Testimony of Scott E. Thomas
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Mr. Chairman, Senator Dodd, and members of the Committee, I thank you for inviting me to testify today on S. 271. Generally speaking, this bill would require some additional organizations registered under section 527 of the Internal Revenue Code to register as "political committees" with the Federal Election Commission and comply with the provisions of the Federal Election Campaign Act, including its contribution limitations and reporting provisions.

This is an important legislative proposal. Non-party "political committees" registered with the FEC must accept contributions of no more than $5,000 per year from any permissible source, and must not accept any contributions from corporations or labor organizations. Those groups that have resisted "political committee" status are most concerned about such funding restrictions, no doubt. In the 2004 election cycle, we saw numerous reports of unregistered groups spending tens of millions of dollars in the aggregate on hard-hitting communications attacking specific candidates, yet as a recent study by the Campaign Finance Institute found, a large share of the donations used by such 527's in 2004 were actually well in excess of the contribution limits. The ability of donors to give huge amounts to groups run by well-connected Washington operatives raises the specter of special access to elected policy makers.

Last year, Vice Chairman Toner and I sponsored a proposal somewhat similar to S. 271 which failed to win the support of our colleagues at the Commission. So, it should come as no surprise that I view S. 271 as a positive step toward dealing with what I believe has become a major and damaging loophole in the statute.

To help explain how we got where we are today, I would like to provide some background on the treatment of 527s, both by statute and, more recently, by the Federal Election Commission, before I specifically discuss S. 271. Although I serve as Chairman of the Commission, the views I offer here are my own and reflect ideas that led to my work on the unsuccessful Thomas/Toner proposal. Commissioner Mason may present a somewhat different perspective and, between the two of us, we hope to offer the Committee a balanced view of the competing thoughts before the FEC as it grappled with the difficult problem on 527s in the electoral process. In fairness to all my colleagues, I hope the Committee will seek written comments from any of them who wish to add to the record of this proceeding.

Definition of "Political Committee" in FECA and 527 "Political Organizations" in the Internal Revenue Code

The Federal Election Campaign Act defines a "political committee" as "any club, association or other group of persons" that receives contributions or makes expenditures

aggregating in excess of $1,000 during a calendar year. 2 U.S.C. § 431(4). The terms "contribution" and "expenditure" are defined to reach funds given or paid "for the purpose of influencing any election for Federal office." 2 U.S.C. §§ 431(8)(A), (9)(A). On its face, the term "political committee" would reach even a law firm that makes a single $2,000 contribution to a federal candidate and thus require its registration as a "political committee" with the Federal Election Commission.

In *Buckley v. Valeo*, 424 U.S. 1, 79 (1976), though, the Supreme Court added an additional condition to the definition when it construed the term "political committee" to cover only "organizations that are under the control of a candidate or the *major purpose* of which is the nomination or election of a candidate" (emphasis added). Later, in *FEC v. Massachusetts Citizens for Life*, 479 U.S. 238, 262 (1986), the Supreme Court clarified that "should MCFL's independent spending become so extensive that the organization's major purpose may be regarded as *campaign activity*, the corporation would be classified as a political committee. . . . As such it would automatically be subject to the obligations and restrictions applicable to those groups whose primary objective is *to influence political campaigns*" (emphasis added).

For years the FEC has allowed groups whose major purpose is campaign activity or influencing political campaigns, and who have crossed the $1,000 threshold under the statute, to separate out their federal activity and only report that activity to the FEC. 11 C.F.R. § 102.5. To assure that non-federal funds ('soft money' sources) are not used to subsidize the federal share of allocable expenses like overhead and generic voter mobilization, the FEC has adopted regulations that require certain percentages to be used for the federal/non-federal split.

Meanwhile, § 527 of the Internal Revenue Code provides tax exempt treatment for certain income received by a "political organization" which is defined as a "party, committee, association, fund, or other organization (whether or not incorporated), *organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function*." 26 U.S.C. § 527(e)(1)(emphasis added). "Exempt function," in turn, is defined as the "function of *influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office* or office in a political organization, or the election of Presidential or Vice-Presidential electors." 26 U.S.C. § 527(e)(2) (emphasis added). In *McConnell v. FEC*, 540 U.S. 93, 174 n. 67 (2003), the Supreme Court observed that "Section 527 'political organizations' are, unlike § 501(c) groups, organized for the express purpose of engaging in partisan political activity." The Court further observed that 527 groups "by definition engage in partisan political activity." *Id.* at 177.

The Internal Revenue Code 527 provisions cover "political committees" that report to the FEC, committees that report to state or local election offices, as well as some groups that register and report with no election office. In the 2000 election cycle, several notable 527 groups actively promoting or attacking candidates were claiming they did not have to operate under FECA "political committee" restraints (or even state or local

election law restraints). In 2000 and 2002, Congress responded by adding IRS-based disclosure responsibilities for the larger 527s to the extent they were not already reporting to either the FEC or a state or local election office. 26 U.S.C. § 527(i), (j).

527 Activity in the 2004 Elections That Possibly Should Have Been Regulated Under "Political Committee" Rules

There is little doubt that 527 organizations not registered with the FEC had a major impact on the 2004 federal elections. According to the Campaign Finance Institute (CFI), "Federal 527" groups (defined as groups that were "primarily or very substantially involved in federal elections") spent over $398 million on the 2004 elections. In addition, these 527 groups received $405 million in net contributions for 2004, an increase of $254 million since the 2002 election cycle. Of most significance, much of the funding for these groups came from individuals who gave far in excess of $5,000 per year. Indeed, the CFI study found that "[t]he number of $100,000+ donors rose from 66 in '02 to 265 in '04. The top 25 $2 million+ individual donors provided $142 million or 56% of all individual contributions to 527s in '04." CFI concluded that "[I]f 527s become fully accepted and institutionalized, they could play even larger financial roles in the future, including the presidential election in 2008." "BCRA and the 527 Groups," Weissman and Hassan, Campaign Finance Institute (February 9, 2005). Left unchanged, the current state of affairs will breed constant inquiry about who the big donors are, what 'special interests' they have, and what efforts they have undertaken to get help from elected leaders in Washington.

The primary legal argument used by organizations avoiding "political committee" status is that the $1,000 threshold for "contributions" received or "expenditures" made should hinge on whether express advocacy is present in a particular communication. The Court in *Buckley*, however, plainly applied the express advocacy test only to groups whose major purpose is not to influence elections. The *Buckley* Court confined the term "political committee" to those groups whose major purpose is influencing elections and noted that expenditures of such groups are "by definition. . . campaign related." 424 U.S. at 79. The Court then stated, "But when the maker of the expenditure is. . . a group other than a 'political committee'. . . the relation of the information sought to the purposes of the Act may be too remote. . . . [W]e construe 'expenditure' for purposes of [the independent expenditure reporting provision for persons other than political committees] to reach only funds used for communications that expressly advocate . . . the election or defeat of a clearly identified candidate." 424 U.S. at 79-80.

I should note at this juncture that the FEC has not foundered completely over this express advocacy argument. While I cannot say what the FEC has done in the enforcement track regarding the 2004 election cycle, I want to assure the Committee that so far the six commissioners have reached consensus on ways to analyze political committee status so that there is some possibility of an FEC response to the 2004 activity.

The Thomas/Toner Proposal to Treat 527s as Political Committees Under FECA

Early last year, Vice Chairman Toner and I introduced a regulation proposal designed to address apparent confusion regarding the application of FECA provisions to 527s. Under Thomas/Toner, 527 organizations that crossed the $1,000 federal threshold by running ads promoting or attacking federal candidates or parties, or by engaging in partisan voter mobilization activities, would have been political committees under FECA, and therefore would have had to register with the FEC and abide by the hard dollar fundraising restrictions for their federal activity. We sought to have these regulations in place for at least the post-nomination phase of the 2004 elections.

The central premise of our proposal was that 527s, by virtue of their chosen tax status, can be presumed to pass the 'major purpose' test. After all, by definition, almost all 527 organizations admit that they are a "political organization. . .organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for . . . [the] function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office. . ." 26 U.S.C. § 527(e)(1), (2). In view of their self-described purposes, it appeared to us that a 527's major purpose almost always was "campaign activity." *MCFL*, 479 U.S. at 262. In order to avoid overbreadth, though, we built in an exception for 527s focused exclusively on non-federal elections, judicial selections, internal party races, or ballot questions.

The Thomas/Toner proposal also would have revised the Commission's allocation rules and required that all political committees pay for their allocable activities (other than allocable fundraising costs or candidate specific costs) using at least 50% hard dollars. (Famously, one political committee that reportedly focused on the presidential race operated in 2004 with a 2% hard dollar, 98% soft dollar allocation split.) Under our proposal, communications that 'promoted, supported, attacked, or opposed' a federal candidate would have counted toward the long-standing 'funds expended' allocation formula. (This would have addressed the claim by some FEC-registered groups that only communications containing express advocacy should count as federal outlays when calculating the federal allocation share.)

In May and August of 2004, the Commission considered the Thomas/Toner proposal, but it failed by a vote of 2-4 with only myself and Vice Chairman Toner voting in favor. One reason given in opposition to our proposal was that the Commission should not change rules during the election year because of the burden it might create. Vice Chairman Toner and I thought that, on balance, the extraordinary amount of funds likely to be raised in excess of the contribution limits by several organizations for obvious federal election purposes demanded the Commission's immediate attention.

A second, and more substantive reason given in opposition to the Thomas/Toner proposal was that in 2000 and 2002, Congress passed legislation merely requiring enhanced IRS-based disclosure and reporting rules for 527 organizations. Moreover, it

was argued, Congress considered a measure similar to the Thomas/Toner proposal (S. 2582) but did not enact it into law. Accordingly, several Commissioners felt that to adopt Thomas/Toner would be to reject a clear congressional judgment. Vice Chairman Toner and I thought that the 2004 record of huge donations flowing freely to 527s was not before Congress in 2000 or 2002 and that Congress would want the administrative agency with the exclusive jurisdiction to administer, interpret and civilly enforce the Federal Election Campaign Act to close this damaging loophole. *See generally* 2 U.S.C. §§ 437c(b)(1), 437d(a), and 437g; s*ee also* 2 U.S.C. § 438(a)(8) and (d).

New Commission Regulations

On August 19, 2004, the Commission adopted new rules dealing with the 527 problem in a more limited fashion. The new rules do not rely on 527 status to help determine a group's responsibility for registering with the FEC and abiding by the contribution limitations. Nor do they apply a 'promote, support, attack or oppose' test to determine what types of public communications or voter mobilization efforts by 527s would count as "expenditures." Instead, the rules revise the allocation scheme with a flat 50% federal funds 'minimum' for non-party political committees' administrative expenses, generic voter drives, and public communications that refer to a political party without any reference to clearly identified candidates. 11 C.F.R. 106.6(c). (Actually, by removing the longstanding 'funds expended' formula, the new rules effectively set a flat rate of 50%.) While the new rules specify that a public communication or voter mobilization effort mentioning only federal candidates has to be treated 100% federal, they also allow such efforts that only mention non-federal candidates to be funded with 100% soft money. The new rules also treat all money received in response to a solicitation as a "contribution" under the Act if the solicitation "indicates that any portion of the funds received will be used to support or oppose the election of a clearly identified Federal candidate." 11 C.F.R. 100.57(a).

I did not vote for these new regulations and, speaking personally, I have several concerns. In addition to leaving a cloud over what types of communications will cause a 527 group to cross the $1,000 "expenditure" threshold, there are several other shortcomings, in my view. First, the 50% allocation rule will only kick in if the group in question qualifies as a "political committee" under the FECA, so its impact will be limited if a group can use an express advocacy test to avoid such status. Second, for acknowledged political committees that truly focus most of their effort on federal candidates, a 50% federal allocation may be too low. As noted, the Commission's new regulations did away with the 'funds expended' allocation formula that would have covered this situation. Third, if a political committee is clever enough to avoid references to particular federal candidates, but includes a reference to a non-federal candidate, 100% of the communication or voter drive can be paid with soft money.

Finally, an organization will be able to avoid the new "contribution" test if its solicitations either: (1) avoid signals that the funds sought will be used in the election process; or (2) avoid references to particular federal candidates. As a result, the

Commission may find itself in the same predicament it has faced for years where groups claim they are not raising "contributions" and are not making "expenditures."

S. 271

"The 527 Reform Act of 2005" (S. 271) is designed to "clarify and affirm" that federal election oriented 527 groups are required to comply with the Federal Election Campaign Act. The bill generally requires such 527 groups to register as political committees with the FEC and comply with the prohibitions and contribution limits as well as the reporting requirements of the FECA. Under this approach, these 527 groups can only use 'hard money' to finance ads that promote or attack federal candidates, regardless of whether the ads expressly advocate the election or defeat of a candidate.

The bill also contains several important exceptions. The bill contains an exclusion for those 527 organizations that raise and spend money exclusively in connection with non-federal candidate elections, or state or local ballot initiatives, or the nomination or confirmation of individuals to non-elected offices such as judicial positions. Moreover, the bill exempts any 527 organization with annual receipts of less than $25,000 from the new 527 registration requirement. The bill does not affect groups that claim 501(c) tax status.

With respect to allocation rules, the bill establishes that when a 527 group, registered as a political committee, makes expenditures for voter mobilization activities or public communications that affect both federal and non-federal elections, at least 50% of the costs of such activities would have to be paid for with hard money. Importantly, the bill provides that with regard to the non-federal funds that can be used to finance a portion of voter mobilization activities and public communications affecting both federal and non-federal elections, such funds must come from individuals only (not corporate and labor organizations) and must be in amounts of not more than $25,000 per year per individual donor.

For a number of reasons, I believe S. 271 will significantly strengthen the law. First, by requiring those federal election oriented 527 organizations currently not registered with the FEC to register, the bill will force these entities to play by the same rules as other partisan groups. This means they will have to follow the same disclosure and receipt restrictions as PACs that have confined themselves to supporting candidates with direct contributions.

Second, S. 271 strengthens the law by requiring that hard money be used by covered 527 groups to finance ads that promote or attack federal candidates and does not use the outdated express advocacy test. This is consistent with the conclusion of the Supreme Court in *McConnell v. FEC* that the express advocacy test is not constitutionally mandated and, indeed, is "functionally meaningless" in the real world of politics. 540 U.S. at 193. It also aligns with the Court's holding that for partisan groups, the 'promote, support, attack, or oppose' standard in BCRA, s*ee* 2 U.S.C. § 431(2)(A)(iii), is not unconstitutionally vague. The Court found that these words " 'provide explicit standards

for those who apply them' " and " 'give the person of ordinary intelligence a reasonable opportunity to know what is prohibited.' " 540 U.S. at 170 n. 64 *quoting Grayned v. City of Rockford*, 408 U.S. 104, 108-109 (1972).

Finally, S. 271 strengthens the law by ensuring that all allocable activities designed to influence federal elections are paid for with at least 50% hard money. Under the FEC's current allocation regulations, there are opportunities to skew 'time/space' allocations by including references to non-federal candidates and thereby using far more soft money than is warranted. S. 271 not only remedies this by imposing a 50% minimum of hard money, but further places a limit of $25,000 per year on the contributions that can be accepted for that non-federal account.

There are several issues of interpretation raised by S. 271, but I believe Commissioner Mason will focus on that topic. For your information, the FEC's legal staff has looked at the bill and noted several areas that will warrant careful analysis. As a body, the FEC will be happy to work with the Committee to resolve any matters that arise during consideration of this legislation.

Conclusion

Mr. Chairman, the Bipartisan Campaign Reform Act was a good step forward in eliminating the use of soft money in federal elections. To maintain the integrity of that statute, though, the 527 loophole should be closed. I believe that S. 271 will achieve that result.

I thank the Committee for this opportunity to testify.