Committee on Rules and Administration

Hearing to Examine and Discuss S 271, a Bill which Reforms the Regulatory and Reporting Structure of Organizations Registered under Section 527 of the Internal Revenue Code

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March 8, 2005

I am grateful for the invitation of the Committee to speak and submit testimony on the subject before it: a bill, S. 271, to regulate "527" organizations as political committees under the Federal Election Campaign Act, and to codify and add to the restrictions on how political committees finance their activities.

I. Basic Background

A "527" is a political organization exempt from tax under the Internal Revenue Code section bearing that number. By definition, it qualifies as such if it receives and spends funds for the exempt 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…." 26 U.S.C. § 527(e)(2).

Some 527s register with the FEC, and comply with FECA financing restrictions, because they contribute to federal candidates, or make expenditures promoting their election or defeat, or coordinate their spending with them. Others, however, remain 527 political organizations for tax purposes, but because they do not, and choose not to, engage in activities regulated under the FECA, they do not acknowledge FECA "political committee" status and comply with the associated legal restrictions.

527s that do register with the FECA may still operate as a federal political committee, but also with a companion "527" or "nonfederal" account that accepts nonfederal funds to account for its activities in state and local elections. This "527" or nonfederal account may, by regulation, share costs with the federal committee, on an allocated basis, for certain "mixed activities" like voter registration and get-out-vote activity that affect both federal and nonfederal elections.

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The relevant law is complex and proposed legislation would make it still more so. As I will discuss at length below, the new bill provides that, with narrow exceptions, all 527s are political committees, and it conditions the exemptions, such as one for committees active only in nonfederal elections, on refraining from certain activities: 1) "promoting, supporting, opposing, or attacking" federal candidates during an election year, and 2) conducting "voter drive activity," such as get-out-the-vote activity. The bill would also subject FECA "political committees" to new restrictions on how they can pay for their mixed activities and their day-to-day operating expenses.

For purposes of this testimony, it may be useful to explain, in broad strokes, how we came to this pass: that after only one election cycle of experience with the last major reform, this Committee is considering another one. Some understanding of the machinery of reform and why it continues to grind away will help to set some context for particular issues raised by the proposed 527 bill.

II. Why More Regulation Post-BCRA?

Why is there a proposal now, and some apparent urgency in its advocacy, only two years and some months after BCRA became effective?

A. The Mystery

It might be thought that those arguing for this reform are convinced that BCRA is foundering on the failure to address so-called "527" activity. But this is not the case, since for some months now, long before even the 2004 election cycle ended, those who actively supported the law have pronounced it a smashing success. Senator McCain has said so. So have other notable reform proponents, such as Professor Mann of the Brookings Institution and Professor Corrado of Colby College. And a long-time leader of campaign and ethics reform, President of Democracy 21, Fred Wertheimer, posted this cheerful appraisal on his website in July of last year: "[T]he McCain-Feingold law banning soft money is working and accomplishing its goals…."

These reform proponents, and others, praise the new law but damn its implementation by the Federal Election Commission. They allege that the FEC could have, and should have, treated most 527s as "political committees" but, in a continuing dereliction of duty, did not. This argument is not altogether satisfactory, either, since the Congress, when considering BCRA, understood fully well how the FEC approached the question of 527s and their status and did not direct a change of course. In a law striking for its clear references to "527s," McCain-Feingold accepted their existence and merely imposed prohibitions on financial transactions between them, on the one hand, and officeholders, candidates and parties, on the other.

This seems consistent with the proposed purpose of BCRA, on which the claims of success to date rest: the separation of "soft money" from the officeholders and parties in whose hands it supposedly becomes—in fact or appearance—corruptive lucre. BCRA was concerned, so it was said, with the corruption or apparent corruption of monies raised by or provided directly—or indirectly through parties—to officeholders and candidates. Yet the proposal before this Committee would apply severe restrictions to "527s" that are not political party committees, not controlled by candidates and not operated in coordination with parties or candidates. And it would impose other new financing restrictions on already registered political committees that are neither parties nor operated under their control or in coordination with them or candidates.

B. The Mystery Solved

The answer lies in the nature of BCRA as one stage in a multi-stage program of regulating money in politics advocated by a standing reform establishment; energized by the increasingly permissive constitutional jurisprudence crowned by the Supreme Court in *McConnell v. FEC*[1]; and now advanced still further by the inevitable emergence of partisan interests believed to be served by fresh changes in the law. This proposed legislation on "527s" is the next phase. It is certain not to be the last.

This is not to say that there are not well argued reasons for reform, or honorable convictions behind the presentation of those reasons. No doubt there are. But it is impossible to understand how this bill comes before this Congress, now, without appreciating that campaign finance regulatory efforts have entered a new phase of relentlessly pursued expansion.

1. The Reform Industry

We have now, agitating ceaselessly for new regulation, a reform establishment that has spent, and will continue to spend, hundreds of millions of dollars to critique and propose changes in the way we finance our elections. PoliticalMoneyLine, a nonpartisan research organization, published in the last days a remarkable study that suggests the scale of the reform enterprise. It reports that in the last ten years, from l994-2004, almost one hundred organizations received and spent roughly $140 million dollars to lobby changes in the campaign finance laws. Most of the money, $104 million, was contributed to seventeen organizations. These numbers do not include the sums spent through the academy to promote these changes in scholarship or

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[1] 540 U.S. 93 (2003).

research designed for that purpose (though some such scholarship is financed through grants from these organizations).

These organizations are visible with proposals like the one before this Committee, but they also seek to move the law in other ways, such as in seeking rulings by the Federal Election Commission, or filing complaints with that agency, or appealing decisions of that agency to the courts. They share a common commitment—expansion of the law and aggressive enforcement—and so it is fair to say that we will not hear from that quarter expressions of satisfaction about the health of our politics or the integrity of its practitioners.

The quest for ever more perfect regulation is not motivated only by a concern about corruption, or even its appearance, which are the grounds on which constitutional regulation rests. The reform program looks to a redesign of democratic process, including the rules governing the use of money, to promote a more participatory, more deliberative, perhaps even less coarsely "political," democracy. Those supporting this program generally wish for less negative and more positive speech; less rather than more "partisanship"; less rather than more scope for political party activity; less horse-trading and more "deliberation."

With the *McConnell* case, decided in 2003, the path has been cleared for these efforts, and it has led in part to the bill now under consideration.

2. *McConnell* and the End of the *Buckley* "Corruption" Era

The reigning case for a long period of time was *Buckley v. Valeo*, in which the Supreme Court held that a specific rationale—corruption or its appearance—could be invoked to support Congressional restrictions on campaign finance. This restriction was viewed within the reform community as narrow, frustrating attempts to both enforce and expand the contribution limitations, source restrictions and other requirements of the FECA.

The Supreme Court's 5-4 decision upholding BCRA effectively ended the reign of *Buckley*, even if the old anti-corruption rationale still dominates the terms in which the campaign finance debate is conducted. The Court concluded that *quid pro quo* corruption, or its appearance, were not, in the senses previously understood, required to validate Congressional restrictions. In fact, it conceded that the chase after corruption was futile, since it not was "easily detected."[2]

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[2] *McConnell at* 153.

The Court substituted a theory of "circumvention," under which Congress could impose new limits on political money as a means of enforcing olds ones. Citing its prior case in *Colorado Republican Federal Campaign Committee v. FEC*,[3] the Court held that circumvention was itself a theory of corruption.[4] This was advantageous to those who wished to argue for still more stringent restrictions. Now any action so far unregulated could be denounced as a "circumvention," hence "corrupt." The Court also stressed that Congress need not have evidence of circumvention, but could even act on its own *predictions* of what means of circumvention might be exploited in the future.[5] And it reflected, and decisively blessed, a decidedly casual approach to the kind of evidence that it would accept as proof of corruption, such as newspaper clippings and the sworn personal opinions of former and current legislators.[6]

But central to the long term significance of *McConnell* is a change in jurisprudential course, somewhat disguised by the Court's continued use of the anti-corruption language from the now defunct *Buckley* era. The Court has now endorsed, in the name of "deference" to Congress' "expertise," a free-ranging legislative program of encouraging enhanced democratic "participation."[7] In the Court's new view, Congress need not confine its efforts to addressing demonstrated corruption, or its appearance: it has constitutional permission to regulate politics in the interest of enriched, more meaningful democratic self-government. The now seemingly quaint constitutional concerns expressed by the *Buckley* Court—about the effect of this kind of regulation on rights of speech and association—have been subordinated to this goal of participatory self-government. The goal is grandiose, all the more so because it is undefined; and it is a standing invitation to all manner of regulation, and there are those determined to regulate the politics who are prepared to accept the invitation.[8]

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[3] 533 U.S. 431 (2001) ("*Colorado Republican II*").

[4] *McConnell at* 165, citing *Colorado Republican II* at 458.

[5] *McConnell* at 165.

[6] *See also Nixon v. Shrink Missouri Gov't PAC,* 528 U.S. 377, 393-395 (2000).

[7] *McConnell* at 144, citing *Shrink PAC* at 390.

[8] Justice Breyer, the principal Court theorist on this point, has argued this point in very explicit terms in other writings, under a conception of "active liberty." Justice Stephen Breyer, Tanner Lecture: "Our Democratic Constitution, Harvard Law School (Nov. 2004). And this momentous change wrought by *McConnell* is now well recognized in the specialized "law and democracy" scholarship on the subject. *See* Richard L. Hasen, "*Buckley* is Dead, Long Live *Buckley*: The New Campaign Finance Incoherence of *McConnell v. Federal Election Commission*," 153 U. Pa.

So *McConnell* has provided reform advocates with powerful new tools in the attempt to add new wings to the edifice of reforms. And the problem of political will has, in the short term at least, been addressed by partisan controversy and motivation.

3. Partisanship

The Court in *McConnell* suggests that the history of campaign finance regulation is one of resolute attention to corruptive effects of big money. Of some of those who have supported these kinds of reforms over the years, this is undoubtedly true. Also true is the traditional and profound effect of partisan interest on the choice of which reforms are promoted, and which are not. Examples range from early Congressional investigations into violations of the Federal Corrupt Practices Act, through the enactments of the Hatch and Smith-Connolly Acts, and the Federal Election Campaign Act of l971. The pressure for 527 reform, in the wake of the 2004 Presidential and Congressional elections, is the latest chapter in this partisan history.

Partisanship is not a one-party affair, of course, and this witness is a partisan and unashamed of it. Yet the fact remains that the Republican Party, once a stalwart skeptic about campaign finance reform on First Amendment and other grounds, is now promoting "527" and related restrictions after a cycle of controversy over 527 criticism of the Bush Presidency. Because the Republican Party is now the majority party, this conversion to the cause of reform is, of course, highly significant: it may prove decisive. It is not, however, reassuring about the motives behind Republican support of the reform. Some Democrats, offended by the ugliness of advertising directed at their nominee in 2004, may well be tempted to join with the Republicans, to express their own understandable resentment.

III. "527" Reform and Its Problems

Out of this brew of has emerged an effort to enact, two years after BCRA, legislation like that before the Committee. As noted, the legislation attacks on two fronts:

1. It provides that any organization that is a political committee for tax purposes, namely, a "527," must, with narrow exceptions, be treated as a political committee under the FECA, subject to the financing restrictions of that statute; and

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L. Rev. 31, 57-60 (2004); Richard H. Pildes, "Foreword: The Constitutionalization of Democratic Politics," 118 Harv. L. Rev. 29, 149 (2003).

2. It provides that any political committee operating under the FECA must observe new restrictions on its financing of public communications and voter drives that may affect federal elections, if only indirectly.

The bill is short and to the point, but highly problematic in a number of its concepts and potential applications.

A. Moving the Line Between Properly Regulated and Other "Election-Influencing" Activity

The bill, as noted, does not turn on any relationship between 527s and parties or candidates: it applies to organizations of the kind that operate independently from both. This is the first problem: that it is not clear why this additional step follows from, much less is required by, BCRA. Some have argued that these organizations can influence elections, and so should not escape the same rules that other organizations, conducting different election-influencing activities, must follow. But that, of course, begs the question: the difference in treatment is a function of a different in activities. By ignoring or glossing over the differences, the 527 bill contributes to an obliteration of the line between regulated and non-regulated activity.

By the logic of the contemporary reform movement, however, the restriction on 527s now proposed makes eminent sense. In the first place, 527s have spent a lot of money, which stirs up the standing anxiety that "too much" of it is being spent on politics. In the face of the concern that 527s will spend still more in the future, as suggested by the recent Campaign Finance Institute study,[9] the bill offers limits—FECA limits—and even limits also on nonfederal contributions.

Moreover, the shift in reform thinking to its post-Buckley incarnation takes the law to be appropriately applied to any "election-influencing" activity. The purpose is not, to repeat, to combat clear corruption, or even its appearance. As recent scholarship has noted, there is not much reason to believe that political money has much direct bearing on how much corruption the public perceives in politics; and there is no more reason to believe that reforms of any kind will alleviate this distress.[10] Still, contemporary reform argument holds that the influence of money on elections should be contained, from whichever direction this influence is exerted.

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[9] Steve Weissman and Ruth Hassan, "BCRA and the 527 Groups," Feb. 9, 2005.

[10] Nathaniel Persilly and Kelli Lammie, "Perceptions of Corruption and Campaign Finance: When Public Opinion Determines Constitutional Law," 153 U. Pa. L. Rev 119 (2004).

The endless relocation of that line of regulation will affect 501(c)s in the future, but at this point, it is worth noting that one proposal among others for continued reform argues on these grounds for the extension of campaign finance restrictions to "think tanks" like the Heritage Foundation and the Brookings Institution.[11] After all, they also influence public policy and collect large and unrestricted sums to do so. Like campaign finance reform "think tanks" do, come to think of it.

B. Fostering Confusion: The FEC as Arbiter of 527 Construction

The FEC and IRS standards for regulating political organizations—"political committees" in the one case and 527 organizations in the other—are not the same. The IRS, for example, has accepted as "political organizations" under section 527 organizations that would not qualify as "political committees" under the FECA. Yet the FEC—the very organizations that bill sponsors scorn as wayward in its administration of the law—would be authorized under the bill to determine whether an organization is "described" in section 527 for IRS purposes and thus, with narrow exceptions, is also a "political committee." It is impossible to see how this would produce anything other than confusion. There is no basis for belief that the IRS and the FEC have the will, the experience, or the necessary guidance to coordinate their approach to avoid this confusion.

C. Fostering Endless Investigation

By empowering the FEC to determine whether an organization is an IRC § 527 "political organization," the bill would surely encourage complaints to the FEC that various organizations, particularly 501(c)s, were operating as 527s, not as 501(c)s. In light of the reform community's distrust of 501(c) advocacy and voter mobilization programs,[12] this is not by any means a remote possibility. For organizations now operating under exemption recognized by the IRS, this is, in fact, a likely and costly effect of the structure of this proposal.

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[11] *See* "Note: The Political Activity of Think Tanks: The Case for Mandatory Contributor Disclosure," 115 Harv. L. Rev 1502 (2002).

[12] "The New Stealth PACs: Tracking 501(c) Non-Profit Groups Active in Elections," Public Citizen, Congress Watch (Sept. 2004)

D. Wreaking Havoc with IRS Guidance to the Regulated Community

527 activity is largely the product of efforts by the IRS to encourage the conduct through these organizations of activities not within the exempt function of 501(c) organizations. Examples are certain forms of issue advocacy and voter education, such as the production of voter guides or voting records evaluating the performance of officeholders on specific issues important to an organization and its membership[13]. Because under IRS—but not FECA—standards these activities are deemed political, 527s were formed to conduct them.

The proposed bill, by converting 527s into political committees, would turn the IRS guidance on its head, and impose significant restrictions on the financing of these activities. The alternatives are not attractive, since 501(c)(3)s could not conduct them without threat of revocation or penalty, and 501(c)(4)s are also at risk under the applicable "primary purpose" test for maintaining their exemption. Moreover, these activities, when conducted by a 501(c)(4), may be subject to gift tax above a certain excluded amount, where no such tax is imposed on gifts for the same purposes when made to a "527."

These are significant concerns, because the activities in question are ones that exempt organizations should not be inhibited from conducting. 527s that engage in issue advocacy, or seek to mobilize voters on the basis of issues, are contributing to the very goal of participatory self-government that the new reform movement claims for its own. They are not financing this speech with voters in coordination with candidates or parties; nor do their communications expressly appeal to voters to vote for or against particular candidates, or to support or oppose particular political parties. There is little question that their actions may influence elections, but many actions do, and it remains necessary to distinguish between conduct, like corrupt conduct, that Congress may restrict for concrete, well-defined and widely accepted reasons, and activity we should let alone out of respect for speech, association and a robust political process. "527s" are not the product of wrongdoing, or "circumvention": they are the solution devised for the conduct of activities that ought not to be forced into the FEC regulatory scheme and that 501(c)s and others have been encouraged to form and operate for these purposes.

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[13] The IRS has provided some guidance over the years on types of permissible issue advocacy and voter education. *See, e.g.* Revenue Ruling 2004-6 (Jan. 26, 2004); Rev. Ruling 80-282 (July 1980); Rev. Ruling 78-248 (Jan. 1978).

E. Federalizing Financing of State and Local Elections

The bill would on its face appear to provide an exemption for committees conducting activities in relation to elections when no candidate for federal office appears on the ballot, or when the activities relate exclusively to nonfederal elections. Yet the bill then proceeds to withdraw, for all practical purposes, the proffered exemption, requiring registration as a political committee when one of these state and local committees:

-- at any time during the year before the general election, spends more than $1,000 to "promote, support, attack or oppose" a clearly identified federal candidate; or

-- pays more than $1,000 in calendar year for "voter drive activity" in connection with an election where a federal candidate appears on the ballot.

The critically important terms used here are not defined. There is no definition offered at all of the charged words "promote, support, attack or oppose," and it is not clear whether the various kinds of voter drive activity named in the bill, such as get-out-the-vote activity, carry the same definitions now assigned to them under BCRA for other purposes. It goes without saying that organizations engaged in comment on public policy questions, or seeking to turnout voters, should have some clear idea of when their words vault them into new, highly regulated status. And the federalization generally of these activities threatens, without a sound basis in policy or law, to severely burden the operation of state legislative caucuses and other state and local political organizations.

F. Imposing Major New Costs on Registered Non-Party Political Committees

The FEC recently changed the rules whereby political committees allocate their costs between federal and nonfederal accounts. The new bill codifies some of those rules, expands others and adds still another. All of these changes add to the costs of committees that may be registered for some activities, but should remain free to finance their state and local elections and efforts and related communications under some reasonable rules that respect their nonfederal purpose.

The rules imposed by this bill are not reasonable.

Examples include:

1) Any such committee would have to pay 50% of its overhead with federally restricted funds, regardless of the relative share of its overall efforts

devoted to federal elections. *Thus*, a committee that devoted 75% of its resources or more to nonfederal elections would have to pay for rent, phones, staff and other overhead with no less than 50% federally restricted money.

2) A committee that financed a public communication supporting a nonfederal candidate, with reference to a political party, would have to pay 50% of the costs with federally restricted money. *Thus,* the government would tightly limit the financing of "Vote for Governor Jones, Democrat."

3) A committee that financed a public communication in which a federal officeholder who was a candidate endorsed a state candidate would have to be paid 50% with federally restricted funds. *Thus*, the 50% "hard money" requirement would apply to an ad, paid by a committee active in state and local elections, featuring Senator Smith appearing alongside and endorsing Governor Jones.

There is an additional example of the excessive reach of the rules, which seems concerned primarily with extending the domain of federal rules without regard to the nature or clarity of the federal interest. All of the expenses paid for the nonfederal share of the costs would have to be paid from individual funds, collected in amounts not to exceed $25,000 per donor. This requirement is imposed without regard to the fact that the amount so spent by definition relates to the committee's interest in elections *other than* federal elections. The bill would proceed, all the same, to impose federal limits on what it, by definition, treats as nonfederal election activity.

IV. Conclusion

These features of the bill are troubling and the consequences deserve the closest attention. They are the product of a movement to enlarge the field of regulation well beyond its original boundaries, and to set the stage for more of the same when the target will have passed from 527s to 501(c)s, and then to others. The goals of many of those supporting these reforms are no doubt honorably conceived and deeply felt; but the outcome is a more complex set of new rules that will not cleanse politics, or make it in some abstract sense better. But these proposals will make the law more complicated; federalize activities outside the federal electoral realm; establish the foundation for more regulation in the future; and encourage the continued misuse of this form of legislation to serve partisan goals.

These are reasons enough to pause when there is still time to turn back. The Court in the name of "deference" has left it to Congress to pause, as it should now, and to decide wisely.