commission's regulatory net if all 527s are treated as political committees under FECA. Because this proposal goes far beyond the range of 527 activities that might affect the compelling state interest that justifies FECA, the proposal is unconstitutionally overbroad.

At the outset, it should be obvious to the Commission that any attempt to regulate *all* 527 organizations would exceed the Commission's federal jurisdiction. Many organizations that qualify for tax exemption under IRC Section 527 are not primarily engaged in influencing federal elections. These 527 organizations operate, in whole or in part, to influence state or local elections or to influence nominations for appointed offices (such as judicial nominations).[30]

Even in the context of races for federal elective office, there are numerous activities that the tax code recognizes as 527 "exempt function" activities – activities that could lead the IRS to classify an organization as a 527 – that are beyond the Commission's statutory and constitutional reach. Some 527s engage in activities related to federal election activities that fall within this

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certainly have reduced the workload of the Commission, it would hardly have provided sufficient assistance those seeking to comply with the law.

[28] *See,* NPRM at 11741 and Letter from Democracy 21, *et al.,* to FEC (March 16, 2004).

[29] The IRS has recognized that its congressionally granted authority to restrict political activities of tax-exempt organizations is appreciably greater than the Commission's authority to regulate political speech more generally. In its training manual for IRS examiners and other staff, the IRS states that, "[t]he language of IRC 501(c)(3) indicates a much broader scope to the concept of participation or intervention in a political campaign." *Id.* at 349 (contrasting the ruling of the court in FEC v. Christian Coalition (52 F. Supp. 2d 45 (D.C.D.C. 1999)) in which the court held that a narrow definition of political activity was constitutionally necessary under federal election law.)

[30] The NPRM's Alternative 2-B would regulate all 527s, but Alternative 2-A acknowledges and exempts 527s that engage in some of these purposes other than influencing races for federal elective office. Yet even Alternative 2-A would only exempt 527s engaged "solely" in these non-federal activities. It is possible that a 527 might engage in some federal election activities but be primarily engaged in efforts to influence state and elections. For example, a 527 organization might dedicate 20% of its efforts and resources to federal election activities with the remainder going to non-federal "exempt function" activities. Yet under Alternative 2-A, the slightest taint of activity related to federal elections would force the 527 to operate under the restrictive rules governing federal political committees.

gap, making per se treatment of them as federal political committees inappropriate. Each of the following examples describes an organization that the IRS would consider to be a 527 organization that under this proposal would be subject to FECA restrictions.

- The sole activity of a 527 created to "elevat[e] the standards of ethics and morality in the conduct of campaigns for political office" is seeking candidate commitment to the organization's "code of fair campaign practices" The organization produces materials that list the names of candidates who support the code. The IRS has ruled that an organization that approaches all candidates for office and asks that they sign or endorse such a code has engaged in an activity that "constitutes participation or intervention in a political campaign."[31] Under current federal election law, this activity would not be an "expenditure"; it would not require federal "hard money."[32] Yet under the proposal, a 527 engaged solely in this activity would be treated as a federal political committee.

- The sole activity of a 527 is to publish advertisements to promote a particular state ballot measure. None of these advertisements refer to a candidate for elective office, but the 527 has evidence that the effort will likely bring out voters who tend to support a federal candidate running for reelection on the same ballot. The IRS has ruled that this organization would qualify under as a 527 organization and would not qualify as a 501(c) organization.[33] Under current federal election law, this activity would not be an "expenditure"; it would not require federal "hard money."[34] Yet under the proposal, a 527 engaged solely in this activity would be treated as a federal political committee.

- The sole activity of a 527 devoted to improving the quality of elected officials is rating the qualifications of all candidates for Congress and publishing the results prior to an election. The ratings are not based on political ideology but rather on nonpartisan criteria including the candidates' prior governmental experience, a survey that asks public officials (such as state legislators, governors, mayors, and other members of Congress) and members of the press to identify those candidates who are "effective," and an evaluation of the candidates' responsiveness to constituent requests for assistance. In many cases, the ratings do not indicate the preferred candidate in a particular race because all candidates for that race share the same rating. Faced with a tax-exempt organization that conducted a similar nonpartisan rating project for state judicial candidates, the IRS ruled that the organization had "intervened" in an election, and the court considering an appeal from the IRS decision stated that although this activity was nonpartisan and in the public interest, it nevertheless constituted

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[31] Rev. Rul. 76-456, 1976-2 C.B. 151 (modifying Rev. Rul. 66-258, 1966-2 C.B. 213).

[32] *See* 11 CFR 114.4(c)(5)(i). (For purposes of this and all subsequent examples, we assume that there is no issue of coordination with candidates.)

[33] *See* PLR 199925051 (March 29, 1999) (effort to support ballot measure is "exempt function" activity if organization has evidence to show that work would support or oppose a candidate for elective office). Because the IRS has ruled this to be an "exempt function" activity, it could not be conducted by a 501(c)(3) nor could it be the sole activity of any other 501(c) organization.

[34] The communication contains no reference to a candidate for federal office is not coordinated with a candidate.

participation or intervention in a political campaign.[35] Under current federal election law, this activity would not be an "expenditure"; it would not require federal "hard money."[36] Yet under the proposal, a 527 engaged solely in this activity would be treated as a federal political committee.

- The sole activity of a 527 is publishing a voter guide for its members and others concerned with environmental issues. The guide compiles incumbents' voting records on selected environmental legislation of importance to the organization and provides a factual, objective summary of the the policy issues that underlie each bill. The guide contains no express statements in support of or in opposition to any candidate. The guide is widely distributed among the electorate during an election campaign. In analyzing a similar example as a 501(c)(3) activity, the IRS stated that "while the guide may provide the voting public with useful information, its emphasis on one area of concern indicates that its purpose is not nonpartisan voter education."[37] In a later private letter ruling, the IRS confirmed this analysis, suggesting that a voting record distributed during the election season and focusing on selected issues of importance to the organization would be an "exempt function" activity under Section 527 of the IRC.[38] Under current federal election law, this activity would not be an "expenditure"; it would not require federal "hard money."[39] Yet under the proposal, a 527 engaged solely in this activity would be treated as a federal political committee.

THE COMMISSION LACKS THE STATUTORY AUTHORITY TO REGULATE ALL 527S

FECA, even with the amendments of BCRA, does not empower the Commission to regulate all 527 organizations. In fact, just the opposite is true: Congress has clearly known about 527s for quite some time, and it has made other choices – in BCRA, in the tax law – to regulate these organizations short of the sweeping authority the Commission seeks to assert here. Furthermore, several provisions of FECA make no sense unless Congress anticipated that some 527s were beyond the reach of the Commission. Indeed, even the Supreme Court in the case upholding BCRA recognized that these independent groups would continue to exist outside of the restrictions on political committees.

Congress has chosen to regulate 527s in different ways.

Congress has not empowered the Commission to regulate 527s, despite the fact that it

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[35] Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), *cert. denied*, 490 U.S. 1030 (1989).
[36] *See* 11 CFR 114.4(c)(5)(i).
[37] Rev. Rul. 78-248, 78-1 C.B. 154. Several IRS rulings suggest that failure to cover a broad range of issues in a voter guide (*id.*), a legislative scorecard (*id.*), or a candidate debate (Rev. Rul. 86-95, 1986-2 C.B. 73), will cause the IRS to treat the activity as political. As a result organizations that focus on a single issue and that wish to engage in these activities as the organization's primary purpose must be organized as 527 organizations.
[38] PLR 980837 (Nov. 21, 1997).
[39] *See* 11 CFR 114.4(c)(5)(i).

has had ample opportunity and impetus to do so. In passing BCRA, the most sweeping revision to FECA in the history of the Act, Congress included no amendment that regulates 527 organizations as a class.

There is no doubt that Congress was aware of the so-called "soft" 527s. When Senator John McCain, a chief sponsor of BCRA (or, as it was better known, the "McCain-Feingold" law) sought the Republican nomination for President in the year 2000, he was targeted by a 527 organization known as "Republicans for Clean Air." Later discovered to be funded by two supporters of then-candidate George Bush, Republicans for Clean Air was widely credited with doing serious damage to McCain's campaign.

In the wake of public outcry about Republicans for Clean Air, Congress did act to regulate 527s, passing legislation in the year 2000 requiring all 527 organizations to disclose their contributions and expenditures.[40] Significantly this new law did not restrict these 527 organizations or require that they be treated as political committees under FECA.

BCRA is inconsistent with Commission regulation of all 527s

In passing BCRA, Congress had another opportunity to expand regulation of the soft 527s. Not only did Congress demur, but there are also provisions in BCRA that only make sense if Congress anticipated that there would be independent organizations engaged in election-related activities that fell short of the Commission's regulatory authority.

For example, BCRA explicitly permits federal candidates to raise funds for an organization that is principally engaged in "federal election activity" as long as the candidate solicits only individuals and the amount solicited does not exceed $20,000 per year. Because only organizations that are not federal political committees, such as soft 527s, could accept contributions greater than $5000 per year, Congress must have intented that some 527s not be classified as political committees.

Similarly, Title II of BCRA (the new limits on "electioneering communications") exists because the Congressional sponsors of BCRA assumed that a more sweeping attempt to regulate issue advertising would not pass constitutional muster.

In Buckley, the Supreme Court rejected a constitutional challenge to FECA's restrictions on expenditures only by limiting the restriction to those communications "containing express words of advocacy of election or defeat."[41] Subsequent court rulings affirmed that FECA could

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[40] Pub.L. 106-230, 114 Stat. 477 (July 1, 2000). In 2002, after the passage of BCRA, Congress again had the opportunity to expand regulation of 527 organizations when it amended the law. Pub.L. 107-276, 116 Stat. 1929 (Nov. 2, 2002). Despite this chance to address any problems left unresolved by the original law and BCRA, Congress again chose not to grant broad authority to the FEC to regulate soft 527s.

[41] Buckley at 44 n. 52.

only limit independent communications that included words of express advocacy.[42]

In light of these rulings, BCRA's sponsors sought a new way to restrict so-called "sham issue ads," and they created the concept of "electioneering communications" – broadcast ads featuring federal candidates that ran within a certain window of time before an election.[43] The content of the ad (apart from the fact that it featured a clearly identified federal candidate) was irrelevant. This bright-line test, the sponsors believed would survive constitutional scrutiny. They were correct.[44]

The question, for the purposes of this NPRM, is why Congress enacted this central provision of BCRA if it believed that existing federal election law gave the Commission the authority to regulate 527s as a class and other organizations engaged in activities that tended to "promote, support, attack, or oppose" federal candidates. Indeed, it was the lack of such authority that led Congress to enact BCRA's electioneering communications provisions.

The Supreme Court has recognized that Congress left 527s beyond Commission control.

To end any lingering doubt about whether Congress gave the Commission any authority to regulate 527s, we need only look to the Supreme Court opinion in *McConnell*. In that case, the Republican National Committee argued that BCRA violated the Constitution's Equal Protection Clause because it allowed nonprofits, including their 527 accounts, to raise large soft money contributions for electoral activity while prohibiting the parties from doing so. The record before the Court also included examples of stand-alone 527 organizations that raised soft money for electoral activity. Nonetheless the Court understood that Congress intended to leave 527 organizations unmolested, acknowledging that "[i]nterest groups...remain free to raise soft money to fund voter registration, GOTV activities, mailings, and broadcast advertising."[45]

SPECIAL REGULATION OF 527S UNFAIRLY IGNORES EQUIVALENT EFFORTS OF OTHERS

Singling out 527s for regulation in this rulemaking treats activities that are indistinguishable from an electoral standpoint differently simply because they are conducted by a 527 rather than a 501(c) organization (or, for that matter, a wealthy individual). The tax-planning rationales that may lead people to engage in political activities through a 527 are irrelevant to the Commission's task. An attempt to single out 527s creates internal contradictions in the law and would merely add to the level of uncertainty as prudent

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[42] *See, e.g.,* Maine Right to Live Committee v. FEC, 98 F.3d 1 (1st Cir. 1996), *cert. denied*, 118 S.Ct. 52 (1997); FEC v. Christian Action Network, 110 F.3d 1049, 1055 (4th Cir. 1997) (holding for narrow definition of "express advocacy"); *but see* FEC v. Furgatch, No. 83-0956-GT(M) (S.D. Cal 1984), (unpublished opinion), *rev'd*, 807 F.2d 857 (9th Cir.), *cert. denied*, 484 U.S. 850 (1987) (upholding broader interpretation of "express advocacy").

[43] 2 USC 441b(c).

[44] McConnell v. FEC, No. 02-1674, slip op. at 87 (Sup. Ct. 2003). As the Court said, "the definition of 'electioneering communication' raises none of the vagueness concerns that drove our analysis in *Buckley*." *Id.* at 87.

[45] *Id.* at 80.

organizations and their advisors would anticipate later regulation of similar activities by other organizations.[46]

As described above, there is no substantive distinction between the activities of 527 organizations and the political activities of 501(c) organizations, and thus there is no reason to regulate them differently. A 501(c) (other than a 501(c)(3)) can conduct any activity that a 527 can conduct.[47] 527s have become more popular only because their use solves specific strategic problems entirely unrelated to the political nature of their activities:

> *Primary Purpose Test:* As discussed above, organizations exempt from federal tax under Section 501(c) of the IRC (except for 501(c)(3)s) may engage in efforts to influence elections as long as such activities do not become the "primary purpose" of the organization. Organizations that wish to engage in additional partisan election-related activity may, however, create a "separate segregated fund" to conduct such activities. These separate segregated funds are treated as separate organizations, exempt from tax under Section 527.[48]
>
> *Tax on Political Activities:* Even when the political activities of a 501(c) organization do not threaten to become the primary purpose of the organization, many organizations choose to create a separate segregated 527 organization to reduce the organization's tax liability under Section 527(f). As described above, 501(c) organizations pay a tax on an amount equal to the lesser of their political expenditures and their investment income.[49] Because 527s can conduct political activities without being subject to tax, 501(c)s that have investment income often choose to put all of their political activities in 527s. Indeed, Congress, in passing Section 527, anticipated that most political activities of 501(c) organizations would be conducted by sister 527 funds for this reason.[50]
>
> *Gift Tax:* Recent popularity in the use of 527 organizations has also been driven by the fact that contributions to most 501(c) organizations are subject to the gift tax but

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[46] We note that although the comments filed by Democracy 21 and other campaign-reform organizations urge the Commission not to regulate 501(c)s in this rulemaking, they also urge the Commission take up this issue at some later date. *See,* comments filed by Democracy 21, the Campaign Legal Center, and the Center for Responsive Politics, posted on the website www.moresoftmoneyhardlaw.com.

[47] Much has been made of the fact that 527 organizations exist for the primary purpose of "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization." As described above, that language from the tax code is not determinative that all 527s must be treated as federal political committees. We note in passing similarly "damning" language that describes at least one other type of tax-exempt organization – the so-called "qualified nonprofit corporation." Section 114.10(c)(1) explains that the "only express purpose" of such an organization "is the promotion of political ideas." Of course Section 114.10(b)(1) explains that the "promotion of political ideas" includes "issue advocacy" and other activities "expressly tied to the organization's political goals." One might assume that those eager to regulate 527s would be likewise eager to regulate this special class of 501(c)(4)s. How fortunate for them that the Supreme Court stands in the way. *See generally* MCFL.

[48] 26 U.S.C. § 527(f)(3).

[49] 26 U.S.C. § 527(f)(1).

[50] S. REP. No. 93-1357 (1974).

contributions to 527s are not.[51] Thus, donors wishing to contribute more than the annual gift-tax exclusion (recently raised from $10,000 per year to $11,000), may wish to make their contributions to 527s rather than, for example, a 501(c)(4) or 501(c)(6).[52]

There are strategic issues that argue *against* use of the 527 form as well. For example, the choice to engage in political activities through a 527 rather than another type of organization will require disclosure of all contributions and expenditures in support of the effort. A 501(c) organization would not have to disclose this information. A single individual with sufficient wealth could make unlimited expenditures to make the types of communications that this NPRM seeks to regulate while avoiding both disclosure and all of the other problems mentioned above as well.[53]

In short, we see no reason for the Commission to impose a more stringent regulatory regime on 527 organizations than on other organizations engaged in exactly the same activities.

PUBLIC POLICY SUPPORTS CONTINUED ROLE OF 527S

In addition to the legal arguments, sound public policy urges the Commission to reject proposals to classify 527s as political committees. Not only do 527s engage in important activities that promote civic engagement, they also serve as an essential balance to other forces that seek to influence the political process.

In an era in which nearly half of all eligible Americans do not exercise their right to vote, the 527 organization is an essential tool to reconnect our citizens with our political process. 527 organizations are the only type of independent organization that can focus effectively on efforts to engage the public in the political process. Unlike 501(c)(3)s, 527s can use election-related messages that resonate with the public: messages that focus on a single issue that motivates a community, messages that explicitly address whether a candidate supports the policy aspirations of a group, messages that target a district lulled into apathy by the apparent invulnerability of a

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[51] *See* Rev. Rul. 82-216, 1982-2 CB 220 ("gratuitous transfers to persons other than organizations described in section 527(e) of the Code are subject to gift tax absent any specific statute to the contrary, even though the transfers may be motivated by a desire to advance the donor's own social, political, or charitable goals"). For a more detailed discussion of the applicability of the gift tax to 501(c) organizations, including arguments against application of the gift tax to 501(c)s *see* B. Rhomberg, "Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions," TAXATION OF EXEMPTS, Vol. 15, No. 2 at 62 (Sept./Oct. 2003).

[52] Until recently, the possibility of avoiding disclosure was another reason to engage in political activity through a 527. Donors wishing to impact elections while remaining anonymous created so-called "soft" 527s. By engaging in activities that were designed to influence elections but that were not subject to regulation by the Commission or state election agencies, donors could avoid public disclosure of their contributions. However in the year 2000, Congress passed a law (Pub. L. No. 106-230) mandating full disclosure of contributions and expenditures by 527 organizations, eliminating this strategic advantage of 527 organizations.

[53] As this unlimited opportunity for independent communications by individuals makes clear, the greatest impact of these proposed rules would not be on wealthy individuals currently making contributions to 527 organizations. Even if these regulations take effect, they will simply engage in these activities on a personal basis. The real impact of these proposed regulations will fall on relatively smaller donors to 527s who need to aggregate their contributions to engage in the types of activities they wish to support.

long-time incumbent, messages that – unlike bland exhortations of civic duty – actually succeed in increasing voter involvement. Unlike other types of 501(c) organizations, 527s can exist solely to engage in this type of effective civic engagement work. If a community or a cause only needs a political solution, then only a 527 can help them.

527 organizations fill an important niche in the political process to balance other centers of political power:

- 527s are the only effective way to aggregate sufficient resources to compete with wealthy individuals who engage in unlimited independent expenditures.
- 527s are the only effective way to compete with corporations and unions that have an unlimited ability to attempt to influence their shareholders, employees, and members.
- 527s can offer a diversity of viewpoints that we may be losing with the increasing consolidation of our nation's media.
- 527s can be an independent voice on an issue – abortion, gun rights, affirmative action – too politically "hot" for poll-driven politicians to bring before the voters in a forthright manner.
- 527s can also offer a *less* strident voice in the political process. For example, a 527 organization committed to ethical behavior by elected officials could present information about impropriety by politicians of all ideologies. That impartiality allows the organization to give voters information they need to make an effective choice without the appearance of opportunism that would taint similar disclosures by the political opponents of the transgressors.

Realistically, 527s could not fulfill these roles if the Commission forced them to become federal political committees. Prohibiting contributions from unions and corporations (including charities) and limiting contributions from individuals to amounts of $5000 or less would prevent most 527s from aggregating sufficient resources to compete in the media or engage in nation-wide efforts.

Even if the Commission could regulate 527s, policy grounds alone urge it not to do so.

CONCLUSION

It is understandably tempting, but misguided, for the Commission to want to regulate 527 organizations as a group. A simplistic look at the nature of the organization under the tax laws, could lead one to think that the Commission would want to regulate organizations that exist primarily for the purpose of "influencing elections." The current media attention to several prominent 527 organizations leads to inevitable cries that the Commission must "do something." Yet a clearer understanding of the nature and obligations of 527s and a careful examination of the Commission's constitutional and statutory authority inevitably must lead the Commission to

reject the unfortunate proposals made in the NPRM.[54]

Thank you for this opportunity to comment on the NPRM. We look forward to providing whatever additional assistance we can provide as the Commission considers this proposal.

Sincerely,

Gail Harmon

John Pomeranz

[54] The legal and policy arguments we make here in opposition to this NPRM apply as well to the Commission's recent Advisory Opinion for "Americans for a Better Country." Advisory Opinion 2003-37 (Feb. 19, 2004). In the course of considering that AO, Commissioner Weintraub, at least, indicated that the Commission's ruling might be reconsidered in the course of this rulemaking. We urge the Commission to do so, adopting an opinion similar to that proposed by Chairman Smith.