

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

CHRISTOPHER SHAYS and  
MARTIN MEEHAN

Plaintiffs,

v.

FEDERAL ELECTION COMMISSION,

Defendant.

Civil Action No. 04-1597 (EGS)

**MEMORANDUM OF U.S. SENATORS JOHN McCAIN AND RUSSELL D. FEINGOLD**  
**AS AMICI CURIAE SUPPORTING PLAINTIFFS'**  
**MOTION FOR FURTHER RELIEF**

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**TABLE OF CONTENTS**

	<u>Page</u>
TABLE OF AUTHORITIES .....	ii
INTRODUCTION AND SUMMARY OF ARGUMENT .....	1
ARGUMENT .....	5
I.    For Nearly Three Years, Spanning Three Election Cycles (2004, 2006, 2008), <i>Amici</i> Have Urged the FEC to Effectively Regulate 527 Groups—to No Avail .....	5
II.   The FEC’s Lack of Clear Guidance Regarding Political Committee Status Has Frustrated <i>Amici</i> , Plaintiffs, and 527 Groups Alike .....	10
III.  The Legal Framework Upon Which the Supplemental E&J Depends is Contrary to Law, Rendering the FEC’s Supplemental E&J and Decision Not to Adopt a Rule Contrary to Law in Violation of the APA.....	11
IV.  An Organization’s Choice of Section 527 Tax Status is Relevant To, Though Not Dispositive of, the Organization’s Political Committee Status .....	15
CONCLUSION.....	20
CERTIFICATE OF SERVICE .....	22
EXHIBITS	

**TABLE OF AUTHORITIES**

**Cases:**

*Buckley v. Valeo*, 424 U.S. 1 (1976)..... *passim*

*Democratic Leadership Council Inc. (DLC) v. United States*, No. 05-1067 (D.D.C).....18

*FEC v. Massachusetts Citizens for Life*, 479 U.S. 238 (1986) .....12

*McConnell v. FEC*, 540 U.S. 93 (2003).....5, 6, 12, 14, 19

*NLRB v. Bell Aerospace Co.*, 416 U.S. 267 (1974) .....11

*Shays v. FEC*, 424 F. Supp. 2d 100 (D.D.C. 2006) .....1, 2, 4, 7, 9, 10, 11

*Trans-Pac Freight Conference of Japan/Korea v. Fed. Mar. Comm’n*, 650 F.2d 1235 (D.C. Cir. 1980) .....10

**Statutes, Legislation and Legislative History:**

2 U.S.C. § 431(4) .....1, 3, 12

2 U.S.C. § 431(8)(A).....12

2 U.S.C. § 431(9)(A).....12

2 U.S.C. § 434(c) .....14

2 U.S.C. § 437g(a)(5).....19

2 U.S.C. § 437g(d) .....19

2 U.S.C. § 441d(a) .....15

5 U.S.C. § 706(2)(A).....3, 4, 11, 15, 20

26 U.S.C. § 527.....1

26 U.S.C. § 527(e)(1).....16, 19

26 U.S.C. § 527(e)(2).....16, 18, 19

Bipartisan Campaign Reform Act of 2002 (BCRA), Pub. L. No. 107–155, 116 Stat. 81 .....5, 6, 14

Federal Election Campaign Act (FECA), codified at 2 U.S.C. §§ 431 *et seq* ..... *passim*

150 Cong. Rec. S4472 (daily ed. Apr. 28, 2004).....7

**Regulations and Agency Materials:**

11 C.F.R. § 100.5(a).....12

11 C.F.R. § 100.52(a).....12

11 C.F.R. § 100.111(a).....12

FEC Advisory Opinion 1995-11 .....20

FEC Advisory Opinion 1996-3.....20

FEC Advisory Opinion 1996-13.....20

FEC, Political Committee Status Notice of Proposed Rulemaking 2004-6, 69 Fed. Reg. 11736 (Mar. 11, 2004) .....5

FEC, Political Committee Status Supplemental Explanation and Justification, 72 Fed. Reg. 5595 (Feb. 7, 2007) .....1, 3, 5, 13, 15, 16, 17, 18

FEC Conciliation Agreement With MoveOn.org Voter Fund (Dec. 13, 2006).....9

FEC Conciliation Agreement With Swift Boat Veterans and POWs for Truth (Dec. 13, 2006) .....9

Campaign Legal Center & Democracy 21, FEC Complaint Against the Lantern Project and Softer Voices (Oct. 19, 2006) .....2, 8

Campaign Legal Center & Democracy 21, FEC Complaint Against Economic Freedom Fund and Majority Action (Oct. 12, 2006) .....2, 8

Campaign Legal Center & Democracy 21, FEC Complaint Against ACT, the Media Fund, and the Leadership Forum (Jan. 15, 2004) .....7

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Sens. McCain and Feingold and Reps. Shays and Meehan, Comments on Notice 2004–6 (Apr. 9, 2004).....5, 6, 19, 20

**Miscellaneous Sources:**

Frances R. Hill & Douglas M. Mancino, TAXATION OF EXEMPT ORGANIZATIONS (2002).....17

J. Solomon, “Casino Executive Contributes \$1 Million to Gingrich Group,” WASH. POST (Jan. 23, 2007).....8

Political Money Line Staff, “Gingrich Group Picks Up Another Million,” CQPOLITICS.COM (March 21, 2007) .....8

R. Vitale, "Brooks takes first step in possible run for Congress," COLUMBUS DISPATCH (Jan. 14, 2007).....8

W. Slater, "Big-money Texans paying to derail Clinton," DALLAS MORNING NEWS (Dec. 4, 2006) .....8

## INTRODUCTION AND SUMMARY OF ARGUMENT

Nearly two years ago, *amici* Senators McCain and Feingold filed a brief *amici curiae* with this Court in the present case, *Shays v. FEC* (“*Shays I*”), 424 F. Supp. 2d 100 (D.D.C. 2006), an action challenging the failure of the Federal Election Commission (“FEC” or “Commission”) to promulgate legally sufficient regulations to define the term “political committee,” 2 U.S.C. § 431(4), as that term is used in the Federal Election Campaign Act, Pub. L. No. 93-443, 88 Stat. 1263 (FECA), and particularly as that term applies to groups organized under section 527 of the Internal Revenue Code (IRC).<sup>1</sup> *See* 26 U.S.C. § 527. This Court held that the FEC “failed to present a reasoned explanation and justification for its decision that 527 organizations will be more effectively regulated through case-by-case adjudication rather than general rule.” *Shays II*, 424 F. Supp. 2d at 117. This Court ordered the FEC to “explain its decision [not to promulgate a rule] or institute a new rulemaking.” *Id.* at 116. More than ten months later, the Commission published in the Federal Register a Supplemental Explanation and Justification (“Supplemental E&J”) for its decision not to promulgate a rule regarding “Political Committee Status.” *See* 72 Fed. Reg. 5595 (Feb. 7, 2007).

*Amici* herein urge this Court to find once again that the Commission has “failed to present a reasoned explanation and justification for its decision that 527 organizations will be more effectively regulated through case-by-case adjudication rather than general rule.” *Shays II*, 424 F. Supp. 2d at 117. What the Commission has presented to this Court is an explanation of its fundamentally flawed case-by-case approach to determining the political committee status of 527 organizations. The problem, as we explain below, is not only that the Commission’s approach is

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<sup>1</sup> On December 12, 2004, *amici* filed an unopposed motion to participate in this case as *amici curiae* by “filing briefs and making arguments on issues before this Court.” On December 14, 2004, this Court by minute order granted *amici*’s unopposed motion to participate in this case as *amici curiae*.

inconsistent with campaign finance law, but also that the Commission’s case-by-case approach simply is not working.

This Court’s decision invalidating the original E&J relied on several findings. The Court found that the FEC had failed in its original E&J to “explain how piecemeal adjudication could be executed on a sufficiently timely basis to be effective.” *Shays II*, 424 F. Supp. 2d at 116. *Amici* submit, as explained in Section I of this brief, that the events and inaction by the agency over the past three years prove that the FEC is incapable of providing such an explanation. For the past three years, spanning three election cycles (2004, 2006, 2008), *amici* and plaintiffs have urged the FEC to effectively regulate 527 groups—to no avail. Instead, as this Court previously observed, “[c]ases arising from the 2004 campaign have languished on the Commission’s enforcement docket” for as long as 38 months, with no end in sight. *Id.* The Court’s observation rang true last year and unfortunately, still rings true today. Under such circumstances, it is no surprise that 527 groups again raised and spent millions of dollars of illegal soft money during the 2006 election cycle, and the FEC is likely to take several years to resolve complaints filed against such groups.<sup>2</sup> With the 2008 federal election cycle already underway, 527 groups are gearing up to again raise and spend illegal soft money.<sup>3</sup>

This Court also found in its earlier *Shays II* decision that the FEC had failed in its original E&J to address “whether the adjudication of individual cases that are resolved on particular facts and legal theories would be effective as a means to provide guidance to 527 groups generally.” *Shays II*, 424 F. Supp. 2d at 116. The FEC again failed in its Supplemental E&J to address whether and how its case-by-case approach to adjudication provides 527 groups with necessary

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<sup>2</sup> As detailed in Section I, below, complaints were filed with the FEC by the Campaign Legal Center and Democracy 21 in October 2006 against four 527 groups: Economic Freedom Fund, Majority Action, the Lantern Project and Softer Voices.

<sup>3</sup> Section I, below, notes the formation of several 527 groups already raising funds with the goal of influencing the 2008 congressional and presidential elections.

clear guidance. As explained in Section II of this brief, *amici* and plaintiffs are not alone in their dissatisfaction with the FEC’s case-by-case approach—indeed, 527 groups are likewise frustrated. This frustration stems directly from the FEC’s failure to provide clear guidance on this issue.

The Supplemental E&J illustrates that the FEC’s approach to determining the political committee status of 527 organizations not only fails this Court’s “sufficiently timely to be effective” and “effective means to provide guidance” requirements, but is also built on a legal framework contrary to the plain language of FECA as interpreted by the Supreme Court in *Buckley v. Valeo*, 424 U.S. 1 (1976). FECA defines “political committee” to include any group that receives “contributions” in excess of \$1,000 or makes “expenditures” in excess of \$1,000 during a calendar year. *See* 2 U.S.C. § 431(4)(A). The *Buckley* Court narrowly construed this definition of “political committee” as applicable only to groups with a “major purpose” of influencing elections and held that, while the FECA definition of “expenditure” (any payment made “for the purpose of influencing” a federal election) is sufficiently clear as applied to “major purpose” groups, the term “expenditure” must be construed narrowly as applied to individuals and non-major purpose groups to include only “express advocacy.” *See Buckley*, 424 U.S. at 79-80. The “major purpose” inquiry, therefore, must be the FEC’s threshold inquiry—as the very definition of the term “expenditure” depends on it. The FEC incorrectly reverses these critical steps, fundamentally undermining the effectiveness of FECA “political committee” restrictions and requirements. *See, e.g.*, Supplemental E&J, 72 Fed. Reg. at 5597. Section III of this brief explains precisely how the FEC’s legal framework for case-by-case adjudication is contrary to law, rendering the Supplemental E&J contrary to law in violation of the Administrative Procedures Act (APA). *See* 5 U.S.C. § 706(2)(A).



Finally, Section IV of this brief explains how an organization’s choice of tax status is relevant to making a determination of such organization’s political committee status—a connection and relevance flatly denied by the Commission in its Supplemental E&J. In an effort to explain and justify its position, the Commission misconstrues plaintiffs’ and *amici*’s arguments. Whereas *amici* and plaintiffs have long argued that an organization’s choice of section 527 tax status is one means of establishing the organization’s “major purpose” as influencing elections, the FEC in Section B of its Supplemental E&J misconstrues this as an argument that an organization’s section 527 tax status alone establishes the organization’s political committee status. In other words, the Commission sets up a straw man and then promptly knocks it down; but knocking down a straw man is not a substitute for reasoned explanation and justification.

For the foregoing reasons, the Commission’s Supplemental E&J as well as its case-by-case adjudication approach itself is arbitrary, capricious, an abuse of discretion, and not in accordance with FECA as interpreted by the Supreme Court in *Buckley*. On these grounds, *amici* support plaintiffs’ motion for further relief and urge this Court to hold unlawful the Commission’s actions pursuant to the APA. *See* 5 U.S.C. § 706(2)(A). Further, though this Court in its March 2006 decision refrained from ordering the FEC to promulgate a rule regarding the political committee status of 527 organizations—noting that such a remedy is reserved for “only the rarest and most compelling of circumstances”—*amici* submit that such circumstances are now present. *See Shays II*, 424 F. Supp. 2d at 116. The FEC has again failed to adequately explain and justify its unwillingness to adopt a rule. Under such compelling circumstances, the Commission should now be ordered by this Court to adopt such a rule consistent with the legal framework set forth herein.

## ARGUMENT

### **I. For Nearly Three Years, Spanning Three Election Cycles (2004, 2006, 2008), Amici Have Urged the FEC to Effectively Regulate 527 Groups—to No Avail.**

On April 9, 2004, *amici* Senators McCain and Feingold filed comments with the FEC in the “Political Committee Status” rulemaking initiated by Notice of Proposed Rulemaking (“NPRM”) 2004-6, 69 Fed. Reg. 11736 (Mar. 11, 2004). *See* Sens. McCain and Feingold and Reps. Shays and Meehan, Comments on Notice 2004–6 (Apr. 9, 2004) (EX 1); *see also* NPRM 2004-6, 69 Fed. Reg. 11763 (Mar. 11, 2004).<sup>4</sup> *Amici* 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.<sup>5</sup> 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.

Comments on Notice 2004-6 at 1 (footnote inserted).

The FEC makes much ado in its Supplemental E&J about the fact that Congress through enactment of BCRA made no amendment to the FECA definition of “political committee”—implying that Congressional inaction constitutes approval of the Commission’s unwillingness to adopt a rule making clear when 527 organizations must register as federal political committees. *See* Supplemental E&J, 72 Fed. Reg. at 5600-01. This is a red herring. *Amici*, the principal Senate sponsors of BCRA, made clear in their 2004 comments to the FEC that BCRA had nothing to do with political committee status. *Amici* have long held the belief FECA’s definition of “political committee,” enacted in 1974, is in no need of amending in order to effectuate the

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<sup>4</sup> Available at [http://www.fec.gov/pdf/nprm/political\\_comm\\_status/04-5290.pdf](http://www.fec.gov/pdf/nprm/political_comm_status/04-5290.pdf).

<sup>5</sup> Bipartisan Campaign Reform Act of 2002 (BCRA), Pub. L. No. 107–155, 116 Stat. 81.

FEC's regulation of 527 organizations raising and spending funds to influence federal elections as federal political committees. *Amici* 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.

Comments on Notice 2004-6 at 1-2. Put differently, the fact that Congress in 2002 did not amend FECA's 1974 definition of "political committee" that was in no need of amending is of no relevance to the Commission's obligation to effectively enforce that definition.

Shortly after *amici* 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 matter, 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 the presidential election while the FEC sits on its hands once again.

150 Cong. Rec. S4472 (daily ed. Apr. 28, 2004) (statement of Sen. McCain) (EX 2).

Despite *amici's* admonitions, which began three years ago and continue today, the Commission has still not met its responsibility to enforce FECA of 1974 by issuing a rule that would effectuate federal election laws with respect to 527 organizations. As a result of the Commission's failure, there is no clear guidance to the regulated community, and 527 organizations continued to violate federal campaign finance laws during the 2004 and 2006 election cycles, and are gearing up for the 2008 election cycle that has already begun.

*Amici's* earlier brief filed with this Court in July 2005 detailed the illegal soft money fundraising and spending by 527 organizations to influence the 2004 presidential race. This Court aptly observed in March 2006 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.” *Shays II*, 424 F. Supp. 2d at 116. The Court further noted: “The FEC can take years to complete an administrative action, and penalties, if they come at all, come long after the money has been spent and the election decided.” *Id.* Unfortunately, not much has changed since the Court made this observation. Complaints about 527 groups from 2004 continue to languish on the Commission’s enforcement docket. For example, complaints filed on January 15, 2004, against America Coming Together (ACT), the leading 527 spender in 2004 (\$78 million), and against the Media Fund, the third largest 527 spender in 2004 (\$57 million), have been languishing on the Commission’s enforcement docket for more than 38 months and remain unresolved.<sup>6</sup>

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<sup>6</sup> The joint complaint filed against ACT, the Media Fund, and the Leadership Forum is available on the Campaign Legal Center Web site at: <http://www.campaignlegalcenter.org/attachments/994.pdf>.

In the face of FEC inaction, soft money fundraising and spending by 527 groups to influence federal elections continued unabated through the 2006 election cycle. Complaints were filed with the FEC in October 2006 against the pro-Republican 527 groups Economic Freedom Fund and Softer Voices, and against the pro-Democratic 527 groups Majority Action and the Lantern Project, alleging that these groups spent millions of dollars of soft money to influence the 2006 Congressional elections.<sup>7</sup>

The 2008 election campaigns are now underway—and still no clear guidance or rulemaking has emerged from the FEC regarding the political committee status of 527 groups. In this climate of lax enforcement of federal campaign finance laws, the founder of one new 527 group called “Stop Her Now” expects “to raise millions of dollars, a lot of it from online people and a lot of it from wealthy, conservative donors from around the country that want to keep Hillary Clinton from being elected President”; and he plans to solicit the donors who bankrolled Swift Boat Veterans for his anti-Clinton 527 efforts.<sup>8</sup> Meanwhile, a 527 organization recently founded by prospective 2008 presidential candidate Newt Gingrich has raised more than \$2 million since November 2006, including \$1 million contributions from real estate developer Fred Godley and gaming executive Sheldon Adelson.<sup>9</sup> Similarly, a prospective 2008 congressional candidate in Ohio has formed a 527 organization to explore and support her candidacy, and may also use the 527 organization to “raise money to support Democratic Presidential candidates.”<sup>10</sup>

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<sup>7</sup> The joint complaint filed against Economic Freedom Fund and Majority Action is available on the Campaign Legal Center Web site at: <http://www.campaignlegalcenter.org/attachments/1633.pdf>. The joint complaint filed against the Lantern Project and Softer Voices is available on the Campaign Legal Center Web site at: <http://www.campaignlegalcenter.org/attachments/1639.pdf>.

<sup>8</sup> W. Slater, “Big-money Texans paying to derail Clinton,” DALLAS MORNING NEWS (Dec. 4, 2006).

<sup>9</sup> See Political Money Line Staff, “Gingrich Group Picks Up Another Million,” CQPOLITICS.COM (March 21, 2007); see also J. Solomon, “Casino Executive Contributes \$1 Million to Gingrich Group,” WASH. POST (Jan. 23, 2007).

<sup>10</sup> R. Vitale, “Brooks takes first step in possible run for Congress,” COLUMBUS DISPATCH (Jan. 14, 2007).

In short, it seems likely that illegal fundraising and spending by 527 organizations to influence federal elections will occur once again in the 2008 election cycle.

The FEC will likely respond that it has in recent months entered conciliation agreements with several 527 groups that illegally raised and spent soft money to influence the 2004 federal elections. But true to this Court's observation that the "FEC can take years to complete an administrative action, and penalties, if they come at all, come long after the money has been spent and the election decided[.]" *Shays II*, 424 F. Supp. 2d at 116, the Commission took years to resolve the complaints and the fines paid by the 527 groups were a tiny percentage of the funds illegally raised and spent by the groups in 2004. Swift Boat Veterans and POWs for Truth, for example, raised more than \$25 million in illegal soft money in 2004 and paid a fine of \$299,500—roughly 1% of funds raised.<sup>11</sup> Similarly, the 527 organization MoveOn.org Voter Fund spent \$21 million during the 2004 election cycle and paid a fine of \$150,000—less than 1% of funds spent.<sup>12</sup> It is hard to imagine that these relatively small penalties, coming more than two years after the 2004 election, will have a significant deterrent effect on future 527 organization activity. They are simply examples of "too little too late."

For nearly three years, spanning three election cycles (2004, 2006, 2008), *amici* have urged the FEC to effectively regulate 527 groups—to no avail. Under such compelling circumstances, this Court should order the Commission to promulgate a 527 group political committee status rule.

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<sup>11</sup> The conciliation agreement entered by Swift Boat Veterans and POWs for Truth and the FEC is available on the Commission's Web site at: <http://eqs.sdrdc.com/eqsdocs/00005900.pdf>.

<sup>12</sup> The conciliation agreement entered by MoveOn.org Voter Fund and the FEC is available on the Commission's Web site at: <http://eqs.sdrdc.com/eqsdocs/000058F4.pdf>.

## II. The FEC's Lack of Clear Guidance Regarding Political Committee Status Has Frustrated *Amici*, Plaintiffs, and 527 Groups Alike.

This Court in its March 2006 decision criticized the Commission's failure to discuss in its original E&J "whether the adjudication of individual cases that are resolved on particular facts and legal theories would be effective as a means to provide guidance to 527 groups generally." *Shays II*, 424 F. Supp. 2d at 116. The Court reasoned:

Rule-making is an essential component of the administrative process and indeed is often the preferred procedure for the evolution of agency policies. Rule-making permits more precise definition of statutory standards than would otherwise arise through protracted, piecemeal litigation of particular issues. It allows all those who may be affected by a rule an opportunity to participate in the deliberative process, while adjudicatory proceedings normally afford no such protection to nonparties. And because rule-making is prospective in operation and general in scope, rather than retroactive and condemnatory in effect, interested parties are given advance notice of the standards to which they will be expected to conform in the future, and uniformity of result is achieved.

*Id.* at 113-14 (emphasis added) (quoting *Trans-Pac Freight Conference of Japan/Korea v. Fed. Mar. Comm'n*, 650 F.2d 1235, 1244-45 (D.C. Cir. 1980)).

This sentiment—that rulemaking is preferable to case-by-case adjudication because it gives advance notice of the standards to which 527 groups will be expected to conform—is clearly reflected in a February 2007 press release issued by the 527 organization Progress For America Voter Fund (PFA-VF), which was recently fined \$750,000 for failing to abide by federal law "political committee" requirements. The PFA-VF press release states:

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

- 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.

Progress for America Voter Fund Statement on the Announced Settlement with the Federal Election Commission (Feb. 28, 2007) (EX 3).

Benjamin L. Ginsburg, legal counsel not only to PFA-VF but also to 527 organization Swift Boat Veterans and POWs for Truth, 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.

*Id.* Thus, those in the regulated community share *amici's* and plaintiffs' frustration with the Commission'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. This Court has recognized that "[i]t is possible ... that an agency's reliance on adjudication can amount to an abuse of discretion." *Shays II*, 424 F. Supp. 2d at 113 (citing *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974)). That day has arrived. The FEC's reliance on case-by-case adjudication with respect to 527 group political committee status clearly amounts to just such an abuse of discretion in violation of the APA, and warrants an order by this Court directing the FEC to promulgate a 527 rule. *See* 5 U.S.C. § 706(2)(A).

### **III. The Legal Framework Upon Which the Supplemental E&J Depends is Contrary to Law, Rendering the FEC's Supplemental E&J and Decision Not to Adopt a Rule Contrary to Law in Violation of the APA.**

The Commission's Supplemental E&J demonstrates that the Commission's approach to determining the political committee status of 527 organizations is built on a legal framework contrary to the plain language of FECA as interpreted by the Supreme Court in *Buckley v. Valeo*,



424 U.S. 1 (1976). FECA defines “political committee” to mean “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 U.S.C. § 431(4); *see also* 11 C.F.R. § 100.5(a). A “contribution,” in turn, is defined as “any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office....” 2 U.S.C. § 431(8)(A) (emphasis added); *see also* 11 C.F.R. § 100.52(a). And an “expenditure” is defined as “any purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value, made by any person for the purpose of influencing any election for Federal office....” 2 U.S.C. § 431(9)(A) (emphasis added); *see also* 11 C.F.R. § 100.111(a).

In *Buckley*, the Court construed the term “political committee” to “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.” *Buckley*, 424 U.S. at 79 (emphasis added).<sup>13</sup> Thus, under FECA as interpreted by the *Buckley* Court, two types of organizations can be regulated as “political committees”—candidate-controlled organizations and so-called “major purpose” groups (*i.e.*, groups that have a “major purpose” of influencing the nomination or election of a candidate).

The *Buckley* Court analyzed the constitutionality not only of the FECA definition of “political committee,” but also of the underlying term “expenditure.” In doing so, the *Buckley* Court made a distinction critical to the effective enforcement of FECA’s “political committee”

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<sup>13</sup> In *FEC v. Massachusetts Citizens for Life (MCFL)*, 479 U.S. 238 (1986), the Court again invoked the “major purpose” test and noted that if a group’s independent spending activities “become so extensive that the organization’s major purpose may be regarded as campaign activity, the corporation would be classified as a political committee.” *MCFL*, 479 U.S. at 262 (emphasis added). In that instance, the Court said the group would become subject to the “obligations and restrictions applicable to those groups whose primary objective is to influence political campaigns.” *Id.* (emphasis added). The Court in *McConnell* restated the “major purpose” test for political committee status as iterated in *Buckley*. *McConnell*, 540 U.S. at 170 n.64.

restrictions and requirements. With respect to candidates and “major purpose” groups, the *Buckley* Court held that the FECA definition of “expenditure” (any payment made “for the purpose of influencing” a federal election) is sufficiently clear and constitutional (*i.e.*, not unconstitutionally vague). Candidates and “major purpose” groups, the Court reasoned, are not vulnerable to concerns of vagueness in drawing a line between issue discussion and electioneering activities because their activities “can be assumed to fall within the core area sought to be addressed by Congress. They are, by definition, campaign related.” *Id.* at 79. Contrary to FEC assertions in the Supplemental E&J, 72 Fed. Reg. at 5597, the *Buckley* Court held that FECA’s “for the purpose of influencing” definition of “expenditure” raises no constitutional vagueness concerns—and is in no need of a narrowing “express advocacy” construction—with respect candidates and groups with a “major purpose” of influencing elections, because money spent by these entities is, by definition, campaign related.

By contrast, the Court developed and applied the “express advocacy” test only to spenders other than candidates and “major purpose” groups, reasoning:

But when the maker of the expenditure is not within these categories—when it is an individual other than a candidate or a group other than a “political committee”—the relation of the information sought to the purposes of the Act may be too remote. To insure that the reach of [the disclosure provision] is not impermissibly broad, we construe “expenditure” for purposes of that section in the same way we construed the terms of [the spending limit]—to reach only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate.

*Buckley*, 424 U.S. at 79–80 (emphasis added).

Thus, the Court in *Buckley* made a crucial distinction: when the spender is a candidate or an organization with a “major purpose” to influence candidate elections, the statutory definition of “expenditure” as spending “for the purpose of influencing” a federal election is sufficiently clear to be facially constitutional, because such organizations “are, by definition, campaign

related” and their spending “can be assumed” to fall within the area properly regulated by Congress. Therefore, there is no need for an “express advocacy” limitation on the definition of “expenditure” in order to save the term from vagueness. The “express advocacy” standard is irrelevant to the determination of whether a “major purpose” group is a “political committee” under FECA. Instead, any group with a “major purpose” of influencing elections that spends more than \$1,000 “for the purpose of influencing” a federal election is a “political committee” under FECA.<sup>14</sup> The Court affirmed this analysis in *McConnell*, where it cited and quoted the same language from *Buckley* in rejecting a vagueness challenge to the “promote, support, attack or oppose” standard in BCRA as applied to political party committees. *McConnell*, 540 U.S. at 170 n.64.

The “major purpose” inquiry must, therefore, be the first step in the Commission’s political committee status analysis—because the very definition of “expenditure” under FECA depends on a group’s “major purpose.” Only after determining that a group has a “major purpose” of influencing elections should the Commission proceed with the second step of the political committee status inquiry: determining whether the group has received more than \$1,000 or made payments exceeding \$1,000 for the purpose of influencing a federal election (*i.e.*, received “contributions” or made “expenditures”). If the group does not have a “major purpose” of influencing elections, then the Commission may only proceed to examine the lawfulness of its campaign finance activities pursuant to the narrower “express advocacy” standard in order to determine compliance with other provisions of FECA, such as independent expenditure reporting requirements,<sup>15</sup> disclaimer requirements,<sup>16</sup> and the like.

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<sup>14</sup> By contrast, when the spender is any other kind of organization—any organization which does *not* have a “major purpose” of influencing elections—then a narrowing construction of “expenditure” is required in order to avoid constitutional problems of vagueness.

<sup>15</sup> *See* 2 U.S.C. § 434(c).

However, as explained in the Supplemental E&J, the Commission’s current analysis of political committee status incorrectly reverses these critical steps—and incorrectly construes “expenditure” to include only payments for “express advocacy” by “major purpose” groups. *See, e.g.*, Supplemental E&J, 72 Fed. Reg. at 5597. Only where the Commission determines that a 527 organization has made more than \$1,000 in express advocacy “expenditures,” or received more than \$1,000 in “contributions” during a calendar year will the Commission proceed to examine the organization’s “major purpose” in order to determine its political committee status. Because the Supplemental E&J makes clear that the Commission’s miss-ordering of these steps and misapplication of an “express advocacy” standard for determining an organization’s political committee status contributed significantly to its explanation of reasons for not promulgating a rule on the political committee status of 527 organizations, its decision not to promulgate a rule is arbitrary, capricious and contrary to law in violation of the APA. *See* 5 U.S.C. § 706(2)(A).

**IV. An Organization’s Choice of Section 527 Tax Status is Relevant To, Though Not Dispositive of, the Organization’s Political Committee Status.**

The Commission in its Supplemental E&J flatly denies the relevance of an organization’s choice of tax status to the determination of such organization’s political committee status. In an effort to explain and justify this denial, the Commission misconstrues plaintiffs’ and *amici’s* arguments regarding the relevance of an organization’s section 527 tax status to the political committee status inquiry. *Amici* and plaintiffs have long argued that an organization’s choice of 527 tax status is one means of establishing the organization’s “major purpose” as influencing elections—with the “major purpose” inquiry constituting only the first step of a two-step process; the second step being the determination of whether the group has received “contributions” or made “expenditures” exceeding \$1,000. The FEC misconstrues this

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<sup>16</sup> *See* 2 U.S.C. § 441d(a).

argument, characterizing it as an assertion that an organization's section 527 tax status alone establishes the organization's political committee status. The heading of Supplemental E&J Section B, for example, reads: "Section 527 Tax Status Does Not Determine Whether an Organization Is a Political Committee Under FECA." 72 Fed. Reg. at 5597. In an attempt to refute the relevance of an organization's section 527 status, Section B begins by noting the obvious: "An organization's election of section 527 tax status is not sufficient evidence in itself that the organization satisfies FECA and the Supreme Court's contribution, expenditure, and major purpose requirements." 72 Fed. Reg. at 5597-98. Of course, an organization's choice of section 527 tax status is not dispositive of its political committee status; but it is strong evidence of that organization's "major purpose." The Commission's rhetorical ploy amounts to no more than setting up and knocking down a straw man.

Section 527 of the tax code provides tax exempt treatment for "exempt function" income received by any "political organization." The statute defines "political organization" to mean a "party, committee, association, fund, or other organization ... organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function." 26 U.S.C. § 527(e)(1) (emphasis added). An "exempt function," in turn, is defined to mean 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...." 26 U.S.C. § 527(e)(2) (emphasis added).

Organizations that self-identify as "political organizations" under section 527 have the self-proclaimed major purpose of influencing the selection, nomination, election, or appointment of individuals to public office—not issue advocacy, not lobbying, etc. To be clear, 527

organizations that do not raise and spend money to influence federal elections are not federal “political committees” under FECA. The Commission notes this obvious fact in the Supplemental E&J, stating:

All federal political committees registered with the FEC are 527 organizations. ... So is every candidate’s campaign committee right down to school board and dogcatcher. Thus, virtually all political committees are 527 organizations. It does not necessarily follow that all 527 organizations are or should be registered as political committees.

72 Fed. Reg. at 5598 (internal quotation marks omitted). However, those 527 “major purpose” organizations that do raise and spend funds to influence federal elections are federal “political committees” under FECA; and those that raise and spend funds to influence a particular state or local jurisdiction’s elections likely fall within the scope of that jurisdiction’s “political committee” campaign finance laws. Thus, an organization’s choice of section 527 tax status, while not dispositive, is directly relevant to determining whether or not the organization’s “major purpose” is influencing elections—the first step in determining whether an organization is a “political committee” under FECA.

As explained by tax law scholar Prof. Frances R. Hill, co-author of the legal textbook *Taxation of Exempt Organizations*,<sup>17</sup> in comments filed in the FEC’s 2004 “Political Committee Status” rulemaking:

The case for treating section 527 organizations as political committees is straightforward. Organizations that seek to avail themselves of the benefit and subsidy provided by tax exemption under section 527 must be engaged exclusively in activities intended to influence the outcome of elections. The intention is not a subjective intent based on self-serving attestations but is a demonstrable nexus between the organization’s expenditures and the influencing elections.

This does not mean that tax law compels the result under election law. Rather, it means that the type of activities that sustain exemption will also support treatment of the entity as a political committee under the FECA. The two statutes are not

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<sup>17</sup> FRANCES R. HILL & DOUGLAS M. MANCINO, *TAXATION OF EXEMPT ORGANIZATIONS* (2002).

perfectly congruent. Section 527 treats confirmation of judges as qualifying activity, while the FECA does not cover confirmation processes. But, every activity that defines a political committee is part of the exempt function definition under section 527(e)(2).

Frances R. Hill, Comments on Notice 2004–6, 7-8 (Apr. 9, 2004) (emphasis added) (EX 4).

The Commission also unreasonably implies in its Supplemental E&J that promulgating a rule regarding the relevance of section 527 tax status to political committee status would somehow inhibit the Commission from determining that other organizations, without section 527 tax status, also meet the federal law definition of “political committee.” In this vain, the Commission once again erects its straw man, stating:

The Commission has demonstrated through the finding of political committee status for a 501(c)(4) organization and the dismissal of a complaint against a 527 organization, that tax status did not establish whether an organization was required to register with the FEC. Rather, the Commission’s findings were based on a detailed examination of each organization’s contributions, expenditures, and major purpose....

72 Fed. Reg. at 5599. Of course, nothing precludes the Commission from looking beyond section 527 organizations to determine if a different type of group has violated federal law by failing to register as a “political committee.” Although it is clear that “[i]n no case is influencing the outcome of a federal election an exempt purpose under any subsection of section 501(c)” of the tax code, Frances R. Hill Comments on Notice 2004–6 at 6-7, organizations do occasionally violate their tax exempt status by engaging in prohibited conduct.<sup>18</sup> Indeed, it is likely that the 501(c)(4) organization that the Commission recently found to be a federal political committee was operating in violation of its tax status.

However, an FEC regulation making clear that any 527 group raising or spending more than \$1,000 in a year for the purpose of influencing federal elections is a federal political

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<sup>18</sup> See, e.g., *Democratic Leadership Council Inc. (DLC) v. United States*, No. 05-1067 (D.D.C) (cross-motions for summary judgment pending, argument scheduled for Apr. 23, 2007) (DLC challenge to the Internal Revenue Service’s revocation of its section 501(c)(4) tax status for impermissible level of political campaign activity).

committee would provide the public with much-needed guidance, and would likely have a prophylactic effect against violations of FECA—thereby eliminating many multi-year, resource-intensive enforcement actions. Furthermore, clear guidance by rule would enable the FEC to more easily identify knowing and willful violations of the law and, as a result, exact more severe penalties likely to serve as more effective deterrents than recent fines assessed by the Commission. *See* 2 U.S.C. §§ 437g(a)(5) and 437g(d).

The Supreme Court in *McConnell* explicitly recognized that section 527 groups have a major purpose of influencing elections—and that law-abiding 501(c) groups do not. The Court stated: “Section 527 ‘political organizations’ are, unlike § 501(c) groups, organized for the express purpose of engaging in partisan political activity.” *McConnell*, 540 U.S. at 174 n.67. The Court noted that 527 groups “by definition engage in partisan political activity.” *Id.* at 177.

Similarly, *amici* explained in their 2004 rulemaking comments to the FEC that an organization’s tax status is a relevant and useful tool for determining the organization’s “major purpose” and, consequently, “political committee status,” provided that such organization is in compliance with its tax status.

527 organizations by definition have the primary purpose of influencing elections. *See* 26 U.S.C. § 527(e). That is the basic characteristic of tax-exempt political organizations that distinguishes them from other entities, including other tax-exempt groups. ... Groups that claim tax exemption because their primary purpose is to influence elections should be required to register as political committees unless their activities are entirely directed at state and local elections.

Comments on Notice 2004-6 at 2 (internal citation omitted) (EX 1). *Amici* continued:

The Supreme Court made it plain in *Buckley v. Valeo*, 424 U.S. 1 (1976), that the FECA must be narrowly interpreted with respect to 501(c) organizations and other groups that do not have as their major purpose the influencing of elections. *See Buckley*, 424 U.S. at 42-44 & n.52. That is why the term “expenditure” has a different meaning in the federal election laws depending on what entity is doing the spending. The *Buckley* [C]ourt did not apply the “express advocacy” test to political parties or other political committees. *See Buckley*, 424 U.S. at 79. It is wholly appropriate for the Commission to undertake in this rulemaking to



regulate 527s, whose major purpose *is* to influence elections, but not 501(c) organizations, whose major purpose, under the laws, must be something other than influencing elections.

Comments on Notice 2004-6 at 2-3 (emphasis added) (EX 1).

By definition, any entity that claims tax exemption as a “political organization” under section 527 is “organized and operated primarily” for the purpose of “influencing or attempting to influence the selection, nomination, election or appointment of” an individual to public office. Despite its denial of the relevance of section 527 tax status in its Supplemental E&J, the Commission itself has previously cited the section 527 standard as identical to the “major purpose” prong of the test for “political committee” status, which only further confuses the regulated community’s understanding of applicable standards. *See, e.g.*, FEC Advisory Opinions 1996-13, 1996-3, 1995-11. Accordingly, any group that chooses to register as a “political organization” under section 527 is by definition an entity “the major purpose of which is the nomination or election of a candidate....” An organization’s choice of section 527 tax status, therefore, is directly relevant to, though not dispositive of, the organization’s political committee status under FECA. The Commission’s refusal to promulgate a rule that makes clear—or to even so much as acknowledge in its Supplemental E&J—the relevance of section 527 tax status is an indication that the FEC has acted in a manner that is arbitrary, capricious, and an abuse of discretion in violation of the APA. *See* 5 U.S.C. § 706(2)(A).

### **CONCLUSION**

For the foregoing reasons, the Commission’s Supplemental E&J as well as its case-by-case adjudication approach itself is arbitrary, capricious, an abuse of discretion, and not in accordance with FECA as interpreted by the Supreme Court in *Buckley*. On these grounds, the Court should grant plaintiffs’ motion for further relief and order the FEC to adopt a political committee status rule consistent with the legal framework set forth by *amici* herein.

Respectfully submitted,

/s/ J. Gerald Hebert

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(D.C. Bar No. 447676)

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Senators John McCain and Russ Feingold

**Dated: April 3, 2007**

**CERTIFICATE OF SERVICE**

I hereby certify that on this 3rd day of April, 2007, I served a copy of the foregoing Memorandum of *Amici Curiae* U.S. Senators John McCain and Russell Feingold Supporting Plaintiffs Motion for Further Relief on the following counsel by placing a copy in the court's electronic case files.

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/s/ J. Gerald Hebert  
J. Gerald Hebert

# **EXHIBIT 1**



"Schiff, Bob (Judiciary)" <Bob\_Schiff@judiciary-dem.senate.gov> on 04/09/2004  
03:26:01 PM

To: politicalcommitteestatus@fec.gov  
cc: mdinh@fec.gov, "Schiff, Bob (Judiciary)" <Bob\_Schiff@judiciary-dem.senate.gov>  
Subject: Notice 2004-6

Dear Ms. Dinh:

Attached are the comments of Senators John McCain and Russell D. Feingold and Representatives Christopher Shays and Marty Meehan on Notice 2004-6. If you have any questions, please contact me at 202-224-8059. Thank you for your attention.

Bob Schiff

Chief Counsel

Sen. Feingold



. comments-final.doc

April 9, 2004

**VIA FAX and E-MAIL**

Ms. Mai T. Dinh  
Acting Assistant General Counsel  
Federal Election Commission  
Washington, DC 204630

Re: Notice 2004-6

Dear Ms. Dinh:

We appreciate the opportunity to comment in response to the Commission's Notice of Proposed Rulemaking on the definition of "political committee," issued as Notice 2004-6, and published in the Federal Register on March 11, 2004, at 69 Fed. Reg. 11736.

As the primary congressional sponsors of the Bipartisan Campaign Reform Act of 2002 ("BCRA"), which was signed by President Bush on March 27, 2002, and upheld by the Supreme Court in *McConnell v. FEC*, 124 S. Ct. 619 (2003), we have a keen interest in the implementation and enforcement of the federal election laws. We believe that 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. The Supreme Court agrees. *See McConnell*, slip op. at 32-33 & n. 44, 35-36. 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.

While our interest in this proceeding stems from our long involvement in the enactment of BCRA, the legal issues that the Commission must address do not. 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 by the political parties and federal candidates, and with phony issue ads run by any organization in close proximity to an election. That does not mean, however, that 527s are free to operate without restrictions. BCRA is not the only law that Congress has passed to address the financing of federal election campaigns. 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.

### **527 Organizations as Political Committees**

527 organizations by definition have the primary purpose of influencing elections. *See* 26 U.S.C. § 527(e). That is the basic characteristic of tax-exempt political organizations that distinguishes them from other entities, including other tax-exempt groups. The Commission's pre-BCRA approach permitted certain 527s active in federal elections not to register as federal political committees if they did not engage in express advocacy. In light of the *McConnell* court's holding that the express advocacy test is not constitutionally mandated, and indeed is "functionally meaningless," that approach was clearly wrong. *See McConnell*, slip op. at 62 n.64, 84, 86.

Groups that claim a tax exemption because their primary purpose is to influence elections should be required to register as political committees unless their activities are entirely directed at state and local elections. 527s should be subject to the same rules that all other political committees are bound by, the rules that Congress has enacted to protect the integrity of our political process. They should be required to raise and spend money that complies with federal contribution limits and source prohibitions for ads they run that promote or attack federal candidates. In addition, like other political committees, a reasonable portion of their spending on partisan voter mobilization activities that are intended to influence federal elections should come from federal funds.

### **Regulation of 501(c) Organizations**

The Supreme Court made it plain in *Buckley v. Valeo*, 424 U.S. 1 (1976), that the FECA must be narrowly interpreted with respect to 501(c) organizations and other groups that do not have as their major purpose the influencing of elections. *See Buckley*, 424 U.S. at 42-44 & n.52. That is why the term "expenditure" has a different meaning in the federal election laws depending on what entity is doing the spending. The *Buckley* court did not apply the "express advocacy" test to political parties or other political committees. *See Buckley*, 424 U.S. at 79. It is wholly appropriate for the Commission to undertake in this rulemaking to regulate 527s, whose major purpose *is* to influence elections, but



not 501(c) organizations, whose major purpose, under the tax laws, must be something other than influencing elections.

It is very unfortunate that this NPRM included proposals that would cover a wide variety of 501(c) organizations, and also corporations and unions. In light of *Buckley* and *McConnell*, we cannot imagine that the Commission would adopt a proposal that would apply the “promote, support, attack, or oppose” test to 501(c) organizations or would require any organization that spends \$50,000 or more on voter registration activities within four months of an election, regardless of the rest of its activities, to register as a political committee under FECA. It was irresponsible for the Commission to put such an absurd and patently unconstitutional test on the table for comment.

We want to be very clear. We oppose the proposals for regulation of 501(c) organizations contained in the Commission's Notice. The Commission should instead focus on deciding when a 527 is required to register as a political committee. This is an important test for the Commission in the post-BCRA world.

### **Allocation Rules**

The Commission must also revise the allocation formulas applicable to organizations that engage in partisan voter mobilization activities. Commission regulations already make clear that any organization engaging in such activities must register as a political committee. But they also allow the allocation of expenses between federal and nonfederal accounts. *See* 11 CFR 106.6(c).

The formulas for that allocation, however, allow for absurd results. In particular, political organizations that aim to influence federal elections through targeted, partisan voter drives can exploit those formulas to use almost exclusively soft money to finance their activities. It is just this kind of result that brings public scorn on the election laws and on the agency sworn to uphold them. The Commission must revise its allocation rules to require a significant minimum hard money share for spending on voter mobilization in a federal election year.

### **Conclusion**

We believe that the Commission improperly applied the law to 527 organizations in previous election cycles. Those errors are now magnified because BCRA's restrictions on state and federal political party committees have increased the prominence of the 527s' fundraising and campaign activities. The Commission's responsibility to clarify and properly enforce the federal election laws with respect to 527 organizations is clear. We believe that the Commission must address now the two key issues identified in these comments. To do nothing

would be to bless a loophole that will have grave consequences for the efficacy of both BCRA and FECA and again leave the public with the impression that the election laws can be treated with disdain without any consequence. This result, coming so soon after Congress closed the last loophole created by the Commission, would be most unfortunate.

Thank you for your consideration of these comments.

Sincerely,

\_\_\_\_\_/s/\_\_\_\_\_  
John McCain  
United States Senate

\_\_\_\_\_/s/\_\_\_\_\_  
Christopher Shays  
Member of Congress

\_\_\_\_\_/s/\_\_\_\_\_  
Russell D. Feingold  
United States Senate

\_\_\_\_\_/s/\_\_\_\_\_  
Marty Meehan  
Member of Congress

# **EXHIBIT 2**

Mr. President, 300 Republicans stood over on the steps of the Capitol in late September 1994 and said: No money, no mandates. If we break our promise, throw us out.

I thought we were the party on this side of the aisle of no Federal unfunded mandates. That was a big movement back then. Everybody got fired up about it. I heard it. I was running around the country trying to offer myself for higher office, which the people rejected. I know the great Contract with America was no more unfunded mandates. I remember Senator Dole saying when he was majority leader the first act on the part of the Senate was no more unfunded mandates. In fact, this unfunded mandate might be so large that according to CBO's letter to us, they cannot calculate how much it will be, although they know it is enough to make it an unfunded Federal mandate.

Why would we do that? Why don't we do what Texas did? Texas did a very direct thing. They said the first \$25 you pay every month is exempt from State and local taxes. It could be \$30, it could be \$35, it could be \$40. Then we won't have any argument about definition. We would not have to worry about whether we were subsidizing companies instead of consumers, and we would actually be giving a benefit to the individual American—maybe there will be 100 million of them 1 day—who subscribe to high-speed Internet access, and we say no State and local taxes at all, none on you.

The States have asked us to do that, and we have not done it. I don't know why. That also is an unfunded mandate, but it is not much money. The way we are doing it is a lot of money. It is at least hundreds of millions of State dollars a year, and the way this latest bill is written, it could be billions a year of State and local revenues.

I thought the National Governors Association letter was thoughtful and respectful and acknowledged the hard work all sides have done on this issue. That is why it is such a hard issue, maybe, because it ought to be easy. It ought to be a small amount of money and a fairly simple issue. But it has been written into a complex issue with the possibility that it might run a Mack truck through State and local budgets.

The National Governors Association yesterday suggested the proposal by the Senator from Arizona falls short of their hope of balancing the interests of State sovereignty and State responsibility with the desire for keeping high-speed Internet access free of excessive taxation. They talked about the specific issues I suggested in my letter to the chairman earlier this week and that formed the basis for amendments I have filed.

One, the definition. Instead of using the definition of the original moratorium in 1998, the one we all agreed to in 1998 and 2000, instead of saying let's do

that permanently or do that again, they have cooked up a new definition. This definition is the one that runs the risk of costing State and local governments so much. That is one.

Second, the language—and this may be inadvertent and if it is, maybe I can ask the Senator from Arizona if there is a way we can agree on how to fix it. If we agree we do not intend to keep States from continuing to collect State and local taxes on telephone services, even telephone calls made over the Internet, then we ought to get that issue off the table, and surely we can find somebody who can write that in a sentence to which we can all agree.

Then there is the term. I applaud the leadership of those Senators on the Commerce Committee who want to address this issue. I think if we go 4 years, which is better than permanent, but if we go 3 or 4 years, we run the risk of freezing into the law provisions that will be much harder for the Commerce Committee and the full Senate to change. Then there is the question of the so-called grandfather act which allows States already collecting taxes to keep doing that.

Those are all the issues we have here. One is the definition, one is telephone, one is term, and one is grandfather. That is tantalizingly close, it would seem to me, but the one that makes the most difference is the definition, which means for the first time, States will not be allowed to apply business taxes to the high-speed Internet industry in the same way they normally would other businesses for the first time. They are not collecting these taxes.

The other issue is the language, we believe, in the latest draft and certainly the language in the House bill runs the substantial risk of over time costing the States up to \$10 billion a year in sales taxes, and the House bill another \$7 billion in business taxes now collected on telephone services.

I do not want to overstate that point. That is not going to happen tomorrow. It is going to gradually happen as telephone calls are made over the Internet.

So that would be my hope since we have narrowed it down to that, and one of them may not be an issue at all, but that is pretty close. I do not know much more that I can say about it except—well, I can say a whole lot more about it. I have stacks of stuff and I will be glad to stick around and talk about it if anybody wants to. I do have the hearing I am expected to chair at 3, but I would say to the distinguished chairman from Arizona that I hope he understands I am not persisting in this just for the purpose of being obstinate. I feel very deeply, from my background as Governor, that it is important for us to respect the ability of State and local governments to fund their programs.

Since I left the Governor's office in Tennessee in 1987, Federal funding for education has gone from 50 cents out of every dollar to 40 cents. Most of that has gone to higher education. Our

chances for job growth and a high standard of living depend to a great extent on the ability of State and local governments to properly fund colleges and universities and create schools our children can attend.

Any time we take away resources from State and local governments, that does not sound like the Republican Party. President Reagan was giving resources to State and local governments. President Eisenhower was giving resources to State and local governments. Last year, we sent a welfare check to State and local governments of \$20 billion, and this year we are talking about taking back up to at least \$10 billion a year. That is my objection.

We could have a separate debate about whether the subsidy is warranted and, if it is, well, we could pay for it from here. But surely we would not send the bill to State and local governments.

THE PRESIDING OFFICER. The Senator from Arizona.

Mr. MCCAIN. Mr. President, I look forward to discussions with the Senator from Tennessee and the Senator from Delaware. As they know, we have a meeting with Secretary Rumsfeld in 407 in about 20 minutes, and we are going to go back on the bill at 4. I would be glad to have discussions. Meanwhile, I hope there would be some amendments proposed by the opponents of the legislation, and we could dispose of them as we did yesterday with the Senator from Texas, who came forward with an amendment and we debated it. Unfortunately, neither the Senator from Tennessee, nor the Senator from Delaware, nor the Senator from Ohio have chosen to do so.

Usually, I like to do business by amendments, debates, and votes. That is the way we usually like to move forward legislatively.

I look forward to that opportunity and also engaging in any discussions which the Senator would like. I want to assure him I am very confident in the sincerity of his views on this issue and his commitment to the issue. I understand his background as a very successful Governor of the great State of Tennessee which gives him a perspective for which I am greatly appreciative.

We are still in morning business?

THE PRESIDING OFFICER. The Senator is correct.

Mr. MCCAIN. I ask unanimous consent that I be allowed to finish my statement, which I hope will be done by 2:55. If not, I ask unanimous consent to finish my complete statement.

THE PRESIDING OFFICER. Without objection, it is so ordered.

#### THE FEDERAL ELECTION COMMISSION CHAIRMAN MUST GO

Mr. MCCAIN. Mr. President, I was in Arizona recently, and by chance I watched C-SPAN airing the Federal Election Commission hearing on the issue of 527s. Let me assure my colleagues, it was both eye opening and appalling.

Once in a while, we have a public debate in Washington that serves as a perfect metaphor for the cynical way in which business is sometimes done here. The argument over whether and when the Federal Election Commission should regulate new soft money fundraising groups provides us with one of those moments. In it, we can see how badly our election watchdog has served the public and the urgent need to fix it.

The Chairman of the Federal Election Commission, Bradley Smith, claims apparently some moral superiority on the issue of 527s because as a Republican he stands in opposition to the Republican Party's effort to ensure 527 groups comply with the law. While some may look upon his views as principles, I can only conclude that they again illustrate the same unfitness to serve on the Federal Election Commission he has shown since he was appointed 5 years ago.

Despite claims that his contempt for the Federal elections laws was merely that of an academic commentator and that he would uphold the laws as passed by Congress if confirmed, Mr. Smith has made no secret since arriving at the FEC of his disdain for the Federal Election Campaign Act of 1974, as well as the Bipartisan Campaign Reform Act of 2002. He has done so once again in the pending rulemaking.

Even after the Supreme Court decision in *McConnell v. FEC*, Mr. Smith has gone out of his way to criticize the Court's decision and the law he is supposed to enforce. In one public speech he said:

Now and then the Supreme Court issues a decision that cries out to the public, "We do not know what we are doing." *McConnell* is such a decision.

Further evidence of Mr. Smith's predilection can be found in an article in the May 3 edition of *National Review* in which he writes:

Campaign reform passed Congress and was upheld by the Supreme Court because groups hostile to freedom spent hundreds of millions of dollars to create an intellectual climate in which free political participation was viewed as a threat to democracy.

This is perhaps the most inflammatory and inappropriate comment I have ever seen by an individual who is supposed to be enforcing existing law, affirmed in its constitutionality by the Supreme Court of the United States of America. To assert that proreform groups had somehow brainwashed Congress and the Supreme Court is simply pathetic and solidifies my belief that Mr. Smith cannot administer our campaign finance laws in good faith because he is incapable of putting his sworn duties above his personal opinion.

By the way, his treatment of Mr. Nobel, a witness before the FEC, was as bullying and as cowardly as I have ever seen anyone conduct themselves in our Nation's Capital and clearly was an abuse of his authority as Chairman of the Commission.

Mr. Smith's views on the constitutionality of the Nation's campaign fi-

nance laws have been repeatedly rejected by the Supreme Court. Mr. Smith was dead wrong in his views that the Federal Election Campaign Act and its restrictions on contributions were unconstitutional, and Mr. Smith was dead wrong in his views that BCRA was unconstitutional. Mr. Smith seems to be incapable of accepting the fact that the Supreme Court of the United States, not Mr. Smith, is the last word on the constitutionality of campaign laws and that it is his job as an FEC Commissioner to carry out, not thwart, the Supreme Court's mandate.

I do not deny that Mr. Smith is entitled to his personal views on the issue of regulating 527s. I am saying, however, that he is failing to fulfill his duties as the chairman of a Federal agency and one who is sworn to uphold and enforce the law. Just as we would not tolerate the appointment of a pacifist to be Chairman of the Joint Chiefs of Staff or the Director of the FBI who believes the whole Penal Code should be null and void, so we should not accept a Chairman of the FEC who opposes campaign laws upheld as constitutional by the U.S. Supreme Court.

Knowing of his opposition to the laws he was sworn to uphold, I cannot fathom why Mr. Smith would have even accepted his current position in the first place, certainly now that the Supreme Court has proven him wrong and upheld the constitutionality of a law that he stated was "clearly unconstitutional." It makes no sense. It makes no sense for him to be charged with enforcing a law he so publicly opposes on policy and legal grounds.

I know if I were in Mr. Smith's shoes, I would do the honorable thing and resign if I was so determined to carry on a crusade against Federal regulation of campaign finance. I would leave the FEC position to be filled by someone who believed in the job.

If any of my colleagues think I am exaggerating about these FEC hearings, by the way, they should get a tape from C-SPAN and look at it themselves. It was shocking.

One very troubling aspect of the hearings was the way in which some Commissioners and antireform witnesses joined in a chorus of complaint that "no one knew what Congress intended to do" when it passed FECA in 1974 and BCRA in 2002.

One witness testified that it took Congress 7 years to figure out what to do about soft money. I am somewhat amazed by such a statement because anyone who was in Washington during those 7 years knows that the main component of our bill—from the very beginning—was a ban on soft money. You can't get much more definitive than a ban. What did take 7 years was convincing our opponents to allow a vote on the measure, and when we finally got our vote, we had clear majorities in both Houses.

Some of the lawyers who testified that no one knows what Congress in-

tended to do in these bills were the very same lawyers who spent years urging Members to vote against BCRA, and argued its unconstitutionality before the Supreme Court. Give me a break. As witnesses to Congressional intent, they have zero credibility. Let me be clear on this: Senator FEINGOLD and I repeatedly told the FEC exactly what we intended to accomplish with our legislation, and the legislative history of FECA from 1974 is equally as clear. The only confusion in this area has been with the FEC itself and those Commissioners who just simply didn't like the actions taken by Congress.

The Commission's hearings centered on the issue of regulation of so-called "527 groups" that are raising and spending millions of dollars in soft money in the current presidential election. These 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." That's the words of The United States Supreme Court.

But here we are, with these groups openly flouting the law and openly spending soft money for the express purpose of influencing the presidential election while the FEC sits on its hands once again. Like the emperor with no clothes, those Commissioners just do not know what to do now that the Supreme Court has removed their "express advocacy" rationale for failing to regulate political activity by the 527 political organizations. As a result, these organizations remain busy soliciting and spending millions for the avowed purpose of influencing Federal elections.

That the FEC's lack of action undermines the law isn't just my opinion. The Supreme Court confirmed this in its recent decision upholding the soft money ban. In *McConnell v. FEC*, the Supreme Court stated, in no uncertain terms, how we ended up in the soft money crisis to begin with. The Justices placed the blame squarely at the

doors of the FEC, concluding that the agency had eroded the prohibitions on union and corporate spending, and the limits on individual contributions through years of bad rulings and rulemakings, including its formulas for allocation of party expenses between Federal and non-Federal accounts. Regarding the allocation regulations for parties, the Supreme Court stated in *McConnell* that the FEC had “subverted” the law, issued regulations that “permitted more than Congress . . . had ever intended”, and “invited widespread circumvention of FECA’s limits on contributions.” That is a damning indictment of the behavior and performance of the Federal Elections Commission.

Based on the recent hearings, it seems entirely possible that the FEC will once again abdicate its statutory responsibilities and refuse to end this new soft money scheme—or at least put off any action until the Presidential election is over. In fact, FFC Vice-chair Ellen Weintraub recently opposed a rulemaking on 527 activity saying that:

At this stage in the election cycle, it is unprecedented for the FEC to contemplate changes to the very definitions of terms as fundamental as “expenditure” and “political committee” . . . sowing uncertainty during an election year.

Ms. Weintraub further stated:

I will not be rushed to make hasty decisions, with far-reaching implications, at the behest of those who see in our hurried action their short-term political gain.

Ms. Weintraub has no business looking at the election calendar. That is none of her business. What is her business is to enforce existing law according to the law in the U.S. Supreme Court upholding its constitutionality. It should not matter to Ms. Weintraub whether we are in an even numbered year, an odd numbered year, fall, spring, winter, or summer. This is an incredible statement as to how politics affects a Federal commission that is supposed to rule on laws, not on political campaigns.

Of course, it is not that complicated. All the FEC needs to do now is simply enforce existing Federal law as written by Congress in 1974 and interpreted by the Supreme Court in a number of cases, including the *McConnell* case. It defies the whole purpose of the FEC, to say it should not properly enforce the law in the middle of an election year because such enforcement might affect that election. We want the law enforced. I have never heard of a regulatory agency that has any reference whatsoever to political campaigns.

The fact the FEC has neglected to properly enforce the law correctly in the past is not a reason or justification for the Commission to continue failing to properly enforce the law, now that the Supreme Court has made clear the FEC was wrong. If the FEC fails to act now, the FEC will simply be treading the same destructive path it has followed for a generation.

We know systemic campaign finance abuses have usually begun when one political party decides to push the envelope and the FEC declines to act, leading the other party to adopt the same illegal tactics. In 1988, one party invented the use of soft money to promote their Presidential campaign, evading campaign finance rules. The Commission let them get away with this. This is well documented. The other party followed.

In 1996, the soft money scheme was raised to an art form and the Commission did nothing. You have to ask whether the Commission has learned anything about the consequences of its failure to properly enforce the law. History proves it is imperative that the Commission act now. If it does not, we can rest assured both parties will soon be trying to out-raise each other in this venue, and a whole new soft money scheme will have blossomed.

By the way, the reality is if these soft money 527s are allowed to stand—they are now, we know, largely funded by Democrats. Who in the world doesn’t understand if you allow this to stand, then the Republicans will do the same thing, and understandably so? Just as in 1988 one party was allowed to do it, so the other party was able to as well.

Much of the controversy at the Commission has been ginned up by an artfully crafted misinformation campaign designed to persuade the nonprofit community—the 501(c)s—that any FEC action to rein in 527s would have the unintended consequence of limiting their own advocacy efforts. It is true certain campaign finance rules for spending by nonprofits are different than they are for political groups like 527s. There is no immediate campaign finance regulatory problem with the 501(c) groups. I repeat, there is no immediate campaign finance regulatory problem with the 501(c) groups as there is with the 527 groups, and no need—no need to address 501(c) groups in this rulemaking.

Some have suggested the agency do what Congress did when it passed BCRA: Issue a ruling but make the change effective after the election.

What these critics fail to recognize, however, is that Congress was creating an entirely new set of election rules in BCRA. All that is required here is for the FEC to properly enforce law that has been on the books for 30 years, and to abandon its wrong interpretations of the law as made clear in the *McConnell* decision. To issue new regulations now and make them effective after the 2004 election would be for the FEC to say that “we know the law has been wrongly interpreted for years but we are going to allow that to continue for the rest of this year, and then next year, we will start interpreting that law correctly.” This is simply not rational and it is an abdication of their responsibilities.

Finally, it is essential that the FEC act quickly to fix its absurd allocation

rules, which govern the mix of soft and hard money a political committee can spend when it is supporting both State and Federal candidates. It is clear that a number of the current crop of 527s exist only to defeat President Bush. But through the absurd FEC allocation formulas, if these same entities also claim to be working in state elections, they could use soft money for 98 percent of their expenditures—a complete end-run around the soft money ban in Federal races.

Despite all the evidence, I am still hopeful the Commissioners will summon the political will to do the right thing now. There are some commissioners who want to do the right thing. I want them to step forward and do it. But even if they do, the agency’s structural problems will be the same as they ever were. By unfortunate custom, three Republicans and three Democrats are chosen by their party leadership, usually with the express purpose of protecting their party’s interests, rather than enforcing the law. It takes four votes for the Commission to take action—a requirement that has been a recipe for deadlock and bipartisan collusion and gave birth to the soft money problem we’re trying to put behind us.

Last month I testified before the Senate Rules Committee on the issue of 527s. During my testimony I stated that one of the problems the FEC faces today is that some Commissioners, and in particular Chairman Smith, refuse to accept the Supreme Court’s conclusions in the area of campaign financing. A decision by the FEC to abdicate its responsibility at this politically inconvenient moment will only provide further evidence that it is time to start over. If the Commission has become too hopelessly politicized to do its job, then we must replace it with an agency that will.

The FEC’s current difficulty in dealing with an issue as straightforward as these 527 organizations spending soft money to influence the 2004 Federal elections, and the 3-3 ties at the Commission when it recently considered an advisory opinion on this issue, are only the most recent examples of the need for fundamental FEC reform. With my fellow BCRA sponsors, I have introduced legislation that would scrap the FEC and start over, using a new organizational structure and administrative law judges to avoid deadlocks and take some of the politics out of the process. Whether we adopt this or some other basic reform, it is time for a watchdog with some bite.

I thank the President for his patience as I ran over the previously agreed-to time.

This is a very serious issue. We are not going to give up on it. We didn’t work for 7 years to get campaign finance reform done and upheld by the U.S. Supreme Court to have a group of six people down there who are so politicized that they refuse to enforce a law which was passed by this Congress in overwhelming numbers, finally, and upheld by the U.S. Supreme Court.

I want to tell them and all of those other people I watched on CSPAN who are trying to undermine this law that we will not let you get away with it. American politics and the political process is too sacred for me to allow these stooges of special interests around this town to prevail and prevent us from restoring faith and confidence in the American people and their electoral system.

Again, I appreciate the patience of the Presiding Officer.

I yield the floor.

#### RECESS

The PRESIDING OFFICER. Under the previous order, the Senate stands in recess until 4 p.m.

Thereupon, the Senate, at 3:04 p.m., recessed until 4 p.m. and reassembled when called to order by the Presiding Officer (Mr. CORNYN).

#### INTERNET TAX NONDISCRIMINATION ACT

The PRESIDING OFFICER. The Senate will resume consideration of S. 150.

Mr. REID. I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The assistant legislative clerk proceeded to call the roll.

Mr. BYRD. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER. Without objection, it is so ordered.

#### ANOTHER WEEK, ANOTHER CLOTURE VOTE

Mr. BYRD. Mr. President, our country is facing record budget and trade deficits. We are in a war of our President's choosing that is not, to put it mildly, going as well as had been expected. Millions of Americans are without health care and millions more worry about the security of their jobs.

These are troubled times and many issues clamor for the attention of the Senate. Yet what is the response of the Senate, the world's greatest deliberative body? Are we debating strategies to quell the violence in Iraq and bring our soldiers home? No. Are we considering plans to shore up Social Security and Medicare? No. Is the Senate deliberating on how to make America's workforce more competitive? No. Is the Senate grappling with reauthorizing welfare reform or the highway bill? No.

This great deliberative body which was forged by the Founding Fathers in the Great Compromise of July 16, 1787, has become a factory that manufactures sound-bite votes that make great fodder for 30-second political ads but which do very little to address the many challenges facing this country. If this continues, I fear that the Senate will be little more than an insignificant arm of the political parties, and we may as well lower the flag that flies over this Capitol and wave the white flag of surrender in its place.

Have we lost the will to legislate? Is the current leadership afraid to allow the Senate to work its will? The Republican leadership seems to feel that their slim majority gives them a blank check to impose their exclusive agenda. Let me be clear. It does not. The Senate, by its very existence, embodies a core tenet in American democracy; namely, the principle that the minority—the minority, the Democrats as of now, the minority—has rights. The Republican leadership is fast making the committee process a thing of the past. Furthermore, the leadership has done everything in its power to prevent Democratic Senators from getting votes on their amendments.

The United States is faced with a trade deficit that has mushroomed to an all-time high for the third year in a row. Adding to that unfortunate situation, in August 2002, the World Trade Organization authorized the European Union to impose up to \$4 billion in trade sanctions against the United States if provisions of the Tax Code were not repealed. How about that?

The distinguish Republican leader brought up the Foreign Sales Corporation legislation to address this situation only after the sanctions were in place. After votes on only two amendments, the majority wanted to shut down the amendment process—shut it down. Many reasons were given, but the truth is that they did not want to vote on an amendment dealing with overtime rules for American workers. Yes, the American workers. While American companies are losing their competitive edge, the "my way or the highway" approach of the leadership has delayed a final resolution on this bill.

In the past, cloture was a rarely used procedural tool. When I came to this Senate, it was rarely used—only once in a while. Not so today. Cloture is routinely filed in an attempt to limit non-germane amendments. Instead of the phrase, "another day, another dollar," the Senate operates in an atmosphere of "another week, another cloture vote."

Last November, we had three cloture votes in one day. What great hopes the leadership must have had for the first two votes to schedule three in a row. How can such a move be seen as anything more than political scorekeeping?

This Senate has spent an extraordinary amount of time and energy and effort on President Bush's judicial nominees. In fact, last November the Senate set aside the VA-HUD appropriations bill to hold an overnight marathon stunt—something to watch indeed, something to watch. What a sham. The majority actually set aside substantive legislation to conduct a circus—a circus—on the floor of the Senate.

The VA-HUD appropriations bill was never completed. Instead, it was rolled into the Omnibus appropriations bill, as has become the unfortunate custom

in recent years. We have had 17 cloture votes on 6 controversial and problematic nominees. The response of the Republican leadership and the administration has not been to address the fundamental underlying concerns raised by various Senators. Oh, no, no negotiation. Instead, they choose the course of holding cloture vote after cloture vote and then bash Democratic Senators as obstructionist. And just for good measure, the President, who has had 96 percent of his judges confirmed, moved two of these divisive nominees on to the bench in recess appointments.

Now, I do not pretend that the conflict over judicial nominees began in this Senate or with the President, but I will state that this Senate leadership and this President have worked in concert to further politicize the process by which we select members of the judiciary.

And it is not just with judicial nominees that the Republican leadership is doing the White House's bidding. The Republican leadership is controlled by this White House—controlled by this White House. Rather than have a legislative branch which crafts a bill and then sends it to the President to sign or veto, this Republican leadership in the Senate and in the House has allowed this President to control both ends of Pennsylvania Avenue.

During the conference on the Omnibus appropriations bill, the Republican majority allowed this White House to assert itself and put in provisions that had been rejected by one or both Houses. Specifically, the provision to allow increased concentration of media ownership had been rejected by both the House and the Senate. However, it was included in the bill at the behest of the White House. Shameful. Yes, shameful.

The House and the Senate were both on record as opposing overtime regulations proposed by the Bush administration. Nevertheless, at the urging of the Bush White House, language to block implementation of these regulations was dropped from the conference report—dropped from the conference report.

Another example of allowing the Bush White House to dictate the legislation produced by the Congress is the highway bill. Here is a bill that is important to every State and every person in the Union. Every Senator's State will benefit from this bill. The transportation bills passed the House and the Senate by wide bipartisan majorities, majorities that could easily override a veto. Yet we are stalled because the Bush White House is demanding that the cost of the highway bill be significantly lower than what was passed by both Houses of Congress.

This White House, under the Bush administration, has threatened a veto if the cost of the bill is over its chosen number. What is meant by "its"? Under the White House's chosen number. Big daddy down at the White House, big daddy.

# **EXHIBIT 3**





FEBRUARY 28, 2007

**Progress for America Voter Fund Statement on the  
Announced Settlement with the Federal Election Commission.**

Today, the Federal Election Commission (FEC) announced its settlement with Progress for America Voter Fund (PFA-VF) related to activities in 2004.

Under the terms of the settlement, PFA-VF is not admitting to any wrong doing. In order to conclude the matter, PFA-VF will pay \$750,000 and agree to register as a political committee if it undertakes any activities similar to those in 2004. With this settlement, all actions regarding PFA-VF are concluded.

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

- 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.

Responding to the announced FEC settlement, Progress for America Voter Fund legal counsel Benjamin L. Ginsburg issued the following statement:

"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."

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P.O. Box 57167  
Washington, D.C. 20037  
877-792-3800  
contact@pfaaction.com

# **EXHIBIT 4**

F.R. Hill  
April 9, 2004

University of Miami School of Law  
1311 Miller Drive  
Coral Gables, Florida 33146

*Submitted via email to [pctestify@fec.gov](mailto:pctestify@fec.gov)*

Ms. Mai T. Dinh  
Acting Assistant General Counsel  
Federal Election Commission  
999 E Street, NW  
Washington, D.C. 20463

RE: Notice of Proposed Rulemaking on Political Committee Status

Dear Ms. Dinh:

I am pleased to submit these comments in response to the Notice of Proposed Rulemaking on Political Committee Status issued by the Federal Election Commission ( FEC ). 69 Fed. Reg. 11736 (March 11, 2004). I have submitted these comments on my personal behalf and not on behalf of the University of Miami School of Law, where I am a Professor of Law and Director of the Graduate Program in Taxation, or on behalf of the Campaign Legal Center, where I am the Tax Program Director. The views expressed in these comments are my own.

I. Tax Law and Election Law

The proposed regulations on the definition of a political committee for purposes of the Federal Election Campaign Act of 1971, as amended ( FECA ) pose the issue of how organizations commonly identified by their federal income tax characteristics should be treated under the FECA when they are engaged in activities that would otherwise be subject to FECA.

The general issue is one of statutory intersection, the application of two or more statutes to the same activities, and the challenge is one of statutory coordination, the interpretation of both statutes in a manner that is consistent with the purposes of each.

The key point is that two statutes can apply simultaneously. When this occurs, the delegation doctrine does not permit an agency to abdicate its responsibility to administer the statute for which it is responsible. The Supreme Court has held that judicial deference to acts of administrative agencies is based on a delegation of authority and on the particular agency's expertise with respect to a particular area of law. *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). In the matter before the Commission, the Internal Revenue Service (IRS) has not been delegated authority to administer FECA and has no expertise in election law. Similarly, the FEC has no delegation of authority and no expertise with respect to the administration of the Internal Revenue Code of 1986, as amended (IRC). Delegation doctrine principles mean that an agency cannot simply adopt a "one statute rule" and abdicate the administrative responsibilities which it has been delegated.

Because two statutes can apply simultaneously to the same activities, it is necessary to define principles of statutory coordination. The fundamental principle is that both statutes should apply with as little modification as possible, and coordination should not become the basis for statutory nullification, another form of the one statute principle. This is not simply a matter of coordinating the rulemaking and adjudication of two or more agencies. It is rather a matter of recognizing that the intersection of two statutes can fundamentally undermine achievement of the purpose of one of the statutes. Planning to achieve precisely that result is the reason for the current rulemaking with respect to the definition of a political committee.

As in all cases, such planning takes advantage of differences between two or more statutes that apply to the same entities or activities for the purpose of avoiding particular elements of one of the statutes. In the rulemaking before the FEC, the planning enterprise is to argue that entities defined in terms of their tax status should not be subject to FECA. The result is what the Supreme Court described in *McConnell v. FEC*, 124 S. Ct. 619 (2003) as "[circumvention]" of FECA.

The Supreme Court made it clear in *McConnell* that administration of federal election law is a matter of preserving democracy, of protecting the First Amendment rights of ordinary voters to participate in elections based on knowledge of, among other things, the sources of funding of candidates and parties, and of preserving the larger policy process from the sale of access by political actors and those persons, including tax exempt organizations, that facilitate such transactions.

The purpose of the laws relating to exemption from taxation is to provide a subsidy to entities engaged in enumerated exempt activities. The Supreme Court has held that exemption from taxation is a subsidy and that exemption can be conditioned. *Regan v. Taxation with Representation*, 461 U.S. 540 (1983). Activities other than those that support exemption can be and are limited or prohibited or taxed. In *Taxation with Representation*, the Court held that different subsections of the section 501(c) could impose different limitations and that the organizations involved could not create a merged structure that would have undermined the limits placed on the lobbying activities of the section 501(c)(3) organization simply because the section 501(c)(4) organization was not subject to the same limitation. In light of these permissible limitations, there is no Constitutional barrier arising from exemption that would

compel the FEC to abdicate its responsibilities to administer the FECA in a manner that safeguards the rights of participants, including voters, in United States federal elections. The challenge arises from specific differences between FECA and the IRC.

## II. Statutory Intersection and Statutory Circumvention

The current rulemaking addresses treatment of certain exempt organizations as political committees within the meaning of FECA. The reasons for engaging in such rulemaking relate to the entrepreneurial efforts by clever political operatives to find in tax law a predicate for circumvention of election law. The planning strategies are based on specific differences between the two statutes and rest on the assertion that only tax law, not election law, should apply to the resulting entities. As argued above, there is no basis for this novel theory of statutory nullification and agency abdication. This section of the testimony addresses the specific planning exercise at the core of the controversy.

The most important differences between FECA and the IRC is that FECA reporting and enforcement are geared to the timing of federal elections, while IRC reporting and enforcement are geared to the appropriate taxable year without regard to the timing of federal elections. To argue that only the IRC should apply to the election activities of organizations exempt from federal income tax means that all reporting and enforcement activities will occur after the relevant federal election. To argue that FECA also applies means that reporting and enforcement will be conducted on a timetable that protect the purposes of FECA. There are other important differences as well.

Tax exempt organizations are not subject under the IRC to disclosure of their

contributors or their expenditures, with the exception of the disclosure requirements enacted in 2000 and applying to certain section 527 organizations that do not report to the FEC. Exempt organizations are subject to no limitations on the identity of contributors or the amount of contributions, contrary to the limitations imposed on contributors and contributions under FECA. The IRS has no formal complaint process akin to that available under FECA, and no third party has standing to challenge the exempt status of an exempt organization. All IRS audits of exempt organizations are secret, while the adjudicatory actions of the FEC are conducted in public. If an entity wishes to choose a statute and an agency to oversee its electoral campaign activities, the IRC administered by the IRS offers distinct advantages.

The consequence of these differences in the two statutes is that money can be collected and deployed by an exempt organization subject only to the IRC for the same activities that are regulated as to disclosure, source, and amount if collected and spent by a political committee. Failure to bring all organization that engage in the same activities under FECA means that the FEC yet again will enable the creation of multiple forms of political money with no statutory basis just as it did in creating soft money. Money collected by those section 527 organizations that do not report to the FEC is, under tax law, [semi-hard] money subject only to disclosure but not subject to limitation on the identity of contributors or the amount of the contribution. Money collected by section 501(c) organizations is [softer money] that is not even subject to disclosure of any kind. Perhaps one could call money collected by section 501(c)(3) public charities [the softest money] because the contributors qualify for a charitable contribution deduction. For a more complete analysis of multiple types of political money created under the IRC, *see* Hill, *Softer Money: Exempt Organizations and Campaign Finance*, 91 Tax Notes 477 (April 16,

2001). The argument must be that the FECA provides no place for such money in federal elections and the FEC has no more authority to create semi-hard or softer money than it had to create soft money in the 1970s. The IRC cannot be used to circumvent the FECA.

The particular patterns of circumvention implicated in the rulemaking relating to the definition of a political committee seek to use the standards for tax exemption to argue that FECA should not apply to the electoral campaign activities of various types of tax-exempt organizations. In effect, the argument is that only one statute should apply to tax exempt organizations and that statute is the IRC. This argument purposively ignores the absence of any support for this claim in other areas. Tax exempt organizations are subject to labor laws, environmental laws, local fire codes, consumer protection statutes, to name only a few.

Proponents of a one-statute approach have attempted to find support for their position in a selective reading of *McConnell*. The reference in *McConnell* to "interest groups" that may use soft money for such activities as voter registration, get-out-the-vote activities, mailings, and political communications refers to organizations engaged in nonpartisan activities that fall outside the definition of a political committee. The Supreme Court was not excising the political committee definition from FECA.

Federal tax law provides two main categories of exempt status with different requirements for each. Section 527 provides exemption for organizations that are organized and operated solely for the purpose of influencing the outcome of federal elections within the meaning of section 527(e)(2). Section 501(a) provides for exemption for organizations that satisfy the requirements of any one of the subsections of section 501(c). In no case is influencing the outcome of a federal election an exempt purpose under any subsection of section



501(c). These two categories of exempt entities present different analytical issues in considering whether they should be treated as political committees for purposes of federal election law. Differences between section 527 organizations and section 501(c) organizations provide a reasonable basis for proceeding now with the rulemaking with respect to section 527 organizations but allowing more time for consideration of the particular issues relating to section 501(c) organizations. In the end, the same principles apply to the challenge of statutory coordination and the problem of circumvention highlighted by the Supreme Court in *McConnell*, but they apply in a more discrete and nuanced manner because activities consistent with treatment as a political committee are not the sole activities of these section 501(c) organizations. Section 501(c) organizations contain embedded political committees. This concept, which is discussed in Part IV below, is based on understanding section 501(c) organizations as aggregates of multiple types of activities, including activities that support characterization of that portion of the section 501(c) organization as a political committee.

### III. Section 527 Organizations as Political Committees

The case for treating section 527 organizations as political committees is straightforward. Organizations that seek to avail themselves of the benefit and subsidy provided by tax exemption under section 527 must be engaged exclusively in activities intended to influence the outcome of elections. The intention is not a subjective intent based on self-serving attestations but is a demonstrable nexus between the organization's expenditures and the influencing elections.

This does not mean that tax law compels the result under election law. Rather, it means

that the type of activities that sustain exemption will also support treatment of the entity as a political committee under the FECA. The two statutes are not perfectly congruent. Section 527 treats confirmation of judges as qualifying activity, while the FECA does not cover confirmation processes. But, every activity that defines a political committee is part of the exempt function definition under section 527(e)(2). When the "new section 527 organizations" were being developed in the mid-1990s, the main technical challenge was to provide evidence that the activities in question were undertaken for the purpose of influence the outcome of an election.

The design concept of the "new section 527 organizations" was to rely on the definition of a political organization engaging in exempt function activity within the meaning of section 527(e) of the IRC, while avoiding any duty to report to the FEC or otherwise comply with FECA. One of the designers of these new vehicles was so proud of his work that he and his law firm issued a press release announcing that they had secured a private letter ruling from the IRS confirming that the entity would satisfy the requirements of section 527 and releasing the letter ruling on behalf of their client before the IRS released the ruling. *See* the press release from Gregory Colvin of Silk, Adler and Colvin at 1999 TNT 83-23. In the press release the firm stated that it was releasing the private letter ruling, which was eventually released by the IRS as PLR 199925051, "because the guidance is likely to be of immediate interest to certain of our clients and colleagues." The same press release promoted the broad adoption of this approach by any number of exempt entities, stating that "[w]e believe that this ruling may provide useful guidance for many types of organizations seeking to maintain Section 527 tax-exempt status, such as political parties, labor unions and trade association PACs, issue-based PACs, and political funds supported by major donors who desire protection from federal gift tax." In short,

as the 2000 election drew near, this new campaign finance vehicle was being promoted for mass production.

The Service had issued three other private letter rulings before it issued PLR 199925051. *See* PLR 9652026, PLR 9725036, and PLR 9808037. In these rulings the organizations that sought section 527 status highlighted the steps they would take to satisfy the requirements of section 527(e)(2). For example, the organization's board passed a resolution stating that the organization was engaging in an activity like support for a ballot initiative or voter registration or issue advocacy for the purpose of influencing the outcome of a candidate election. In one case, the organization offered an opinion letter from a political scientist stating that the activities, while not normally thought to be the kind of activities engaged in to influence the outcome of a campaign, would in this case have that effect. For a discussion of these rulings, *see* Hill, *Probing the Limits of Section 527 To Design a New Campaign Finance Vehicle*, Tax Notes 387 (January 11, 2000).

As these "new section 527 organizations" multiplied and as their activities became more controversial, it became clear that the IRS had no information about these new structures. Most did not seek private letter rulings and most were not organized as corporations under state law. These structures filed a tax return, Form 1120-POL, only if they had taxable income. This lack of information for the purpose of tax compliance was remedied in the summer of 2000, when Congress amended section 527 to require reporting to the IRS by section 527 organizations that did not report to the FEC. Section 527 entities that do not report to the FEC are required to give notice of their existence to the IRS under section 527(I) and to disclose their contributors and expenditures under section 527(j). These notices and reports must be available to the public

under section 527(k). These reporting and disclosure requirements do not absolve the FEC of its duty to apply the requirements of FECA to these entities. These section 527 organizations argue that they should be treated as exempt from tax because they are engaged in activities that they have undertaken to influence the outcome of elections. They accept contributions and/or make expenditures to this end. They thus satisfy the requirements under FECA for treatment as political committees.

#### IV. Section 501(c) Organizations as Political Committees

Section 501(c) organizations can be divided into two categories. The first category consists of organizations that are permitted to engage in a certain amount of electoral campaign activity, which are section 501(c)(4) social welfare organizations, section 501(c)(5) trade unions, and section 501(c)(6) trade associations. The second category are the section 501(c)(3) public charities, which are subject to a prohibition on certain election-related activities. For detailed technical analysis of the various types of section 501(c) organizations, *see* Hill and Mancino, *Taxation of Exempt Organizations* (Warren, Gorham & Lamont, 2002, with supplements twice each year). Both types of section 501(c) organizations are aggregates of multiple types of activities. Certain of these section 501(c) organizations can engage in the same type of activities undertaken by section 527 organizations without jeopardizing their exempt status, provided that such activities are not the organization's primary purpose. In effect, these organizations contain embedded political committees.

##### A. Section 501(c) Organizations as Aggregates of Activities

Section 501(c) organizations, unlike section 527 organizations, are not entities engaged

in a single type of activity but are instead aggregates of multiple types of activities, including activities that are identical to the activities that define section 527 organizations and that define political committees within the meaning of FECA. In sum, section 501(c) organizations are aggregates of activities that encompass embedded political committees.

Understanding the nature and consequences of treating section 501(c) organizations as aggregates of activities helps clarify the use of willfully imprecise language such as "issue advocacy" to obscure the types of activities in which section 501(c) organizations engage. Section 501(c) organizations are aggregates of exempt activities, permissible activities, and taxable activities, with certain section 501(c) organizations also being defined in terms of prohibited activities. Working through this complexity provides a conceptual foundation for understanding the concept of an embedded political committee and for understanding that treating such activities as an embedded political committee does not limit the public education activities or lobbying activities of section 501(c) organizations.

To support exempt status for any section 501(c) organization, the exempt activities enumerated in the IRC must be the organization's primary activities. There is no guidance with respect to the determination of what constitutes an organization's primary activities, but this is a matter for the IRS. In addition to exempt activities, a section 501(c) organization may engage in certain permissible activities. These activities do not support exempt status, but they also do not jeopardize exempt status unless they become the organization's primary activity. Certain commercial activities that produce unrelated business taxable income subject the organization to the unrelated business income tax. Other commercial activities neither support exempt status nor result in unrelated business taxable income. How these activities are accounted for in

determining an organization's primary purpose for federal income tax purposes is an unresolved issue that does not bear directly on the topic of this rulemaking. Some activities are prohibited activities, any amount of which can, in theory, result in denial of exempt status or revocation of an organization's existing exemption. One such prohibited activity is "inurement" that generally means certain conflicts of interests involving the founders or managers of the organization. The other type of prohibited activity applies only to section 501(c)(3) public charities, which may not "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office." This prohibition is absolute, but it is far from clear what activities are absolutely prohibited. The section 501(c)(3) definition of participation or intervention applies to other organizations as well, but in the case of other section 501(c) organizations such activities are not prohibited. They are instead permissible but limited activities that may not be the organization's primary activities. For a more complete discussion of exempt organizations as aggregates of activities, see Hill, *Targeting Exemption for Charitable Efficiency: Designing a Nondiversion Constraint*, 56 Southern Methodist Law Review 675 (2003).

Distinguishing exempt activities from permissible activities from prohibited activities in the case of section 501(c) organizations begins with identifying the three categories of advocacy activities as they relate to these categories. Education of the public by taking positions on the issues, including controversial issues, is an exempt activity for all types of section 501(c) organizations. What constitutes public education depends on the facts and circumstances of each particular case. Lobbying is a permissible but not exempt activity for all section 501(c) organizations except for section 501(c)(4) social welfare organizations, for which lobbying is

an exempt activity. The kind of activities that are prohibited participation or intervention in a political campaign when engaged in by a section 501(c)(3) organization are permissible activities for other section 501(c) organizations, provided they are not the organization's primary activity.

These distinctions among education of the public, lobbying, and election campaign activity are obscured by discussions that conflate all three types of activity under the general heading of "advocacy" or "issue advocacy." Appropriate rulemaking in this area depends on preserving the distinctions.

#### B. Social Welfare Organizations, Labor Unions and Trade Associations

All three types of section 501(c) organizations may, consistent with their exempt status, participate or intervene in electoral campaigns provided that such activities are not their primary activities. Tax law provides little guidance as to the meaning of this standard, but the fundamental fact is that these section 501(c) organizations may engage in precisely the same types of activities as section 527 organizations. The subject of this rulemaking is whether section 501(c) organizations that engage in the same activities that support treatment as a political committee will be treated as a political committee with respect to these activities or whether the FEC will take the position that such embedded political activities may not be subject to election law because they are embedded in a larger entity. In short, how should embedded political committees be treated under FECA?

Section 527(f)(1) applies to these activities by section 501(c) organizations. The IRS has recently provided useful guidance on the application of section 527(f)(1) to these section 501(c) organizations. *See*, Rev. Rul. 2004-6, 2004-4 I.R.B. 1. Much of the discussion of this revenue ruling has centered on characterization issues. The basic approach, which is to disaggregate the

section 501(c) organization into components based on the particular activities and apply section 527 to the appropriate activities, is equally important.

Revenue Ruling 2004-6 suggests an approach to statutory coordination in the case of embedded political committees. This approach ensures that the same activities will be treated consistently for FECA without regard to the entities in which they are embedded. It prevents the use of the IRC to circumvent FECA.

This approach is scarcely novel since FECA has long applied to these organizations. Labor unions may not make either contributions or expenditures using their treasury funds, a provision that has been in place since 1947. Any of these organizations that are organized in corporate form are treated as corporations for election law purposes, which means that they may not make contributions directly and that they may not use treasury funds to make independent expenditures. The most important point for purposes of this rulemaking is that the FEC has long taken the position that both statutes apply. The issue in this rulemaking is whether, to what extent, and in what manner the definition of a political committee should apply to specific types of structures designed from the building blocks of tax law for the purpose of engaging in the activities covered by FECA.

### C. Section 501(c)(3) Organizations

Although the prohibition in the language of section 501(c)(3) appears to leave no room for activities that support treatment as a political committee for FECA purposes, this would be a premature conclusion that ignores the history of the electoral roles of section 501(c)(3) organizations. Part of this history could be fairly characterized as a series of challenges to the IRS to enforce the IRC, and the results have been mixed. Even if the IRS had issued more useful



guidance and had a more comprehensible public record, this would not provide a basis for the FEC to enforce the provisions of FECA that have no parallel in the IRC.

Contemporary controversy over section 501(c)(3) organizations' campaign roles dates back to the mid-1980s, when certain exempt organizations launched a series of television advertisements attacking particular members of Congress for opposing the Reagan administration's sale of sophisticated weapons to the fundamentalist regime in Iran that had previously held American diplomats hostage and used the proceeds of these arms sales to fund insurgent groups in Latin America, particularly Nicaragua. Whatever one thinks of this policy, the use of section 501(c)(3) organizations to fund political advertisements of this time, engaged the attention of members of Congress. The Oversight Subcommittee of the House Ways and Means Committee held hearings on the approach taken by the IRS to enforcing the provisions of section 501(c)(3). Subcommittee on Oversight, House Ways and Means Committee, Hearings on Lobbying and Political Activities of Tax-Exempt Organizations (1987). The hearings provided evidence of similar activities by other section 501(c)(3) organizations. None of the exempt organizations that testified condoned these activities and some organizations urged that section 501(c)(3) be more effectively enforced to maintain the integrity of the exempt sector. All of the testimony drew appropriate distinctions between lobbying and participation or intervention in electoral campaigns. Brian O'Connell, then President of Independent Sector, defended exempt organizations' rights to lobby but said of electoral campaign activity: "It undermines the integrity and credibility of nonprofit organizations if political figures set up or use exempt organizations that blatantly serve their candidacies, or if some political action

committees go beyond their intended prerogatives and use section 501(c)(3) entities to pursue their political ends. 1987 Hearings at 161. In its report to the full Ways and Means Committee, the Oversight Subcommittee expressed concern that "[t]he increasing use of tax-exempt organizations to benefit a political candidate for public office runs counter to Federal tax concerns and allows for the circumvention of the contribution and spending restrictions contained in the Federal Election Campaign Act." Subcommittee on Oversight of the Committee on Ways and Means, Report and Recommendations on Lobbying and Political Activities by Tax-Exempt Organizations 45 (1987). The Ways and Means Committee also issued a report on the electoral campaign activities of exempt organizations. Ways and Means Committee of the House of Representatives, Report on HR 3545, Revenue Bill of 1987. In the case of section 501(c)(3) organizations, the Ways and Means Committee found that the pattern of electoral participation or intervention revealed by the Oversight Subcommittee's Hearings potentially violated three requirements of section 501(c)(3): the requirement that the organizations be organized and operated exclusively for an exempt purpose; the prohibition on participation or intervention in an electoral campaign; and the prohibition on inurement to the benefit of a private person, including a candidate or a political party. The Ways and Means Committee Report called for more effective enforcement of the tax laws by the IRS and greater coordination between the IRS and the FEC "for the purpose of assuring that the assets of tax-exempt charities are not being diverted to prohibited purposes." Ways and Means Committee Report at 1625.

The issues in this rulemaking are not new or novel. These issues do not arise from BCRA but are based, for election law purposes, in FECA. Arguments that section 501(c)(3)

organizations should be excepted from FECA because of their tax status have no basis in law or in practice.

The FEC has already applied the one statute theory to section 501(c)(3) organizations in its regulations under the electioneering communication provisions. It should not compound this error by excepting section 501(c)(3) organizations from the definition of a political committee. The FEC has no constitutional basis for so abdicating its responsibility to administer the FECA. Even if the definitions were completely consistent, the two statutes involve different enforcement procedures on different timetables consistent with the different purposes of the two statutes.

The section 501(c)(3) definition of electoral participation rests on facts and circumstances balanced in each individual case. The IRS has taken controversial positions for reasons best know to itself. While audits of particular organizations remain confidential, the core point is that there is almost no public guidance relevant to contemporary campaigns. Exempt organizations rely primarily on nonprecedential guidance that seems in some cases inconsistent with the treatment of certain high profile organizations linked with powerful political figures.

When the magic words test held sway over the FEC, it was possible to conclude, as the IRS did, that the section 501(c)(3) test was broader than the election law standard. Now, in light of the guidance offered by the Supreme Court in *McConnell*, it may well prove to be the case that the section 501(c)(3) definition is less inclusive than the election law standard for defining a political committee.

Some cases with respect to section 501(c)(3) organizations should pose little difficulty

for concluding that they are functioning as political committees within the meaning of FECA. For example, when a wealthy contributor announces that he has directed a contribution far in excess of any contribution from any other contributor to a section 501(c)(3) organization and announces that he has done so for the purpose of supporting or defeating a named candidate, there should be little difficulty for purposes of political committee characterization under FECA. The consequences for the organization's exempt status within the meaning of section 501(c)(3) are not the concern of the FEC and should be left to the IRS. If the organization takes out a full page advertisement in mass circulations newspapers denouncing a candidate for federal office as a "sinner" unfit to hold the public office for which he is currently as candidate, there should be little difficulty concluding that the organization in question is a political committee within the meaning of FECA. *See Branch Ministries, Inc. v. Commissioner*, 211 F. 3d 137 (D.C. Cir. 2000).

Most situations involving section 501(c)(3) organizations will involve less stark situations. For this reason, it would be desirable for the FEC and the IRS to heed the request of the Ways and Means Committee in its 1987 Report that they work together to assess the roles played by section 501(c)(3) organizations in election campaigns before clarifying the law in this area. Both agencies have ample statutory authority to take any necessary regulatory action based on this assessment.

Thank you for the opportunity to submit written testimony with respect to this important issue.

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Respectfully,

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