

ARTICLE

527S IN 2008: THE PAST, PRESENT, AND FUTURE OF 527 ORGANIZATION POLITICAL ACTIVITY REGULATION

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In 2004 and 2006, political organizations with tax-exempt status under section 527 of the Internal Revenue Code spent large sums to influence elections without registering as political committees or abiding by the campaign finance regulations that go along with political committee status. Although many of these organizations later paid substantial fines to the Federal Election Commission, the FEC has yet to offer adequate guidance about which 527 organizations are required to register as political committees. As a result, many organizations are likely to attempt to influence future elections without registering as political committees, and to claim in later proceedings that they were unclear about their status. This Article analyzes federal and state campaign finance law, court decisions, and FEC settlement agreements to clarify what factors determine whether a given 527 political organization must register as a political committee. The Article proposes legislation to institute a presumption that groups which identify themselves as political organizations under section 527 are political committees unless they fall into a limited range of exceptions.

With the 2008 presidential election in full swing, one of the most controversial questions persisting in campaign finance law is what factors determine whether an organization claiming tax-exempt status under section 527 of the Internal Revenue Code (“527 organization”) must register as a “political committee” pursuant to a given jurisdiction’s campaign finance laws.¹ The importance of this question cannot be overstated. “Political committee” status is the linchpin of most campaign finance law restrictions. Under federal law and the laws of many states and local jurisdictions, political committees are subject to limits on the amount of contributions they may receive,² prohibitions on contributions from corporations and labor unions,³ registration requirements,⁴ detailed campaign finance reporting and

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¹ See I.R.C. § 527(e)(1) (2007) (defining “political organization” for the purpose of federal tax law as “a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.”); see also, 2 U.S.C. § 431(4)(A) (2000) (defining “political committee” for the purpose of federal campaign finance law to include “any committee, club, association, or other group of persons which receives contributions aggregating in excess of \$1,000 during a calendar year or which makes expenditures aggregating in excess of \$1,000 during a calendar year[.]”).

² See, e.g., 2 U.S.C. § 441a (Supps. 2001–2005) (imposing dollar limits on contributions to federal political committees).

³ See, e.g., 2 U.S.C. § 441b (Supps. 2001–2005) (prohibiting contributions to federal political committees from corporation and labor organization treasuries).

disclosure requirements,⁵ and other restrictions. By contrast, 527 organizations that are not “political committees” are generally subject to few if any campaign finance restrictions but nevertheless receive the benefits of federal tax-exemption as “political organizations.”⁶ Political committee campaign finance restrictions serve compelling government interests such as reducing the threat of real or apparent political corruption and informing the electorate of the sources of financial support for specific political committees.⁷ These government interests are at stake in the debate over whether to apply political committee status to 527 organizations.

In concrete terms, whereas federal political committees active in the 2008 elections may receive no more than \$5,000 per contributor per calendar year⁸ and are prohibited from receiving contributions from corporations and labor unions,⁹ 527 organizations active in the 2008 elections that do not qualify as federal political committees are not subject to these federal law contribution restrictions. This is as it should be; organizations that are not federal political committees should not be subject to federal political com-

⁴ See, e.g., 2 U.S.C. § 433 (2000) (requiring that federal political committees register with the Federal Election Commission).

⁵ See, e.g., 2 U.S.C. § 434 (Supps. 2001–2005) (requiring that federal political committees file reports with the Federal Election Commission disclosing the amount of money raised, the sources of such funds, how the funds were spent, etc.).

⁶ Federal law and the laws of some states and local jurisdictions do contain some minimal campaign finance provisions applicable to individuals and organizations not qualifying as “political committees”—for example, independent expenditure reporting provisions. See, e.g., 2 U.S.C. § 434(c) (Supps. 2001–2005).

⁷ Some, including recently the organization SpeechNow.org, have argued that the application of contribution limits and other campaign finance restrictions to political committees that make only independent expenditures—i.e., that do not make contributions directly to candidates and that do not make expenditures in coordination with candidates—violates the First Amendment. See, e.g., Complaint, SpeechNow.org v. FEC, No. 1:08-cv-00248 (D.D.C. filed Feb. 14, 2008) (challenging not only the application of contribution limits to the organization, but also the application of “political committee” status). I disagree with this interpretation of First Amendment jurisprudence, but an examination of this question of constitutional law is beyond the scope of this Article. Regardless, federal law has for many years limited contributions to and imposed other restrictions upon such committees. See, e.g., FEC Contribution and Expenditure Limitations and Prohibitions, 11 C.F.R. § 110.1(n) (2005) (limiting “[c]ontributions to committees making independent expenditures.”).

⁸ This is admittedly an oversimplification of federal campaign finance law contribution limits applicable to political committees. In fact, contribution limits vary under federal law depending on the specific type of political committee receiving the contribution, and section 527 of the tax code covers many types of political committees. A candidate’s principal campaign committee, for example, may receive no more than \$2,300 per contributor per election, 2 U.S.C. § 441a(a)(1)(A), while a national political party committee is subject to a \$28,500 per calendar year limit, 2 U.S.C. § 441a(a)(1)(B). These candidate and party committee limits are adjusted based on changes in the Consumer Price Index. 2 U.S.C. § 441a(c). However, political committees of the sort discussed in this Article, i.e., non-candidate, non-party committees, typically qualify for the \$5,000 per calendar year limit established by 2 U.S.C. § 441a(a)(1)(C), which is not adjusted for changes in the cost of living. See FEDERAL ELECTION COMMISSION, CONTRIBUTION LIMITS 2007–2008 (2007), <http://www.fec.gov/pages/brochures/contriblimits.shtml> (stating the cost of living adjusted contribution limits for the 2007–08 election cycle).

⁹ 2 U.S.C. § 441b.

mittee restrictions. But there are two problems with the current situation: first, the Federal Election Commission (“FEC” or “the Commission”) has been unwilling to provide the public with sufficiently clear guidance as to which 527 organizations are federal political committees; and second, increasing numbers of 527 organizations that are federal political committees have been choosing to ignore federal campaign finance laws and accept the risk that they might be required to pay fines years down the road for their violations. As a result, 527 organizations that should have registered, but did not register, as federal political committees in 2004 and 2006 illegally raised and spent hundreds of millions of dollars to influence federal elections, seeking refuge behind alleged ambiguity in the law. Indeed, the 2004 presidential election year was dubbed “the year of the 527 organization” because 527 organizations that refused to register as “political committees” with the FEC spent more than \$400 million to influence federal elections.¹⁰ Years later, these organizations paid relatively small fines to the FEC as a penance for their transgressions.¹¹

Much of this illegal campaign activity in the 2004 and 2006 federal elections could have been avoided had the FEC enacted any one of several proposed “political committee status” regulations considered by the Commission in 2004, but it did not.¹² Instead, the FEC proceeded with enforcement actions on a case-by-case basis, which encouraged the illegal activity to continue through two federal election cycles. The FEC’s chosen approach to this issue prompted a lawsuit against the Commission in an effort to force the agency to promulgate a regulation addressing the political committee status of 527 organizations.¹³ The Commission’s refusal to promulgate such a regulation also prompted the introduction of legislation in the House of Representatives and the Senate that would clarify the application of federal law political committee requirements to 527 organizations despite the FEC’s recalcitrance.¹⁴ Recognition of this federal campaign finance law controversy

¹⁰ See Richard Briffault, *The 527 Problem . . . and the Buckley Problem*, 73 GEO. WASH. L. REV. 949, 949 (2005).

¹¹ The FEC, for example, took more than two years to resolve a complaint filed in 2004 against the 527 organization Swift Boat Veterans and POWs for Truth. After concluding that the organization had violated federal law by failing to register as a “political committee” and raising more than \$25 million to influence the 2004 federal election, the FEC entered a settlement agreement with the group in December 2006, collecting a penalty of \$299,500. See FEC Conciliation Agreement with Swift Boat Veterans and POWs for Truth (Dec. 13, 2006), available at <http://eqs.nictusa.com/eqsdocs/000058ED.pdf>.

¹² See Notice of Proposed Rulemaking 2004-6, Political Committee Status, 69 Fed. Reg. 11,736 (proposed Mar. 11, 2004, rejected May 13, 2004), available at http://www.fec.gov/pdf/nprm/political_comm_status/04-5290.pdf.

¹³ See *Shays v. FEC*, 424 F. Supp. 2d 100 (D.D.C. 2006); *Shays v. FEC*, 511 F. Supp. 2d 19, 26 (D.D.C. 2007). I, along with my colleagues at the Campaign Legal Center, served as counsel to amici Senators McCain (R-Ariz.) and Feingold (D-Wis.) in the lawsuit supporting plaintiffs Rep. Christopher Shays (R-Conn.) and Rep. Martin Meehan (D-Mass.).

¹⁴ See, e.g., 527 Reform Act of 2004, H.R. 5127, 108th Cong. (2004); 527 Reform Act of 2004, S. 2828, 108th Cong. (2004); 527 Reform Act of 2005, H.R. 513, 109th Cong. (2005); 527 Reform Act of 2005, S. 271, 109th Cong. (2005); 527 Reform Act of 2006, S. 2511, 109th

among legislators and campaign finance law administrators from coast to coast, combined with increased activity by non-registered political committee 527 organizations in state and local elections, has also prompted legislative proposals in numerous states.¹⁵ This Article examines the recent history of this legal issue and the administrative and legislative efforts to resolve it in order to lend insight into how 527 organizations will likely be regulated during the 2008 campaigns and beyond.

The question of 527 organization political committee status lies at the intersection of two distinctly different general bodies of law—tax law and campaign finance law—and at the intersection of countless specific bodies of law, given that campaign finance laws vary from municipality to municipality, from state to state, and from the municipal to the state to the federal government level.¹⁶ Every candidate committee from city council to U.S. President, for example, is exempt from federal income tax under section 527 of the tax code. Similarly, every political party committee, from county Democratic and Republican organizations around the nation to the Democratic National Committee and Republican National Committee, are exempt from federal income tax under section 527 of the tax code. For the sake of clarity, before addressing the question of whether a particular 527 organization must register as a political committee, it is important to note that many thousands of organizations exempt from taxation under section 527 are registered as political committees at the local, state, and/or federal levels.¹⁷ Only in recent years have some organizations claiming tax exemption under section 527 refused to register as “political committees” with the FEC and/or with a state or local campaign finance agency. It is these 527 organizations—the ones not registered as “political committees”—that have become known in political parlance as “527 organizations” or “527s” for short.¹⁸

During the 2004 election cycle, and continuing today, many election law scholars have framed the debate as whether the political activities of 527s generally should be regulated and, if so, by whom—the FEC or the

Cong. (2006); 527 Reform Act of 2007, H.R. 420, 110th Cong. (2007); 527 Reform Act of 2007, S. 463, 110th Cong. (2007).

¹⁵ See *infra* Part I.B.

¹⁶ For example, a single 527 organization may qualify as a “political committee” under several different jurisdictions’ campaign finance laws, while simultaneously engaging in identical activities in other jurisdictions where it does not qualify as a “political committee.” Furthermore, a 527 organization may not qualify as a “political committee” under *any* jurisdiction’s campaign finance laws. Part I of this Article discusses these various permutations of 527 organization “political committee” status.

¹⁷ At the federal level, for example, in addition to the candidate and political party committees registered with the FEC, more than 4,000 non-candidate, non-party “political committees” are likewise registered with the Commission. See FEC, FEC Records Slight Increase in the Number of PACs (Jan. 17, 2008), available at <http://www.fec.gov/press/press2008/20080117paccount.shtml>.

¹⁸ See Briffault, *supra* note 10, at 949 n.2 (explaining that most political organizations participating in federal elections *are* registered as “political committees” with the FEC).

Internal Revenue Service (“IRS”).¹⁹ This framing of the question misses the mark; framed as such, it is unanswerable. As to the “whether” portion of the question, the only acceptable answer under existing federal tax law is that all 527 organizations—which, by definition, are “political organizations” and are therefore engaged primarily in “political” activity—are and should continue to be regulated to varying degrees; and as to the “by whom” portion of the question, the only acceptable answer under existing law is that the IRS clearly has a legitimate and important role to play with respect to the regulation of 527 organizations, because 527 organizations are a creation of federal tax law. But with respect to regulation by the FEC and/or numerous state and local government campaign finance agencies, the answer can only be: “It depends.” These campaign finance agencies may have legitimate and important roles to play in the regulation of a given 527 organization, depending on the specific activities engaged in by that organization—namely, whether the organization is raising and spending money to influence elections in an agency’s jurisdiction. But 527 tax status alone does not a “political committee” make.

527 organizations are named for their federal income tax status and there can be no doubt regarding the IRS’s role in regulating such entities to ensure their compliance with the requirements and restrictions of section 527 of the Internal Revenue Code (“IRC”).²⁰ Beyond this generalized regulation by the IRS under tax law, however, 527 organizations are only subject to further regulation—in particular, regulation under campaign finance laws—if they perform or engage in certain specific activities. Some 527 organizations should be regulated as federal “political committees” by the FEC, some as state “political committees” by state campaign finance agencies, and some as local “political committees” by local government campaign finance agencies. Some will meet the definition of “political committees” in more than one jurisdiction, and so should be regulated by more than one of these campaign finance agencies, and some 527 organizations should not be regulated as “political committees” in any jurisdiction.

For this reason, I frame the principal 527 question as follows: what factors determine whether, under existing federal campaign finance law²¹ (and under the campaign finance laws of state and local governments), a particular organization claiming tax-exempt status under section 527 of the

¹⁹ See, e.g., Lloyd H. Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625, 626 (2007). Mayer, for example, began his article about 527 organizations questioning whether, how, and by whom they should be regulated: “What does tax law have to do with political activity—isn’t that what election law is for? And given the existence of election law and the [FEC], how should Congress determine what role, if any, the tax law and the [IRS] should play with respect to political activity? Can these two bodies of law and their administering agencies both effectively regulate political activity?” *Id.*

²⁰ I.R.C. § 527 (2007).

²¹ By the phrase “existing federal campaign finance law,” I mean existing federal campaign finance statutes as interpreted by court decisions as well as FEC regulations, advisory opinions, and enforcement action documents.

Internal Revenue Code must register as a “political committee” and abide by campaign finance restrictions? The FEC has to some extent clarified the answer to this question through a series of enforcement action settlements (i.e., “conciliation agreements”) in 2007-08, but has not done so in an entirely satisfactory manner,²² which leads to another important question: what type of legislation, if any, should be enacted to further clarify whether a particular 527 organization must register as a “political committee” pursuant to a given jurisdiction’s campaign finance laws? This Article aims to answer these questions.

To this end, Part I of this Article provides an overview of the relevant existing federal tax laws, as well as federal campaign finance laws and the campaign finance laws of several states, including some recent state legislative enactments that specifically target 527 organizations. Part II details FEC enforcement actions resolved in late 2006 through 2007 regarding 527 organizations active in the 2004 federal elections. FEC settlement agreements resolving these enforcement actions provide the greatest insight into how 527 organizations active in the 2008 federal elections will be regulated, and also debunk the argument that 527s active in 2004 were some sort of new political creature raising difficult questions of law. The FEC’s settlement

²² FEC conciliation agreements have no formal legal precedential value beyond the parties to the agreement (i.e., the FEC and the alleged violator of the law) and their precedential value even between the parties to the agreement is limited given that as a standard course of practice the alleged violator admits no wrongdoing and in the event that the alleged violator does not meet its obligations under the agreement, the FEC’s only legal recourse is to file a civil action in federal court to obtain relief. *See, e.g.*, FEC Conciliation Agreement with Swift Boat Veterans and POWs for Truth, § V (Dec. 13, 2006), available at <http://eqs.nictusa.com/eqsdocs/000058ED.pdf> (“Solely for the purpose of settling this matter expeditiously and avoiding litigation, without admission with respect to any other proceeding, and with no finding of probable cause by the Commission, SwiftVets agrees not to contest the Commission’s conclusions, as stated herein, that it violated 2 U.S.C. §§ 433, 434, 441a(f) and 441b(a) of the Act by failing to register and report as a political committee with the Commission, by knowingly accepting individual contributions in excess of \$5,000, and by knowingly accepting corporate contributions.”); *see also id.* at § VII (“If the Commission believes that this agreement or any requirement thereof has been violated, it may institute a civil action for relief in the United States District Court for the District of Columbia.”).

Nevertheless, the FEC asserts that the conciliation agreements it has entered into with various 527 organizations provide the necessary guidance to the regulated community regarding what factors determine whether a 527 organization must register as a federal “political committee.” *See* FEC, Political Committee Status, Supplemental Explanation and Justification, 72 Fed. Reg. 5595, 5603–04 (Feb. 7, 2007) (“Any organization can look to the public files for the Political Committee Status Matters and other closed enforcement matters, as well as advisory opinions and filings in civil enforcement cases, for guidance as to how the Commission has applied the statutory definition of ‘political committee’ together with the major purpose doctrine. The public documents available regarding the 527 settlements in particular provide more than mere classification of legal principle; they provide numerous examples of actual fundraising solicitations, advertisements, and other communications that will trigger political committee status. These documents should guide organizations in the future as they formulate plans and evaluate their own conduct so they may determine whether they must register and report with the Commission as political committees. To the extent uncertainty existed, these 527 settlements reduce any claim of uncertainty because concrete factual examples of the Commission’s political committee status analysis are now part of the public record.”).

agreements make clear that—at least in the view of a majority of the FEC’s members—the overwhelming majority of high-spending 527 organizations active in 2004 that refused to register as “political committees” simply broke the law. Part III discusses recent court decisions examining the relevance of tax status to “political committee” status. Finally, Part IV analyzes federal legislation introduced in 2007 to address when a 527 organization is a political committee for the purposes of campaign finance laws²³ and makes the case that Congress should enact the legislation—and further makes the case that state legislatures and municipal governments should likewise enact legislation—to codify the relationship between section 527 tax status and campaign finance law.

I. OVERVIEW OF APPLICABLE TAX AND CAMPAIGN FINANCE LAWS

The nature of 527 organizations is best understood in the context of the overall federal tax code structure regarding tax-exempt organizations. The bottom line is that, by definition, the primary purpose of organizations claiming tax exempt status under section 527 is to influence the “selection, nomination, election, or appointment” of an individual to public office.²⁴ As detailed in subpart I(B) below, this self-identified primary purpose creates a strong presumption that one part of the two-part test for being a “political committee” under federal campaign finance law and the laws of most states and local jurisdictions has been fulfilled.

A. Overview of Applicable Tax Laws

Tax exempt organizations are defined by specific sections of the Internal Revenue Code.²⁵ The significant shared characteristic of all tax-exempt organizations is that they are not required to pay federal tax on income used

²³ See 527 Reform Act of 2007, H.R. 420, 110th Cong. (2007); 527 Reform Act of 2007, S. 463, 110th Cong. (2007).

²⁴ See I.R.C. § 527(e)(1) (2007) (defining “political organization” under § 527 as “a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.”); I.R.C. § 527(e)(2) (2007) (defining “exempt function” as “the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.”)

²⁵ See, e.g., I.R.C. § 501(a) (2007) (establishing tax exemption, generally, for organizations described in subsections (c) or (d) of I.R.C. section 501 or section 401(a)); see also I.R.C. § 527(a) (2007) (establishing tax exemption, generally, for organizations defined as “political organizations” in I.R.C. section 527(e)(1)). For a thorough examination of federal tax laws applicable to exempt organizations, see FRANCES R. HILL & DOUGLAS M. MANCINO, TAXATION OF EXEMPT ORGANIZATIONS (2002).

for purposes allowable under their specific tax-exempt status.²⁶ The most widely recognized type of tax-exempt status is that established by section 501(c) of the federal tax code. Section 501(c)(3) organizations, for example, are established for religious, charitable, or educational purposes, among others.²⁷ Section 501(c)(3) organizations are not only free from federal taxation of their income, but donations to 501(c)(3)s are also generally tax-deductible for donors.²⁸ In turn, 501(c)(3)s are prohibited from intervening in candidate elections and may only do a limited amount of lobbying.²⁹ 501(c)(3) public charities are usually not required by tax law to disclose the identity of their donors to the public.³⁰

Section 501(c)(4) social welfare organizations,³¹ by comparison, can do an unlimited amount of lobbying, as long as the subject of the lobbying

²⁶ Tax-exempt organizations are required, however, to pay federal tax on certain income that does not meet the specific legal requirements of their tax-exempt status. An organization generally exempt from taxation under section 527, for example, must pay tax on capital gains, I.R.C. § 527(b)(2), income derived in a manner that does not qualify as “exempt function income,” I.R.C. § 527(b)(1), (c), and on “exempt function income” not in compliance with disclosure requirements applicable to 527 organizations, I.R.C. §§ 527(j)(1)–(2).

²⁷ See I.R.C. § 501(c)(3). The following types of organizations may qualify for tax exemption under section 501(c)(3) of the Internal Revenue Code:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Id.

²⁸ See I.R.C. § 170 (2007).

²⁹ See I.R.C. § 501(c)(3) (2007) (“no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . and which does not participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office.”); see also I.R.C. § 501(h) (2007) (“exemption from taxation . . . shall be denied because a substantial part of the activities of such organization consists of carrying on propaganda, or otherwise attempting, to influence legislation,” but allowing such lobbying up to specified “ceiling” amounts).

³⁰ See I.R.C. § 6103(a) (2007); see also *Stanbury Law Firm, P.A. v. IRS*, 221 F.3d 1059 (8th Cir. 2000) (explaining that, absent a specific statutory provision providing for the public disclosure of tax return information, the general confidentiality provision of section 6103(a) prohibits the IRS from disclosing information contained on tax returns, including the identities of donors to section 501(c)(3) public charities).

³¹ See I.R.C. § 501(c)(4) (2007). The following types of organizations may qualify for tax exemption under section 501(c)(4):

Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

relates to the organization's exempt purpose,³² and may also raise and spend money to influence candidate elections, as long as such candidate election intervention is not the organization's primary purpose.³³ Lobbying organizations and ballot initiative committees often claim tax-exempt status under section 501(c)(4). Donations to 501(c)(4)s are not tax deductible for the donors,³⁴ however, and may be subject to the federal gift tax.³⁵ 501(c)(4)s are generally not required by tax law to disclose the identity of their donors to the public, but some operate connected "separate segregated funds" that are subject to disclosure under section 527.³⁶ Other section 501(c) organizations—such as 501(c)(5) labor unions and 501(c)(6) business leagues—engage in political activities under rules similar to those applicable to 501(c)(4) organizations.³⁷ And as is the case with 501(c)(4) organizations, donations to these other 501(c) organizations are not tax-deductible for donors.³⁸

Id.

³² See I.R.C. § 501(h)(3) (2007) (making clear that the limitations on lobbying activities established by section 501(h)(1) apply only to section 501(c)(3) organizations; see also HILL & MANCINO, *supra* note 25, at 13–17 (2002) ("A Section 501(c)(4) organization may engage in an unlimited amount of legislative lobbying as long as the subject matter of such lobbying efforts is related to the organization's exempt purpose."); see also, e.g., Rev. Rul. 67-293, 1967-2 C.B. 185 (rejecting an animal shelter's request for section 501(c)(3) status because of its "substantial" lobbying activities, but maintaining the organization's section 501(c)(4) tax-exempt status).

³³ Although I.R.C. § 501(c)(4) provides tax exemption for organizations "operated exclusively for the promotion of social welfare," federal regulations provide that an "organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community." 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) (2007). This regulation seemingly converts "exclusively" into "primarily." And though federal regulations 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," IRS Income Taxes, 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii), the IRS declared in Rev. Rul. 81-95, 1981-1 C.B. 332 that "an organization may carry on lawful political activities and remain exempt under section 501(c)(4) as long as it is primarily engaged in activities that promote social welfare." For a discussion of how the IRS distinguishes between lobbying activity and political campaign activity, see Rev. Rul. 2004-6, 2004-1 C.B. 328.

³⁴ Donations to 501(c)(4) organizations do not meet the definition of "charitable contribution" in I.R.C. § 170(c)—the federal law establishing a tax deduction for donations to 501(c)(3) organizations—nor does any other provision of federal law establish a tax deduction for donations to 501(c)(4) organizations.

³⁵ See I.R.C. § 2501 (2007) (establishing the gift tax); I.R.C. § 2503(b) (2007) (creating an exemption from the gift tax for donations not exceeding \$10,000 adjusted annually for changes in the cost of living). Uncertainty exists regarding the application of the gift tax to 501(c)(4) organizations. See AMERICAN BAR ASSOCIATION SECTION OF TAXATION, COMMENTS OF THE INDIVIDUAL MEMBERS OF THE EXEMPT ORGANIZATIONS COMMITTEE'S TASK FORCE ON SECTION 501(c)(4) AND POLITICS 13–16 (2004), available at <http://www.abanet.org/tax/pubpolicy/2004/040525exo.pdf>.

³⁶ See I.R.C. § 527(f)(3) (2007) (providing for the treatment of a "separate segregated fund" established by a section 501(c) organization for political activity as a separate organization for the purposes of section 527).

³⁷ See, e.g., Rev. Rul. 2004-6, 2004-4 C.B. 328 (explaining the federal law treatment of lobbying activity and political campaign activity with respect to section 501(c)(4), (c)(5), and (c)(6) organizations).

³⁸ As with 501(c)(4) organizations, donations to section 501(c)(5) and (c)(6) organizations do not meet the definition of "charitable contribution" in I.R.C. § 170(c), nor does any other

Unlike section 501(c) organizations, which are limited in their candidate-related political activities, to qualify to be a section 527 “political organization,” an organization must be “organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures . . . [for] the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office”³⁹ All candidate and party committees at the local, county, state, and federal level fall within the scope of section 527, and virtually all of them claim tax-exempt status under section 527 to avoid federal income tax liability. Likewise, all other organizations operating primarily for the purpose of influencing candidate elections independent of candidates and parties, such as the groups that put the 527 issue on the national radar in 2004—pro-Senator John Kerry (D-Mass.) “America Coming Together” and pro-George W. Bush “Swift Boat Veterans for Truth”—qualify for tax-exempt status under section 527. Organizations not involved in candidate elections, but existing instead for the primary purpose of influencing appointments to non-elective public offices, such as judgeships at the federal level, also qualify for tax-exempt status under the plain meaning of section 527.

Though all organizations operated primarily for the purpose of influencing candidate elections by definition constitute “political organizations” under section 527 of the tax code, not all 527 “political organizations” constitute “political committees” under the campaign finance laws of federal, state and local governments, because campaign finance law definitions of “political committee” are typically narrower than the section 527 definition of “political organization” (e.g. whereas section 527 defines “political organization” simply as an organization with a primary purpose of influencing the election or nomination of individuals to public office, campaign finance laws typically define “political committee” to mean an organization that in fact makes expenditures and/or receives contributions in excess of a specified dollar amount to influence candidate elections).⁴⁰ Nevertheless, as detailed in Part I(B) below, an organization’s self-identification as a section 527 “political organization” arguably establishes a strong presumption that one part of the two-part campaign finance law “political committee” test has been met.

In comparison to section 501(c) of the tax code, section 527 provides the advantage that all of a 527 organization’s resources may be spent to influence candidate elections without the organization losing its tax-exempt status. The only additional burden of 527 status relative to 501(c)(4) status is

provision establish a tax deduction for donations to 501(c)(5) and (c)(6) organizations. *See also* I.R.C. § 501(h) (2007) (denying tax exemption for donations to nonprofit organizations that engage in substantial lobbying).

³⁹ I.R.C. §§ 527(e)(1)–(2).

⁴⁰ *See, e.g.*, 2 U.S.C. § 431(4) (2000) (defining “political committee” as an organization that receives contributions or makes expenditures in excess of \$1,000 during a calendar year).

that the organization is generally required to disclose the identity of its donors either to a federal, state or local campaign finance regulatory agency or to the IRS itself.⁴¹ The penalty for a 527 organization's failure to comply with disclosure requirements is payment of tax on the undisclosed funds,⁴² which amounts to a non-disclosure option. Also, unlike donations to 501(c)(3) organizations, which are tax deductible,⁴³ Congress did not establish a donor deduction in section 527 or elsewhere in the Internal Revenue Code for donations to 527 organizations. The following table lays out the differences between the best-known types of tax-exempt organizations with respect to political activity.

B. Overview of Applicable Campaign Finance Laws

Whether a particular 527 organization must register as a "political committee" subject to campaign finance law regulation depends on the specific campaign finance laws in effect in the jurisdiction(s) where the 527 organization is raising and/or spending money. Although it is well beyond the scope of this Article to detail every state and local government campaign finance law definition of "political committee," I will discuss the federal law definition and the definitions of several states.

As a general matter, "political committee" status under campaign finance law depends on a two-part test. First, the U.S. Constitution, as interpreted by the Supreme Court in *Buckley v. Valeo*,⁴⁴ limits the application of "political committee" restrictions to organizations with a "major purpose" of influencing elections.⁴⁵ Second, "political committee" status depends on such a "major purpose" organization meeting a particular jurisdiction's statutory definition of "political committee." In my view, an organization's election of tax-exempt status under section 527 of the Internal Revenue Code serves as strong evidence that the organization's "major purpose" is influencing candidate elections, with the exception being the tiny subset of

⁴¹ A 527 organization must file disclosure reports either with a federal, state or local campaign finance agency—if registered somewhere as a "political committee"—or with the IRS, if not registered and reporting as a "political committee" in any jurisdiction. See I.R.C. § 527(j) (2007) (requiring disclosure generally); § 527(j)(5) (2007) (exempting federal, state, and local political committees); § 527(e)(5) (2007) (defining "qualified state or local political organizations" for the purpose of disclosure exemption).

⁴² See I.R.C. § 527(j)(1) (2007).

⁴³ See I.R.C. § 170 (2007).

⁴⁴ 424 U.S. 1 (1976).

⁴⁵ *Id.* at 78–79. The *Buckley* Court did not elaborate on what it meant by the phrase "major purpose." Instead, the Court simply stated: "[t]o fulfill the purposes of the Act [the words 'political committee'] need only encompass organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate." *Id.* at 79. Although one might argue that the *Buckley* Court's "major purpose" test is not required in the context of local and state campaign finance laws because it was articulated in the context of construing a specific federal statute, I have never heard such an argument made. This Article assumes that the *Buckley* Court's "major purpose" test is applicable to state and local law "political committee" restrictions.

CHART 1: TYPES OF TAX EXEMPT ORGANIZATIONS:
BENEFITS AND BURDENS

Tax Exemption Type	Benefits	Burdens
501(c)(3)	<ul style="list-style-type: none"> • Exempt from federal income tax. • No disclosure of donor identities. • Donations to organization are tax deductible for donors. 	<ul style="list-style-type: none"> • Prohibited from intervening in candidate elections. • Lobbying subject to limits.
501(c)(4)	<ul style="list-style-type: none"> • Exempt from federal income tax. • No disclosure of donor identities. • Lobbying activities unlimited. 	<ul style="list-style-type: none"> • Donations to organization are not tax deductible for donors. • Candidate election intervention may not be organization's primary purpose.
527	<ul style="list-style-type: none"> • Exempt from federal income tax. • Unlimited candidate election intervention. 	<ul style="list-style-type: none"> • Donations to organization are not tax deductible for donors. • Disclosure of donor identities. • Lobbying activities may not be organization's primary purpose.

527 organizations with the primary purpose of influencing appointments to public office. Put differently, an organization's election of 527 status creates a strong presumption that it meets the "major purpose" prong of the two-part political committee test (a presumption that may only be rebutted by a 527 organization with a primary purpose of influencing appointments, not elections, to public office). Nevertheless, a 527 organization should not be regulated as a "political committee" unless it meets a jurisdiction's statutory definition of that term.

Under federal campaign finance law, the term "political committee" is defined to mean any group of persons receiving "contributions" or making "expenditures" in excess of \$1,000 a year.⁴⁶ The terms "contribution" and "expenditure," in turn, are defined to mean anything of value received or spent "for the purpose of influencing" a federal election.⁴⁷ The Supreme

⁴⁶ See 2 U.S.C. § 431(4)(A) (2000).

⁴⁷ See 2 U.S.C. §§ 431(8)(A)(i), (9)(A)(i) (2000).

Court in *Buckley* rejected a claim that the federal definition of “expenditure” used in the definition of “political committee” was unconstitutionally vague, as long as the term “political committee” is construed so as to only cover “organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate.”⁴⁸ The Court reasoned that “[e]xpenditures of candidates and of ‘political committees’ so construed can be assumed to fall within the core area sought to be addressed by Congress. They are, by definition, campaign related.”⁴⁹ By contrast, with respect to non-major purpose groups and individuals, the *Buckley* Court held that the phrase “for the purpose of influencing” in the statutory definition of “expenditure” is unconstitutionally vague and must be narrowly interpreted to include only express advocacy of the election or defeat of a candidate.⁵⁰

The Supreme Court made clear in *Buckley* that the statutory “for the purpose of influencing” definition of “expenditure” is constitutional as applied to organizations with a “major purpose” of influencing elections; funds spent by such “major purpose” organizations are, “by definition, campaign related.”⁵¹ The *Buckley* Court declined to extend its bright-line “express advocacy” restriction on the definition of “expenditure” to major purpose groups. Instead, an organization with a “major purpose” of influencing elections can and should be regulated as a “political committee” under federal campaign finance law—i.e., subject to detailed disclosure requirements,⁵² contribution amount limits,⁵³ contribution source prohibitions,⁵⁴ etc.—if it receives or spends funds in excess of \$1,000 a year for the purpose of influencing federal elections.

However, this is not how the FEC interprets and applies the federal “political committee” statutory definition. Instead, the FEC will only regulate an entity as a “political committee” if it receives contributions or makes express advocacy expenditures in excess of the \$1,000 threshold.⁵⁵ A federal court recently opined that the FEC’s interpretation of *Buckley* on this point is incorrect.⁵⁶ This issue generally—and this court decision in particular—are detailed below in Parts II and III.

The *Buckley* Court’s rationale necessitates a particular ordering of steps one and two of the two-part “political committee” test. An organization’s “major purpose” should be ascertained first, because the constitutionally

⁴⁸ *Buckley*, 424 U.S. at 79.

⁴⁹ *Id.*

⁵⁰ *See id.* at 79–80.

⁵¹ *Id.* at 79.

⁵² *See* 2 U.S.C. § 434 (Supps. 2001–2005).

⁵³ *See* 2 U.S.C. § 441a(a)(1) (Supps. 2001–2005).

⁵⁴ *See* 2 U.S.C. § 441b (Supps. 2001–2005).

⁵⁵ *See, e.g.*, FEC, Political Committee Status, Supplemental Explanation and Justification, 72 Fed. Reg. 5595 (Feb. 7, 2007) (explaining the Commission’s belief that it is constrained by the “express advocacy” test in determining an organization’s “political committee” status), available at http://www.fec.gov/law/cfr/ej_compilation/2007/notice_2007-3.pdf.

⁵⁶ *See Shays v. FEC*, 511 F. Supp. 2d 19, 26 (D.D.C. 2007) (“As plaintiffs contend, this is a misreading of *Buckley*.”).

permissible scope of the term “expenditure” depends on it—i.e., “express advocacy” versus a broader “for the purpose of influencing” standard.⁵⁷ Put differently, it is impossible to properly determine, under *Buckley*, whether an organization is a federal “political committee” without first ascertaining the group’s “major purpose,” because a “major purpose” organization is subject to the broad “for the purpose of influencing” statutory definition of “expenditure”—a term that underlies the definition of “political committee”—whereas a non-“major purpose” organization is constitutionally entitled under *Buckley* to a narrow “express advocacy” definition of “expenditure” with respect to the application of all federal campaign finance law regulations of “expenditures” (e.g., independent expenditure reporting requirements).⁵⁸

In my view, an organization’s decision to self-declare its “primary” purpose as influencing the selection, nomination, election, or appointment of individuals to public office by registering with the IRS as a 527 organization creates a strong presumption that such a group’s “major” purpose is influencing candidate elections for constitutional purposes. Section 527 political organizations, by definition, are “operated primarily for the purpose” of accepting contributions or making expenditures to influence “the selection, nomination, election, or appointment” of any individual to public office or office in a political organization.⁵⁹ The Supreme Court in *Buckley* construed the term “political committee” to cover “organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate.”⁶⁰ The words “major” and “primary” should be treated as synonyms in this context.⁶¹ An organization’s “primary” purpose and “major” purpose are one and the same. Unless a 527 organization’s primary/major purpose is influencing the appointment of individuals to non-elective office (e.g., judicial appointments), then its primary/major purpose is by definition influencing candidate elections.

Therefore, when 527 organizations spend money “for the purpose of influencing” federal elections—regardless of whether or not they engage in

⁵⁷ Also, given that all “political committees” are “major purpose” groups, but not all “major purpose” groups are “political committees,” it seems wise to first determine if an organization is in the larger “major purpose” universe before determining if that organization is likewise within the smaller “political committee” universe contained within the “major purpose” universe. An example of an organization that would be a “major purpose” group but not a “political committee” is one that openly dedicated itself to electing a particular individual President, but did so entirely through volunteer efforts, never receiving the contributions or making the expenditures that would make it a “political committee” under federal campaign finance law.

⁵⁸ See 2 U.S.C. § 434(c) (Supps. 2001–2005).

⁵⁹ See I.R.C. §§ 527(e)(1)–(2) (2007).

⁶⁰ 424 U.S. at 79.

⁶¹ See, e.g., “major,” *Roget’s New Millennium Thesaurus, First Edition* (v 1.3.1), Lexico Publishing Group, LLC., Mar. 14, 2008; Thesaurus.com, <http://thesaurus.reference.com/browse/major> (last visited Mar. 19, 2008).

express advocacy—such organizations should be deemed to fall within the federal statutory definition of “political committee.”

Just as the question of 527 organization “political committee” status has arisen in the context of federal elections, so too has the question arisen in the context of state elections. Once it is determined that a particular organization has a “major purpose” of influencing elections—step one of the “political committee” test—it is then necessary to apply the given state’s campaign finance law definition of “political committee” as step two of the test. Significant variation exists among state law definitions of “political committee.” Whereas the federal statutory “for the purpose of influencing” standard for determining “political committee” status is quite broad, some state law definitions of “political committee” are considerably narrower, often limited to “express advocacy” with respect to expenditures.

Colorado law, for example, defines “political committee” to mean “any person, other than a natural person, or any group of two or more persons, including natural persons that have accepted or made contributions or expenditures in excess of \$200 to support or oppose the nomination or election of one or more candidates.”⁶² This state law definition of “political committee” is similar to the federal definition of the term.⁶³ However, in contrast to the broad federal law “for the purpose of influencing” definition of “expenditure,”⁶⁴ Colorado law defines the term “expenditure” more narrowly to mean “any purchase, payment, distribution, loan, advance, deposit, or gift of money by any person for the purpose of expressly advocating the election or defeat of a candidate or supporting or opposing a ballot issue or ballot question.”⁶⁵ Colorado’s definition of “expenditure” is nearly identical to the *Buckley* Court’s narrow construction of the term as applied to non-major purpose groups and individuals.⁶⁶ These definitions are enshrined in the state’s constitution, which can only be amended by popular vote.⁶⁷ Perhaps troubled by the narrow state law definition of “expenditure” but not wanting to manage a ballot measure campaign to amend the state constitution’s definition of “political committee” in order to regulate 527 organizations active in the state’s elections, Colorado legislators enacted a statute in 2007 to require disclosure from 527 organizations “engaged in influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any state or local public office in the state,”⁶⁸ even if the group does not meet the state law definition of “political committee.”

⁶² COLO. CONST. art. XXVIII, § 2(12)(a).

⁶³ See 2 U.S.C. 431(4)(A) (2000).

⁶⁴ See 2 U.S.C. 431(9)(A)(i) (2000).

⁶⁵ COLO. CONST. art. XXVIII, § 2(8)(a).

⁶⁶ *Buckley*, 242 U.S. at 79–80.

⁶⁷ See *id.* art. XIX, § 2.

⁶⁸ COLO. REV. STAT. § 1-45-103(14.5) (2007) (defining “political organization”); see also COLO. REV. STAT. § 1-45-108.5 (2007) (requiring disclosure by “political organizations”).

Florida law also defines the term “political committee” more narrowly than federal law, limiting “political committee” status to groups engaging in express advocacy. Florida law defines “political committee” in operative part to mean:

A combination of two or more individuals, or a person other than an individual, that, in an aggregate amount in excess of \$500 during a single calendar year:

- a. Accepts contributions for the purpose of making contributions to any candidate, political committee, committee of continuous existence, or political party;
- b. Accepts contributions for the purpose of expressly advocating the election or defeat of a candidate or the passage or defeat of an issue; [or]
- c. Makes expenditures that expressly advocate the election or defeat of a candidate or the passage or defeat of an issue⁶⁹

Like Colorado’s legislators, Florida legislators have also taken an indirect route to regulating 527 organizations active in the state, even where such organizations do not engage in express advocacy and thus do not meet the state’s definition of “political committee.” Florida law requires disclosure by state officeholders who, “in whole or in part, establish, maintain, or control” a 527 or 501(c)(4) organization.⁷⁰

West Virginia has enacted the farthest-reaching legislation pertaining to the campaign finance activities of 527 organizations. West Virginia law requires registration and disclosure by 527 organizations and also limits donor contributions to 527 organizations to \$2,000 per two-year election cycle: \$1,000 for the primary election and \$1,000 for the general election.⁷¹ The new West Virginia law provides:

No political organization (as defined in Section 527(e)(1) of the Internal Revenue Code of 1986) may solicit or accept contributions until it has notified the Secretary of State of its existence and of the purposes for which it was formed. During the two-year elec-

⁶⁹ FLA. STAT. §§ 106.011(1)(a)(1)(a)–(c) (2007).

⁷⁰ See FLA. STAT. § 106.0701 (2007). This Florida 527 disclosure law reads, in part:

The Governor, Lieutenant Governor, members of the Cabinet, state legislators, or candidates for such offices who directly or indirectly solicit, cause to be solicited, or accept any contribution on behalf of an organization that is exempt from taxation under s. 527 or s. 501(c)(4) of the Internal Revenue Code, which such individuals, in whole or in part, establish, maintain, or control, shall file a statement with the division within 5 days after commencing such activity on behalf of the organization. The statement shall contain the following information:

- (a) The name of the person acting on behalf of the organization.
- (b) The name and type of the organization.
- (c) A description of the relationship between the person and the organization.

Id. at § 106.0701(1).

⁷¹ W. VA. CODE § 3-8-12(g) (2006).

tion cycle, a political organization (as defined in Section 527 (e) (1) of the Internal Revenue Code of 1986) may not accept contributions totaling more than one thousand dollars from any one person prior to the primary election and contributions totaling more than one thousand dollars from any one person after the primary and before the general election.⁷²

However, West Virginia's law was inadvertently drafted too broadly. By its plain meaning, it restricts even 527s operating in West Virginia solely to influence federal elections—e.g., federal candidate committees, federal party committees, and federal independent committees—which is clearly beyond the scope of the state's legislative authority.⁷³ My understanding is that regulating federal 527s was not the intent of the legislature.⁷⁴ The Secretary of State began a rulemaking in 2006–07 to clarify this matter by exempting from the state law 527 organizations registered with the FEC as federal political committees but, without explanation, the proposed rule was withdrawn in January 2007.⁷⁵

It is also worth noting that the State of Virginia has enacted a disclosure law intended to obtain disclosure from 527 organizations making contributions to Virginia candidates and political committees. The new law appears to have no impact on 527 organizations making only independent expenditures. The statute defines “out-of-state political committee” to mean:

an entity covered by § 527 of the United States Internal Revenue Code that is not registered as a political committee or candidate campaign committee in Virginia and that does not have as its primary purpose expressly advocating the election or defeat of a clearly identified candidate. The term shall not include a federal political action committee.⁷⁶

An “out-of-state political committee” must file a statement of organization on or before the date on which it makes contributions of \$10,000 or more in the aggregate in a calendar year to state registered political committees.⁷⁷ An “out-of-state political committee” must then file reports disclosing contributions it makes to state political committees, and the source of funds used to

⁷² *Id.*

⁷³ *See* 2 U.S.C. § 453 (Supps. 2001–2005).

⁷⁴ My understanding is based on telephone conversations with staff in the Secretary of State's office, as well as on conversations with staff of The Reform Institute (<http://www.reforminstitute.org>) who assisted members of the state legislature in drafting the legislation.

⁷⁵ *See* Regulation of Campaign Finance During Electioneering Communication Periods, Proposed Rule 146-5 (W.Va. Sec'y of State July 18, 2006). I was advised via a January 18, 2008 telephone conversation with an attorney in the Secretary of State's office that Proposed Rule 146-5 had been withdrawn in January 2007, terminating the rulemaking proceeding without adoption of a rule.

⁷⁶ VA. CODE ANN. § 24.2-945.1 (2006).

⁷⁷ *See id.* § 24.2-949.9:1(A).

make such contributions, but need not disclose any information pertaining to expenditures.⁷⁸

So while federal campaign finance statutes and regulations do not clarify or even mention the relevance of an organization's choice of section 527 tax-exempt status to the application of federal campaign finance laws, several states have attempted to address and rein in unregulated fundraising and spending by 527 organizations to influence those states' elections. However, no state has taken the approach embodied in the federal 527 reform legislation pending before Congress and described in Part IV; no state has amended its laws to clarify the relationship of section 527 tax status to that state's campaign finance law "political committee" status.

II. FEC TREATMENT OF 527 ORGANIZATIONS

In March 2004, with highly visible, well funded 527 organizations hitting the national stage with plans to influence the 2004 presidential election—but with no plans to register with the FEC as "political committees"—the FEC initiated a rulemaking to consider whether it should promulgate a rule making clear when a 527 organization must register as a federal "political committee."⁷⁹ On April 9, 2004, Senators John McCain (R-Ariz.) and Russell Feingold (D-Wis.) and Representatives Christopher Shays (R-Conn.) and Martin Meehan (D-Mass.)—the principal sponsors of the "527 Reform Act of 2007"—filed comments with the FEC in this rulemaking.⁸⁰ They explained to the Commission:

We believe the Commission's failure to properly enforce the Federal Election Campaign Act of 1974 ("FECA") made necessary our seven-year legislative effort to enact BCRA.⁸¹ The Supreme Court agrees. *See [McConnell v. FEC, 540 U.S. 93, 142, 142 n.44, 143-46 (2003)]*. We urge the Commission to learn from this history and to take measured, but decisive action to apply the law correctly and prevent the development of a massive new loophole that would allow 527 organizations to spend unlimited soft money on activities plainly designed to influence federal elections.⁸²

These Members of Congress have long held the belief that FECA's definition of "political committee," on the books since 1974, does not need to be amended in order to effectuate the FEC's proper regulation of 527 organiza-

⁷⁸ *See id.* § 24.2-949.9:2.

⁷⁹ Notice of Proposed Rulemaking ("NPRM") 2004-6, 69 Fed. Reg. 11,736 (Mar. 11, 2004).

⁸⁰ *See* Sens. McCain and Feingold and Reps. Shays and Meehan, Comments on Notice 2004-6 (Apr. 9, 2004), available at http://www.fec.gov/pdf/nprm/political_comm_status/comm2/02.pdf [hereinafter Comments on Notice 2004-6].

⁸¹ Bipartisan Campaign Reform Act of 2002 (BCRA), Pub. L. No. 107-155, 116 Stat. 81.

⁸² Comments on Notice 2004-6, *supra* note 80, at 1 (citation inserted).

tions raising and spending funds to influence federal elections. The Senators explained to the Commission during its 2004 rulemaking:

Our conviction that many 527 organizations must register as political committees is based not on BCRA, but on FECA. That is a very important point. A number of our colleagues in the Congress have commented in this rulemaking, and in connection with the recent Advisory Opinion proceeding, AO 2003-37, that BCRA was not intended to address 527s. They are correct. Our bill was concerned with the raising and spending of soft money. . . and with phony issue ads. . . . That does not mean, however, that 527s are free to operate without restrictions. . . . The question of whether and how 527s should be regulated in their fundraising and in their spending on activities other than electioneering communications is a question that has to be answered under FECA.⁸³

Shortly after the Members filed comments in the FEC's "Political Committee Status" rulemaking, the Commission held a public hearing on the matter. Not long after the hearing on this subject, Senator McCain reiterated on the floor of the Senate his concerns regarding the Commission's failure to clarify and properly enforce longstanding federal political committee restrictions and requirements, stating:

These [527] groups readily admit that their intended purpose is to influence the outcome of Federal elections. FECA has long required these groups to register as Federal political committees and comply with Federal campaign finance limits. Unfortunately, because the FEC has misinterpreted and undermined the law, we find ourselves in this unenforced regulatory limbo today. The 1974 law requires that any group with a "major purpose" of influencing a Federal election, and which spends more than \$1,000 doing so, must use the same limited hard money contributions as the political parties and the candidates themselves. In recent years though, the FEC slouched into the feckless and unjustified position of not enforcing the law in the case of groups which avoided the "magic words" of "express advocacy" but were set up and operated to influence Federal elections. Then, in *McConnell*, the Supreme Court itself made clear what many of us already knew—that the Constitution did not require an "express advocacy" standard, and that such a standard is "functionally meaningless." . . .

But here we are, with these groups openly flouting the law and openly spending soft money for the express purpose of influencing

⁸³ *Id.* at 1–2.

the presidential election while the FEC sits on its hands once again.⁸⁴

Despite these admonitions from Senators and House Members, the FEC eventually decided in 2004 not to promulgate a rule clarifying when 527 organizations must register as political committees and, instead decided to proceed on a case-by-case enforcement action basis.⁸⁵ In its “Explanation and Justification” for its decision not to adopt a rule clarifying the relevance of section 527 tax status to federal campaign finance law “political committee” status, the Commission noted that some who commented during the rulemaking objected that the proposed rules would be overbroad in their application. The “Explanation and Justification” noted that the “comments raise valid concerns that lead the Commission to conclude that incorporating a ‘major purpose’ test into the definition of ‘political committee’ may be inadvisable” and that the “Commission has been applying this [‘major purpose’ judicial] construct for many years without additional regulatory definitions, and it will continue to do so in the future.”⁸⁶

Reps. Shays and Meehan then sued the FEC for the Commission’s refusal to promulgate a rule addressing the political committee status of 527 organizations, a case described in greater detail in Part III, below.⁸⁷ Although the U.S. District Court for the District of Columbia did order the FEC to provide a more detailed explanation for its decision not to promulgate a 527 rule,⁸⁸ the court eventually concluded that the FEC had met its obligations under the federal Administrative Procedure Act.⁸⁹

Without clear guidance from the FEC, 527 groups refusing to register with the Commission as “political committees” proliferated in 2004. Complaints were filed against many of these organizations, including America Coming Together (ACT), the Media Fund, Progress for America Voter Fund, Swift Boat Veterans and POWs for Truth, MoveOn.org and others.⁹⁰

In the face of FEC inaction,⁹¹ soft money fundraising and spending by 527 groups to influence federal elections continued unabated through the

⁸⁴ 150 CONG. REC. S4472 (daily ed. Apr. 28, 2004) (statement of Sen. McCain).

⁸⁵ See Political Committee Status, Definition of Contribution, and Allocation for Separate Segregated Funds and Nonconnected Committees, 69 Fed. Reg. 68,056, 68,064–65 (Nov. 23, 2004).

⁸⁶ *Id.* at 68,065.

⁸⁷ See *Shays v. FEC*, 511 F. Supp. 2d 19 (D.D.C. 2007).

⁸⁸ See *Shays v. FEC*, 424 F. Supp. 2d 100 (D.D.C. 2006).

⁸⁹ See *Shays v. FEC*, 511 F. Supp. 2d at 31.

⁹⁰ The FEC maintains a database of documents relating to enforcement actions that have been resolved. FEC, Enforcement Query System, <http://eqs.sdrdc.com/eqs/searcheqs> (last visited Mar. 21, 2008). The Campaign Legal Center has also compiled complaints made against several of these organizations. Campaign Legal Center, FEC Proceedings, <http://www.campaignlegalcenter.org/FEC-129.html> (last visited Mar. 21, 2008).

⁹¹ It was not until December of 2006 that the FEC began announcing the first settlement agreements concluding investigations of 527 organizations active during the 2004 election cycle. See FEC Collects \$630,000 In Civil Penalties From Three 527 Organizations (Dec. 13, 2006), available at <http://www.fec.gov/press/press2006/20061213murs.html>.

2006 election cycle. Complaints were filed with the FEC in October 2006 against the 527 groups Economic Freedom Fund, Softer Voices, Majority Action and the Lantern Project, alleging that these groups spent millions of dollars of soft money to influence the 2006 Congressional elections.⁹²

Beginning in November 2006, however, the FEC began announcing settlement agreements with numerous 527 organizations, resolving complaints that had been filed against the organizations for their activities to influence the 2004 federal elections. As explained in Part I, *supra*, an organization is a “political committee” under federal campaign finance law if it has a “major purpose” of influencing elections and receives “contributions” or makes “expenditures” in excess of \$1,000 in a year.⁹³ The terms “contribution” and “expenditure,” in turn, are defined to mean anything of value received or spent “for the purpose of influencing” a federal election.⁹⁴ And though the FEC refrained from promulgating a rule in 2004 clarifying the “political committee” status of 527 organizations, it did amend its rules through that rulemaking to establish that funds received by an organization are “contributions” under federal law if received in response to a communication that “indicates that any portion of the funds received will be used to support or oppose the election of a clearly identified Federal candidate.”⁹⁵ The conciliation agreements announced by the FEC in late 2006 and 2007 stated the Commission’s conclusion that a number of 527 organizations were “political committees,” several as a result of their express advocacy “expenditures,” several as a result of their solicitation of “contributions” via communications indicating that the funds would be used to support or oppose federal candidates, and several on both grounds.

Three aspects of these conciliation agreements are worth noting. First, whereas prior to the announcement of these conciliation agreements the Commission had for nearly a decade relied exclusively on a narrow “magic words” construction of “express advocacy” for the purpose of identifying “expenditures,” the Commission in late 2006 resurrected its much broader “reasonable interpretation” standard for defining express advocacy expenditures.⁹⁶ Political attorneys advising their 527 organization clients in 2004

⁹² See, e.g., Complaint by Democracy21 and Campaign Legal Center against Economic Freedom Fund and Majority Action (2006), <http://www.campaignlegalcenter.org/attachments/1633.pdf>; Complaint by Democracy21 and Campaign Legal Center against The Lantern Project and Softer Voices (2006), <http://www.campaignlegalcenter.org/attachments/1639.pdf>.

⁹³ See 2 U.S.C. § 431(4) (2000); Buckley v. Valeo, 424 U.S. 1 (1976).

⁹⁴ See 2 U.S.C. §§ 431(8)(A)(i), (9)(A)(i) (2000).

⁹⁵ FEC Scope and Definitions, 11 C.F.R. § 100.57(a) (2007); see also Political Committee Status, Definition of Contribution, and Allocation for Separate Segregated Funds and Nonconnected Committees, 69 Fed. Reg. 68,056, 68,066 (Nov. 23, 2004).

⁹⁶ See, e.g., FEC Conciliation Agreement with Swift Boat Veterans and POWs for Truth, § IV, ¶ 25 (Dec. 13, 2006), available at <http://eqs.nictusa.com/eqsdocs/000058ED.pdf> (“The Commission concludes that, speaking to voters in this context, the advertisements unambiguously refer to Senator Kerry as a Presidential candidate by discussing his character, fitness for office, and capacity to lead, and have no other reasonable meaning than to encourage actions to defeat him. See 11 C.F.R. §100.22(b); *Explanation and Justification*, 60 Fed. Reg. at

likely did not anticipate this and, instead, likely assumed that so long as 527 organizations avoided using the “magic words” of express advocacy—e.g., “vote for candidate X,” “vote against candidate Y”—in their communications, they would not be making “expenditures” under the federal law definition of “political committee.” Instead, the FEC relied upon its broader regulatory definition of express advocacy, whereby a payment to produce any communication “that could only be interpreted by a reasonable person as containing advocacy of the election or defeat” of a candidate is an “expenditure,” even if it does not contain “magic words” such as “vote for” or “vote against.”⁹⁷

Second, the Commission found several organizations to be “political committees” based solely on the nature of their contribution solicitations, even when they did not engage in express advocacy.⁹⁸ Again, federal law defines “political committee” to include any group that makes expenditures or receives contributions in excess of \$1,000 during a calendar year.⁹⁹ FEC regulations further provide that any funds received by an organization in response to a communication are “contributions” to the group making the communication “if the communication indicates that any portion of the funds received will be used to support or oppose the election of a clearly identified Federal candidate,” regardless of how the money is eventually spent by the group (i.e., regardless of whether the use of funds constitutes an “expenditure” under federal law).¹⁰⁰

Third, the Commission did not rely on these organizations’ self-identification as section 527 political organizations in determining the organizations’ “major purpose.” Instead, the Commission looked to other evidence, such as statements made by the organizations and their representatives to the public and to contributors regarding these organizations’ intentions and

35,295.”). *See also id.* at § IV ¶ 30 (“While the Commission disagrees with its reasoning, SwiftVets contends that it was uncertain as to the continued validity and application of the alternative express advocacy test set forth in 11 C.F.R. §100.22(b) because of: (1) SwiftVets’ understanding of the First and Fourth Circuit court decisions holding 11 C.F.R. §100.22(b) unconstitutional; (2) SwiftVets’ understanding of the Commission’s history of not relying on 11 C.F.R. §100.22(b) in recent enforcement matters; (3) SwiftVets’ understanding of the division on the Commission in voting whether to initiate a rulemaking to revise or repeal 11 C.F.R. §100.22(b); and (4) SwiftVets’ understanding of the Commission’s decision in 2004 not to issue specific regulation regarding the political committee status of 527 organizations whose major purpose was the nomination or election of Federal candidates (May 13, 2004), and its September 27, 2001 decision to hold in abeyance a rulemaking to revise the definition of ‘expenditure’ and to promulgate a definition for the ‘major purpose’ test.”).

⁹⁷ *See* 11 C.F.R. § 100.22(b) (2007). For a thorough examination of the history of these two alternative “express advocacy” legal standards, *see* Paul S. Ryan, *Wisconsin Right to Life and the Resurrection of Furgatch*, 19 STAN. L. & POLY REV. (forthcoming Spring 2008).

⁹⁸ *See, e.g.*, FEC Conciliation Agreement with MoveOn.org Voter Fund § 4, ¶ 15 (Dec. 13, 2006), available at <http://eqs.nictusa.com/eqsdocs/000058F4.pdf> (“The Commission concludes that contributions received in response to MOVF’s solicitations that clearly indicated the funds received would be used to defeat George Bush in the 2004 general election caused MOVF to surpass the \$1,000 statutory threshold. *See* 2 U.S.C. § 431(4)(A).”)

⁹⁹ *See* 2 U.S.C. § 431(4) (2000).

¹⁰⁰ 11 C.F.R. § 100.57(c) (2007).

goals. Indeed, the Commission has found that several 501(c)(4) organizations active in the 2004 federal elections had a “major purpose” of influencing elections, a purpose that is inconsistent with the strictures of federal tax law.¹⁰¹

The Commission, for example, concluded that the 527 organization Swift Boat Veterans and POWs for Truth (“SwiftVets”) violated federal campaign finance law by failing to register as a federal “political committee” and comply with attendant restrictions and requirements in 2004.¹⁰² The Commission found that SwiftVets not only received “contributions” and made “expenditures” in excess of \$1,000, but also had a “major purpose” of influencing elections. The Commission concluded that SwiftVets had received “contributions” because “language used in various SwiftVets fundraising solicitations that made reference to Senator Kerry’s 2004 Presidential campaign clearly indicated that the funds received would be directed toward the defeat of Senator Kerry.”¹⁰³ And, despite the fact that SwiftVets had refrained from using “magic words” express advocacy, the Commission concluded that SwiftVets had made “expenditures,” explaining that:

The Commission concludes that all of these communications comment on Senator Kerry’s character, qualifications, and fitness for office, explicitly link those charges to his status as a candidate for President, and have no other reasonable meaning than to encourage actions to defeat Senator Kerry. Therefore, because the Commission concludes that the communications are “unmistakable, unambiguous, and suggestive of only one meaning” and because reasonable minds cannot differ that the communications urge Kerry’s defeat, the Commission concludes that they are express advocacy as defined at 11 C.F.R. § 100.22(b). Accordingly, the Commission concludes that SwiftVets made expenditures in excess of \$1,000, surpassing the statutory threshold for political committee status. *See* 2 U.S.C. § 431(4)(A).¹⁰⁴

Tellingly, the conciliation agreement also summarizes the defense asserted by SwiftVets in the enforcement action, which is worth quoting at length.

While the Commission disagrees with its reasoning, SwiftVets contends that it was uncertain as to the continued validity and application of the alternative express advocacy test set forth in 11 C.F.R § 100.22(b) because of: (1) SwiftVets’ understanding of the

¹⁰¹ *See supra* Part II; *see also, e.g.*, FEC Conciliation Agreement With Freedom, Inc. (Oct. 31, 2006), available at <http://eqs.sdrdc.com/eqsdocs/00005949.pdf>.

¹⁰² *See* FEC Conciliation Agreement with Swift Boat Veterans and POWs for Truth (Dec. 13, 2006), available at <http://eqs.nictusa.com/eqsdocs/000058ED.pdf>.

¹⁰³ *Id.* at § 4, ¶ 18.

¹⁰⁴ *Id.* at § 4, ¶ 28.

First and Fourth Circuit court decisions holding 11 C.F.R. § 100.22(b) unconstitutional; (2) SwiftVets' understanding of the Commission's history of not relying on 11 C.F.R. § 100.22(b) in recent enforcement matters; (3) SwiftVets' understanding of the division on the Commission in voting whether to initiate a rulemaking to revise or repeal 11 C.F.R. § 100.22(b); and (4) SwiftVets' understanding of the Commission's decision in 2004 not to issue specific regulation regarding the political committee status of 527 organizations whose major purpose was the nomination or election of Federal candidates (May 13, 2004), and its September 27, 2001 decision to hold in abeyance a rulemaking to revise the definition of "expenditure" and to promulgate a definition for the "major purpose" test.¹⁰⁵

SwiftVets gambled and lost; consequently, the organization agreed to pay a \$299,500 civil penalty, which, given that the organization had illegally raised more than \$25 million to influence the 2004 federal elections, was little more than a slap on the wrist.¹⁰⁶

Similarly, the National Association of Realtors ("NAR") 527 organization agreed to pay a \$78,000 fine for its failure to register as a federal "political committee" in 2004.¹⁰⁷ The Commission concluded that, despite the fact that the NAR 527 had avoided using "magic words" that amounted to express advocacy, various communications distributed by the NAR 527 nonetheless contained express advocacy under the FEC's broader "only reasonable interpretation" definition. Consequently, the Commission concluded, "disbursements made to finance these communications constitute 'expenditures' under 2 U.S.C. § 431(9)(A), the aggregate amount of which exceeds the \$1,000 statutory threshold for triggering political committee status."¹⁰⁸

Other 527 organizations entering into settlement agreements to resolve enforcement actions pertaining to illegal campaign finance activity in 2004 included the League of Conservation Voters, which was fined \$180,000 for making expenditures in excess of the \$1,000 threshold and failing both to register as a federal "political committee" and to abide by the applicable restrictions.¹⁰⁹ The 527 organization Environment2004, Inc. agreed to pay a \$16,000 fine for making express advocacy expenditures in excess of the \$1,000 threshold and failing to register as a federal political committee.¹¹⁰

¹⁰⁵ *Id.* at § 4, ¶ 30.

¹⁰⁶ *See id.* at § 4, ¶ 14.

¹⁰⁷ *See* FEC Conciliation Agreement with National Association of Realtors (June 19, 2007), available at <http://eqs.sdrdc.com/eqsdocs/00005DB9.pdf>.

¹⁰⁸ *Id.* § 4, ¶ 19.

¹⁰⁹ *See* FEC Conciliation Agreement with League of Conservation Voters 527 (Dec. 16, 2006), available at <http://eqs.nictusa.com/eqsdocs/00005905.pdf>.

¹¹⁰ *See* FEC Conciliation Agreement with Environment2004, Inc. and Environment2004 Action Fund (Mar. 29, 2007), available at <http://eqs.nictusa.com/eqsdocs/00005F42.pdf>.

The MoveOn.org Voter Fund 527 organization agreed to pay a \$150,000 fine after the FEC concluded that the organization's solicitations had resulted in its receipt of "contributions" in excess of the \$1,000 "political committee" threshold because the solicitations indicated that "funds received would be used to defeat George Bush in the 2004 general election."¹¹¹ Similarly, the Empower Illinois Media Fund agreed to pay a \$3,000 fine when the FEC concluded that the 527 organization's solicitations "clearly indicated the funds received would be used to defeat Barack Obama in the 2004 general election," causing the organization to surpass the \$1,000 statutory "political committee" threshold.¹¹²

In February 2007, the 527 organization Progress For America Voter Fund agreed to pay a \$750,000 fine—one of the largest fines in FEC history—for its failure to register as a federal political committee in 2004.¹¹³ Progress For America Voter Fund had raised more than \$44 million to influence the 2004 federal elections and ran advertisements that the Commission concluded had constituted express advocacy expenditures.¹¹⁴

The FEC collected an even larger fine of \$775,000 from the organization America Coming Together ("ACT") in August 2007.¹¹⁵ ACT maintains both a registered federal political committee and a separate account that is not registered as a federal political committee, but is exempt from federal taxation under section 527. ACT raised more than \$136 million in connection with the 2004 elections, of which approximately \$33.5 million was raised in compliance with federal campaign finance laws and deposited into the 527 organization's registered federal political committee account.¹¹⁶ The remaining \$103 million was not in compliance with federal campaign finance laws and was deposited into the organization's "non-federal" 527 account.¹¹⁷ The Commission found that roughly \$70 million disbursed from the non-federal account was spent to influence federal elections and should have been paid for either with federal funds, or with an allocated mixture of federal and non-federal funds.¹¹⁸ Another \$30 million in disbursements made in

¹¹¹ See FEC Conciliation Agreement with MoveOn.org Voter Fund § 4, ¶ 15 (Dec. 13, 2006), available at <http://eqs.nictusa.com/eqsdocs/000058F4.pdf>.

¹¹² See FEC Conciliation Agreement with Empower Illinois Media Fund § 4, ¶ 19 (Aug. 1, 2007), available at <http://eqs.sdrdc.com/eqsdocs/00006143.pdf>.

¹¹³ See FEC Conciliation Agreement with Progress For America Voter Fund (Feb. 28, 2007), available at <http://eqs.nictusa.com/eqsdocs/00005AA7.pdf>.

¹¹⁴ See *id.* at § 4, ¶ 13. ("between May 27, 2004 and the November 2, 2004 General Election, PFA-VF raised \$44.9 million in corporate and individual contributions . . ."); see also *id.* at § 4, ¶ 17 ("The Commission concludes that certain television advertisements run by PFA-VF before the 2004 General Election expressly advocated that recipients vote for, campaign for, or contributed to a clearly identified candidate.").

¹¹⁵ See FEC Conciliation Agreement with America Coming Together (Aug. 24, 2007), available at <http://eqs.sdrdc.com/eqsdocs/000061A1.pdf>.

¹¹⁶ *Id.* at § 4, ¶ 3.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at § 4, ¶ 12.

connection with the 2004 federal election were improperly allocated to the organization's non-federal account.¹¹⁹

The FEC was unable to reach a conciliation agreement with the 527 organization Club For Growth and, consequently, filed a civil action in the U.S. District Court for the District of Columbia against the organization for its failure to register as a federal political committee and comply with applicable restrictions.¹²⁰ In September 2007 the Commission and Club for Growth entered a Consent Judgment, in which Club for Growth agreed to pay a \$350,000 fine to settle the lawsuit.¹²¹

Most recently, the FEC entered a conciliation agreement with The Media Fund, yet another 527 organization active in 2004 that refused to register as a federal political committee. In November 2007 The Media Fund agreed to pay a \$580,000 fine to the FEC to settle a complaint against it.¹²² The FEC explained in a press release announcing this settlement agreement:

This is the eleventh settlement the Commission has entered into in the past year with organizations exempt from taxation under either section 527 or 501(c)(4) of the Internal Revenue Code. The Commission determined all of these organization[s] violated election laws during the 2004 campaign, most by failing to register as political committees. The Commission collected more than \$3,000,000 in civil penalties from these cases.¹²³

As noted above, to date the FEC has assessed approximately \$3 million in fines against 527 organizations that were active in the 2004 federal elections. Despite the large scale of the problem, the Commission has not analyzed or even considered the self-elected section 527 status of these organizations when determining whether the groups' "major purpose" is to influence elections. The Commission has ignored the organizations' section 527 status and, instead, has examined statements made by the organizations to the public and to potential donors regarding the organizations' purposes and intent. The FEC's refusal to consider an organization's 527 status was explained by the Commission in the context of the *Shays v. FEC* lawsuit¹²⁴ filed in 2004 and resolved in 2007, which brings us to the next section of this Article.

¹¹⁹ *Id.* at § 4, ¶ 17.

¹²⁰ *See* Complaint, *FEC v. Club for Growth*, 432 F. Supp. 2d 87 (D.D.C. 2006) (No. 05-1851).

¹²¹ *See* Consent Judgment, *FEC v. Club for Growth*, 432 F. Supp. 2d 87 (D.D.C. 2007) (No. 05-1851).

¹²² *See* FEC Conciliation Agreement with The Media Fund (Nov. 15, 2007), available at <http://eqs.sdrdc.com/eqsdocs/00006691.pdf>.

¹²³ Press Release, FEC, Media Fund to Pay \$580,000 Civil Penalty (Nov. 19, 2007), available at <http://www.fec.gov/press/press2007/20071119mediafund.shtml>.

¹²⁴ *Shays v. FEC*, 511 F. Supp. 2d 19 (D.D.C. 2007).

III. COURT DECISIONS OPINING ON THE RELEVANCE OF TAX STATUS TO POLITICAL COMMITTEE STATUS

Since the 2004 federal elections when 527 organizations stepped into the limelight, two courts have weighed in on the “political committee” status of 527 organizations. As noted in the preceding section, the FEC’s refusal in 2004 to promulgate a rule making clear when a 527 organization must register as a federal “political committee” prompted Congressmen Shays and Meehan to sue the agency in *Shays v. FEC*.¹²⁵ The other court to weigh in on the matter is the Washington State Supreme Court, in a lawsuit involving the Washington State Public Disclosure Commission’s attempts to obtain political committee campaign finance disclosure from an organization spending money to influence a state election.¹²⁶

Through the course of the *Shays* litigation, the plaintiffs made two principal arguments: (1) the FEC’s refusal to promulgate a rule clarifying when 527 organizations must register as political committees was arbitrary and capricious in violation of the federal Administrative Procedure Act (“APA”); and (2) the FEC’s substantive approach to analyzing an organization’s “political committee” status is contrary to law in violation of the APA. With respect to the first argument, the U.S. District Court for the District of Columbia held in March 2006 that the FEC had violated the APA by failing to explain its decision not to issue rules requiring section 527 organizations spending money to influence federal elections to register as federal political committees.¹²⁷ The Commission had issued an “Explanation and Justification” following the 2004 rulemaking, but had simply stated in the document its decision to proceed addressing the political committee status of 527 organizations on a case-by-case adjudication basis, rather than by addressing the issue in a regulation. The court was “troubled . . . by FEC’s lack of explanation for its conclusion that adjudication is preferable to rulemaking for regulating 527 groups.”¹²⁸ In reaching the conclusion that the FEC had violated the APA, the court noted that “[c]ases arising from the 2004 campaign have languished on the Commission’s enforcement docket for as long as 23 months, with no end in sight, even as the 2006 election campaign has begun.”¹²⁹ The court further noted: “[t]he FEC can take years to complete an administrative action, and penalties, if they come at all, come long after the

¹²⁵ *Id.*

¹²⁶ *See* *Voters Education Committee v. Public Disclosure Commission*, 166 P.3d 1174 (Wash. 2007), *petition for cert. filed*, No. 07-1153 (U.S. Mar. 10, 2008). I, along with my colleagues at the Campaign Legal Center, represented the Center as an *amicus* in the case before both the trial court and the Washington State Supreme Court.

¹²⁷ *Shays v. FEC*, 424 F. Supp. 2d 100, 117 (D.D.C. 2006) (“[T]he FEC has failed to present a reasoned explanation for its decision that 527 organizations will be more effectively regulated through case-by-case adjudication rather than general rule.”).

¹²⁸ *Id.* at 115.

¹²⁹ *Id.* at 116.

money has been spent and the election [has been] decided.”¹³⁰ However, the court concluded that the circumstances were “not sufficiently compelling” for the court to order the FEC to promulgate a 527 rule.¹³¹ Instead, the court remanded the matter to the FEC for further explanation of its approach.¹³²

Nearly a year later, the FEC published a revised “Explanation and Justification” for its refusal to promulgate a 527 rule and its decision to instead proceed on a case-by-case basis.¹³³ In this document, the FEC detailed its approach to analyzing “political committee” status, which differs in two fundamental ways from the approach advocated by the plaintiffs in the *Shays* litigation and by me both in this Article and as counsel to *amici* Senators McCain and Feingold in the lawsuit. Rather than first considering an organization’s “major purpose” and then applying the broad statutory “for the purpose of influencing” definition of “expenditure” to groups with a major purpose of influencing elections, the Commission instead applies a narrower “express advocacy” construction of the term “expenditure” to the organization.¹³⁴ Then, if and only if it deems the organization to have surpassed the statutory thresholds of \$1,000 in “expenditures” or “contributions,” does it examine the organization’s “major purpose.”¹³⁵ Second, when examining an organization’s “major purpose,” the Commission places no significance on an organization’s self-identification as a section 527 “political organization” operated primarily for the purpose of influencing the “selection, nomination, election, or appointment” of an individual to federal, state or local public office.¹³⁶

The plaintiffs in *Shays* filed a renewed motion for summary judgment in response to the FEC’s revised explanation of its case-by-case approach to regulating 527 organizations. In August 2007, the District Court issued its opinion on the renewed motion, taking the opportunity to address the plaintiffs’ arguments that the FEC misinterpreted the statutory definition of “political committee” contrary to the Supreme Court’s interpretation in *Buckley*. In a section of the opinion entitled “FEC’s Misinterpretation of *Buckley*,” the court explained at length:

[T]he FEC believes that there is an “express advocacy requirement for expenditures on communications made independently of a candidate,” which applies to all organizations regardless of whether they satisfy the “major purpose” test.

¹³⁰ *Id.*

¹³¹ *Id.* (such a remedy “is reserved for ‘only the rarest and most compelling of circumstances,’” (quoting *American Horse Protection Ass’n v. Lyng*, 812 F.2d 1, 7 (D.C. Cir. 1987))).

¹³² *Id.* at 117.

¹³³ See Political Committee Status, 72 Fed. Reg. 5,595 (Feb. 7, 2007) (to be codified at 10 C.F.R. pt. 72).

¹³⁴ See *id.* at 5596–97.

¹³⁵ See *id.*

¹³⁶ See *id.* at 5,601; see also I.R.C. § 527(e) (2007).

As plaintiffs contend, this is a misreading of *Buckley*. In *Buckley*, the Court addressed constitutional concerns that the statutory definition of “political committee” was overbroad and, to the extent it incorporated the definition of “expenditure,” vague as well. The Court found the term “expenditure” caused “line drawing problems” by potentially “encompassing both issue discussion and advocacy of a political result,” so that the “political committee” standard might “reach groups engaged purely in issue discussion.” The Court resolved these concerns by imposing two different limiting constructions. First, it narrowed the definition of “political committee” to encompass only “organizations that are under the control of a candidate or the major purpose of which is the nomination [or] election of a candidate.” For such “major purpose” groups, there is no concern about vagueness of the “expenditure” definition because disbursements by such groups “can be assumed to fall within the core area sought to be addressed by Congress. They are, by definition, campaign related.” Second, “when the maker of the expenditure is not within these categories [, i.e.,] when it is an individual other than a candidate or a group other than a ‘political committee,’” the Court narrowly construed the term “expenditure” to reach “only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate.”¹³⁷

The court further noted that the Supreme Court has since reaffirmed that the “narrowing gloss of express advocacy” on the term “expenditure” applies only to groups other than “major purpose” groups, citing the Court’s 2003 decision in *McConnell* where the Court quoted its *Buckley* decision on this point.¹³⁸ The district court concluded that, “having misinterpreted *Buckley*, the FEC is applying the express advocacy requirement to expenditures in cases where it is unnecessary.”¹³⁹

Nevertheless, the court found that with respect to the legal claim at issue in the lawsuit, the FEC’s misinterpretation of *Buckley*’s constitutional test for “political committee” status was harmless error, because “the decision of whether to codify detailed standards for the ‘major purpose’ test in a general rule—the subject of this suit—is separate and apart from the question of the proper interpretation of ‘expenditure.’”¹⁴⁰ And in the end, despite finding serious fault with the FEC’s approach to regulating 527 organizations, the court concluded that the law required a great deal of deference for agency decisions as to whether to promulgate rules, and that the FEC had

¹³⁷ *Shays v. FEC*, 511 F. Supp. 2d 19, 26–27 (D.D.C. 2007) (internal citations omitted).

¹³⁸ *Id.* at 27.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

met its burden under the APA of providing a reasoned explanation for its course of action.¹⁴¹

The *Shays* court's decision is significant because it constitutes the only federal court decision opining (albeit in dicta) on the question of whether "major purpose" groups are entitled to an "express advocacy" construction of "expenditure" under *Buckley* or whether they may constitutionally be regulated under the broader "for the purpose of influencing" statutory language. Even though the FEC has chosen to apply the narrower "express advocacy" standard, the *Shays* decision makes clear that the FEC, as well as state and local governments, may take the approach to identifying "political committees" that I advocate in Part I, *supra*.

The Supreme Court of the State of Washington has also weighed in on the matter of "political committee" status and 527 organizations. In *Voters Education Committee v. Public Disclosure Commission*, the Washington Public Disclosure Commission initiated an enforcement action against the 527 organization Voters Education Committee ("VEC") to compel the organization to comply with state campaign finance law "political committee" registration and reporting requirements and to seek penalties for noncompliance.¹⁴² At the same time, the VEC initiated its own action seeking a declaratory judgment that the VEC's advertisements related to a 2004 state election were protected speech under the state and federal constitutions and could not be subject to state disclosure requirements.¹⁴³ The trial court had granted summary judgment in favor of the state and the VEC appealed directly to the State Supreme Court.¹⁴⁴

Washington state law defines "political committee" as "any person . . . having the expectation of receiving contributions or making expenditures in support of, or in opposition to, any candidate or any ballot proposition."¹⁴⁵ The State Supreme Court rejected the VEC's claim that this definition of "political committee" is unconstitutionally vague¹⁴⁶ and quoted the Campaign Legal Center's *amicus* brief on the relevance of VEC's status as a 527 organization to its status as a "political committee" under Washington law, explaining:

As VEC notes, the definition of "political organization" in section 527 does have a broader sweep than does the definition of "[p]olitical committee" in former RCW 42.17.020(33). However, VEC fails to justify how it qualifies as a "political organization" but not a "political committee." Thus, the fact that VEC registered as a "political organization" under section 527 organi-

¹⁴¹ *Id.* at 30–31.

¹⁴² *Voters Educ. Comm. v. Pub. Disclosure Comm'n*, 166 P.3d 1174, 1178 (Wash. 2007).

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 1180; *see also* WASH. REV. CODE § 42.17.020(38) (2006).

¹⁴⁶ *Voters Educ. Comm.*, 166 P.3d at 1185.

zation is a persuasive fact that indicates that VEC was seeking the tax benefits of section 527 while disingenuously seeking to avoid the disclosure requirements of the [Fair Campaign Practices Act].¹⁴⁷

The Washington State Supreme Court understood that, while an organization's election of section 527 tax status does not definitively establish its status as a "political committee" under a given jurisdiction's laws, it does serve as strong evidence of the organization's major purpose. Having acknowledged this fact, and having rejected the claim that the state law definition of "political committee" was unconstitutionally vague, the court went on to hold that the state's "political committee" registration and reporting requirements were constitutional as applied to the 527 VEC.¹⁴⁸

IV. FEDERAL "527 REFORM ACT OF 2007" AND THE NEED FOR FEDERAL, STATE, AND LOCAL 527 LEGISLATION

The "527 Reform Act of 2007" (the "Act" or "527 Reform Act") was introduced in the U.S. House of Representatives on January 11, 2007 by Reps. Meehan, Shays, and Castle (R-Del.), and in the U.S. Senate on January 31, 2007 by Sens. McCain and Feingold.¹⁴⁹ Nearly identical legislation has been introduced in every Congress since 2004.¹⁵⁰ Unlike the state laws described in Part I, *supra*, the Act would amend the federal campaign finance law definition of "political committee" to make clear that 527 organizations active in federal elections are "political committees" subject to campaign finance law disclosure requirements, contribution amount limits and contribution source prohibitions.

Specifically, the Act would add a subpart (D) to the existing definition of "political committee" at 2 U.S.C. § 431(4) to include within that definition "any applicable 527 organization."¹⁵¹ The Act would, in turn, define the term "any applicable 527 organization" to mean any organization that "has given notice to the Secretary of the Treasury under section 527(i) of the Internal Revenue Code of 1986 that it is to be treated as an organization described in section 527 of such Code" and that is not exempt from the Act pursuant to the section entitled "Excepted Organizations."¹⁵² The Act would

¹⁴⁷ *Id.* at 1186 n.14.

¹⁴⁸ *Id.* at 1189.

¹⁴⁹ See 527 Reform Act of 2007, H.R. 420, 110th Cong. § 2(a) (2007); 527 Reform Act of 2007, S. 463, 110th Cong. § 2(a) (2007).

¹⁵⁰ See 527 Reform Act of 2004, H.R. 5127, 108th Cong. (2004); 527 Reform Act of 2004, S. 2828, 108th Cong. (2004); 527 Reform Act of 2005, H.R. 513, 109th Cong. (2005); 527 Reform Act of 2005, S. 271, 109th Cong. (2005); 527 Reform Act of 2006, S. 2511, 109th Cong. (2006).

¹⁵¹ See 527 Reform Act of 2007, H.R. 420, 110th Cong. § 2(a); 527 Reform Act of 2007, S. 463, 110th Cong. § 2(a).

¹⁵² See H.R. 420 § 2(b); S. 463 § 2(b).

then except the following organizations from this amended federal law definition of “political committee”:

- Certain 501(c) organizations required to pay tax for expenditures to influence candidate elections;
- 527 organizations that reasonably anticipate gross receipts of less than \$25,000 for the taxable year;
- State and local candidate and political party committees;¹⁵³
- State and local candidate slates that engage only in non-federal election activities;¹⁵⁴
- 527 organizations whose election or nomination activities “relate exclusively to” elections where no candidate for federal office is on the ballot, or whose activities relate exclusively to state or local ballot measures or appointments to non-elective offices;¹⁵⁵ and
- 527 organizations engaged in voter drive activities “with respect to elections in only [one] State,” that do not refer to any federal candidate, that do not involve any federal candidate controlling or materially participating in their direction or fundraising, that do not make contributions to federal candidates, and that comply with “all applicable election laws of that State, including laws related to registration and reporting requirements and contribution limitations.”¹⁵⁶

The Act includes an “exclusivity test” that would be employed to determine if an organization’s activities “related exclusively to” non-federal elections. An organization would not meet the “exclusivity” test if it makes disbursements aggregating more than \$1,000 for a public communication that promotes, supports, attacks, or opposes a federal candidate within the year preceding that candidate’s election, or engages in voter drive activity, subject to the exception described in the last bullet point above.¹⁵⁷

Finally, the Act would add a new section to the Federal Election Campaign Act establishing rules for allocation of expenses by 527 organizations that maintain both a federal “political committee” and a non-federal account.¹⁵⁸ In short, this new statutory provision would require such organizations to pay for any communications that refer to one or more federal candidates, but do not refer to any non-federal candidates, entirely with federal “hard money” (i.e., funds raised pursuant to the federal campaign finance law contribution amount limits, source prohibitions, and disclosure requirements), while other “mixed” federal election related activities (e.g., voter drive activities in connection with elections with a federal candidate on

¹⁵³ See H.R. 420 § 2(b); S. 463 § 2(b). See also I.R.C. § 527(f)(1) (2007) (requiring payment of tax by certain 501(c) organizations); I.R.C. § 527(i)(5) (2007) (excepting from the section 527 disclosure requirements certain 501(c) organizations, 527 organizations with receipts of less than \$25,000 and state and local candidate and political party committees).

¹⁵⁴ See H.R. 420 § 2(b); S. 463 § 2(b).

¹⁵⁵ See H.R. 420 § 2(b); S. 463 § 2(b).

¹⁵⁶ See H.R. 420 § 2(b); S. 463 § 2(b).

¹⁵⁷ See H.R. 420 § 2(b); S. 463 § 2(b).

¹⁵⁸ See H.R. 420 § 3; S. 463 § 3.

the ballot that refer to non-federal candidates as well as federal candidates and/or political parties; administrative expenses such as rent, utilities, and office supplies) could be paid for with a minimum of 50 percent federal “hard money.”¹⁵⁹

Unlike the recently-enacted state laws described in Part I, *supra*—which carved out new niches in state campaign finance law for 527 organizations—the federal 527 Reform Act would simply clarify that any 527 organization raising and spending funds to influence federal elections is subject to all of the federal campaign finance law “political committee” restrictions and requirements. Unfortunately, the FEC’s approach to enforcing the federal “political committee” laws lacks this degree of clarity and, consequently, may lead to ongoing illegal soft money fundraising and spending by 527 organizations that simply argue once again—after the fact—that they were unsure of what the law requires.

So we are left now with the question of whether, given the current state of campaign finance law as interpreted by the FEC, corollary state and local agencies, and the courts, there is a need for additional federal, state, and local legislation—modeled on the 527 Reform Act of 2007—addressing 527 organization political activity at the federal, state, and local levels.

Several things have certainly changed since the explosion of unregulated 527 organization activity in 2004, in my view for the better. The FEC has found many 527 organizations active in the 2004 presidential elections to have violated federal campaign finance laws by failing to register as political committees and abide by applicable restrictions. The Commission’s resolution of several 527 enforcement actions, and its assessment of approximately \$3 million in fines for federal law violations by these organizations, puts new 527 organizations on notice that the FEC will not allow their federal election influencing activities to go unexamined. Furthermore, the manner in which the FEC has resolved these enforcement actions—i.e., scrutinizing the way in which 527 organizations solicit funds and also applying the agency’s long-dormant “reasonable interpretation” express advocacy test—has made clear to future 527 organizations that the “functionally meaningless” magic words express advocacy test is not the gatekeeper to political committee status. The FEC’s recent settlement agreements with 527 organizations make it clear that the “political committee” test is broader than many thought back in 2004.

Nevertheless, the FEC’s case-by-case enforcement action approach has serious shortcomings. The fines paid by 527 organizations for massive violations of federal campaign finance laws amounted to a tiny fraction of the amounts illegally raised and spent, and the fines came more than two years after the election.¹⁶⁰ Several complaints filed against 527 organizations in

¹⁵⁹ See H.R. 420 § 3; S. 463 § 3.

¹⁶⁰ Although the fines were small by relative comparison to the amounts illegally raised and spent, the fact that the fines were among the largest ever collected by the FEC evidences

2006 remain unresolved.¹⁶¹ It is possible that 527 organizations wishing to raise and spend illegal soft money to influence the 2008 federal elections will take their chances with the FEC, viewing a fine that amounts to one or two percent of the amount illegally raised and spent as the cost of doing business. One remedy against this sort of brazen disregard for federal campaign finance laws would be an announcement by the FEC and the Department of Justice that they will seek heightened penalties for “knowing and willful” violations of the law if 527 organizations in 2008 repeat the behaviors of their predecessors.¹⁶²

Another shortcoming of the FEC’s case-by-case approach has been a general lack of the clarity that a regulation or statute would provide. It is difficult work to parse the many conciliation agreements on the subject, which currently serve as the FEC’s official guidance to the regulated community regarding the “political committee” status of 527 organizations, and the agreements themselves have no formal legal precedential value beyond the parties to the agreements.¹⁶³ Members of the “regulated community” share my general frustration with the FEC’s unwillingness to provide clear guidance in the form of a rule as to the circumstances under which a 527 organization must abide by federal campaign finance law “political committee” requirements. For these reasons, federal legislation on the topic of 527 organizations is still warranted. Similarly, to the extent states’ and local governments’ laws are equally unclear—and most if not all of them are—state and local legislation modeled on the 527 Reform Act of 2007 is also warranted.

The sentiment that a federal rule or statute would be preferable to the FEC’s case-by-case adjudication, because it would give advance notice of the standards to which 527 groups will be expected to conform, is reflected in a February 2007 press release issued by the 527 organization Progress For America Voter Fund (“PFA-VF”), which was fined \$750,000 for failing to abide by federal law “political committee” requirements. The PFA-VF press release stated:

PFA-VF was formed in 2004 and prior to any PFA-VF communications, the Federal Election Commission had refused to:

the “massive” nature of the violations. *See, e.g.*, FEC To Collect \$750,000 Civil Penalty From Progress For America Voter Fund (Feb. 28, 2007), available at <http://www.fec.gov/press/press207/20070228MUR.html> (“This represents the third largest civil penalty in the Commission’s thirty-two year history.”); *see also* FEC to Collect \$775,000 Civil Penalty From America Coming Together (Aug. 19, 2007), available at <http://www.fec.gov/press/press2007/20070829act.shtml> (“This settlement represents the third largest civil penalty in an enforcement matter in the Commission’s thirty-three year history.”).

¹⁶¹ *See, e.g.*, Complaint by Democracy21 and Campaign Legal Center against Economic Freedom Fund and Majority Action (2006), <http://www.campaignlegalcenter.org/attachments/1633.pdf>; Complaint by Democracy21 and Campaign Legal Center against The Lantern Project and Softer Voices (2006), <http://www.campaignlegalcenter.org/attachments/1639.pdf>.

¹⁶² *See* 2 U.S.C. §§ 437g(a)(5)(B), (a)(6)(C), (d)(1) (2000 & Supps. 2001–2005).

¹⁶³ *See supra* note 22.

- Clarify by advisory opinion how the newly enacted McCain-Feingold bill impacted 527 organizations (ABC PAC);
- Act upon a complaint charging the 527 groups with violating the law (Bush-Cheney '04, RNC), and
- Issue a rulemaking delineating permissible 527 activities.

The FEC's inactions left all 527 groups, including PFA-VF, to their own interpretation of the law. The FEC subsequently announced a "case by case" enforcement policy and opened investigations into violations of the very statutes for which the Commission had refused to provide guidance.¹⁶⁴

Benjamin L. Ginsburg, legal counsel not only to PFA-VF but also to 527 organization SwiftVets, another federal law violator, summed up his frustration with the FEC's case-by-case approach in the PFA-VF press release:

Today's settlement brings to close a disappointing chapter in the evolution of election law. Despite Congressional pressure to impose some set of rules or provide guidance for so called "527" groups, the FEC still refuses to do so. Given the ambiguous legal nature of this situation and the cost of litigating this dispute, PFA-VF has decided it is a more prudent use of its resources and energy to conclude this proceeding.¹⁶⁵

In the absence of willingness by the FEC to promulgate a rule on the subject, the "527 Reform Act of 2007" would make clear that organizations claiming tax exemption under section 527 of the tax code qualify as federal "political committees" if they raise and spend funds for the purpose of influencing federal elections. Appropriately, the legislation would not subject state and local organizations that do not raise and spend funds in connection with federal elections to federal campaign finance laws.

Furthermore, though state and local governments have not yet seen an explosion of unregulated political activity by 527 organizations, they would be wise to enact prophylactic measures to prevent a torrent of illegal political fundraising and spending in future elections. Just as the federal 527 Reform Act of 2007 would not apply to purely state and/or local 527 organizations, a state or local 527 law should not apply to purely federal 527 organizations. At least one early state effort to regulate 527 activity, the West Virginia statute described in Part I, *supra*, was mistakenly drafted in a manner that is overbroad, on its face subjecting federal political committees active in the state to state campaign finance laws. Care must be taken in

¹⁶⁴ PROGRESS FOR AMERICA VOTER FUND, STATEMENT ON THE ANNOUNCED SETTLEMENT WITH THE FEDERAL ELECTION COMMISSION (Feb. 28, 2007), <http://pfavoterfund.com>.

¹⁶⁵ *Id.*

drafting future state and local 527 legislation so as not to repeat the same mistake.

The general guiding principal for federal, state, and local 527 legislation should reflect the fact that section 527 tax status alone does not and cannot definitively establish “political committee” status under campaign finance law. Instead, 527 reform legislation should establish a presumption that an organization with a self-proclaimed primary purpose of influencing elections—evinced by its election of tax-exemption under section 527—can and should be regulated as a political committee in a given jurisdiction when it receives contributions and/or makes expenditures to influence that jurisdiction’s elections. Such legislation would go a long way toward answering the question I posed at the outset of this Article, by helping to define what factors determine whether a particular organization claiming tax-exempt status under section 527 of the Internal Revenue Code must register as a “political committee” pursuant to a given jurisdiction’s campaign finance laws.