Heidi Abegg <habegg@WC-B.com> on 04/09/2004 02:20:53 PM

To: "'politicalcommitteestatus@fec.gov'" <politicalcommitteestatus@fec.gov>
cc:

Subject: Comments on NPRM

April 9, 2004

Dear Ms. Dinh,

Attached are the comments of Webster, Chamberlain & Bean on the Notice of Proposed Rulemaking on political committee status.

If you have any questions or problems with this attachment, please do not hesitate to call me.

Sincerely,

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April 9, 2004

Via E-Mail: politicalcommitteestatus@fec.gov
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Ms. Mai T. Dinh
Acting Assistant General Counsel
Federal Election Commission
999 E Street, N.W.
Washington, D.C. 20463

Re: Notice of Proposed Rulemaking: Political Committee Status

Dear Ms. Dinh:

Webster, Chamberlain & Bean submits the following comments on the Notice of Proposed Rulemaking, 69 Fed. Reg. 11736 (March 11, 2004), on whether to amend the definition of "political committee" applicable to nonconnected committees. Although these comments are not being filed within the time period for those testifying, the undersigned would agree to testify should the Commission so request.

Webster, Chamberlain & Bean specializes in the representation of non-profit organizations, including charities, social welfare organizations, trade associations, professional societies, pension funds, insurance trusts, educational institutions, civic leagues, and scientific societies. Webster, Chamberlain & Bean helps to set up non-profit organizations, including drafting and filing articles of incorporation, and obtains and helps clients maintain federal and state tax exemptions. Additionally, Webster, Chamberlain & Bean advises clients regarding their communications and activities to help ensure compliance with federal and state election and tax laws. Because the proposed rulemaking would impact many of the firm's clients, Webster, Chamberlain & Bean is submitting these comments.

I. Role of Non-Profit Organizations

A brief review of the role of non-profits generally, as well as their role in the political process, may be especially helpful here because the proposed rulemaking would convert many non-profits into political committees simply because their activities are believed to affect federal elections.

It cannot be disputed that non-profits do good things. Not only do they perform acts of charity; educate; shape and define values, policies, and culture; and lessen the burden of government, they serve to amplify the voices of individuals. Within this role, they are also concentrations of power which can buffer, or stand up to, the power of the majority, other interest groups, and the state. In short, they are an important part of our democratic structure.[1]

Concern exists today, and rightly so, about whether non-profit organizations will be able to continue to play their very important role in our representative democracy. The proposed rulemaking is only the latest in a series of laws and regulations which have chipped away at the ability of non-profit organizations to participate fully and freely in our democratic process. The increasing web of federal and state laws and regulations is leading some non-profits to throw up their hands in defeat because making a simple communication is not worth the time and expense it takes to ensure compliance. While this state of affairs may not seem to be troubling to attorneys from a financial standpoint, who stand to gain from the increased work, nor to the politicians and government officials whose views and actions are criticized, it is nevertheless extremely disturbing when non-profits are prevented from accomplishing the salutary and public-benefitting purposes for which they were organized.

Zechariah Chafee, Jr. pointedly observed that "[t]he men who propose suppressions, in Congress and elsewhere, speak much of the dangers against which they are guarding, but they rarely consider the new dangers which they are creating *or the great value of what they are taking away.*" Zechariah Chafee, Jr., Does Freedom of Speech Really Tend to Produce Truth?, in THE PRINCIPLES AND PRACTICE OF FREEDOM OF SPEECH 334 (Haig Bosmajian ed., 1971) (emphasis added). The proposed rulemaking would take away a valuable part of the unique role non-profit organizations play in our political life.

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[1] For this reason, non-profit associations are often referred to as the "Independent Sector," the "Third Sector," or the "Non-Profit Sector." This sector should be distinguished from the public sector (governmental bodies) and the private sector (proprietary organizations).

In the 1830s, Alexis de Tocqueville marveled at the special role nonprofits play in America's political life:

> As soon as several Americans have conceived a sentiment or an idea that they want to produce before the world, they seek each other out, and when found, they unite. Thenceforth they are no longer isolated individuals, but a power conspicuous from the distance whose actions serve as an example; when it speaks, men listen.
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> Americans of all ages, all stations in life, and all types of disposition are forever forming associations. There are not only commercial and industrial association in which all take part, but others of a thousand different types – religious, moral, serious, futile, very general and very limited, immensely large and very minute. Americans combine to give fetes, found seminaries, build churches, distribute books. . . . [I]f they want to proclaim a truth or propagate some feeling by the encouragement of a great example, they form an association. In every case, at the head of any new undertaking, where in France you would find the government or in England some territorial magnate, in the United States you are sure to find an association.

Alexis de Tocqueville, 2 Democracy in America 512-13 (J.P. Mayer ed. & George Lawrence trans., Harper Perennial 1966) (1840). Tocqueville's oft quoted description of America's heterogeneous and continuously expanding sector remains pertinent today and highlights the special role non-profits continue to play in our representative democracy.

Sometimes we associate not just for altruistic purposes, but to influence public policy and get something done. As Justice Harlan noted, "[e]ffective advocacy of both public and private points of view, particularly controversial ones, is undeniably enhanced by group association . . . ." *NAACP v. Alabama*, 357 U.S. 449, 460 (1958). Yet non-profit associations serve another important purpose in American society. As the Court observed in *Dale*, the freedom of association is "crucial in preventing the majority from imposing its views on groups that would rather express other, perhaps unpopular ideas." *Boy Scouts of Am. v. Dale*, 530 U.S. 640, 647-48 (2000). Not only do associations facilitate individual expression, they serve as a bulwark against an ambitious majority. As one scholar noted,

associations "are the hedgerows of civil society." Richard W. Garnett, *The Story of Henry Adams's Soul: Education and the Expression of Associations*, 85 Minn. L. Rev. 1841, 1853 (2001). Associations are the "critical buffers between the individual and the power of the State." *Roberts v. U.S. Jaycees*, 468 U.S. 609, 618-19 (1984); *see also* Peter L. Berger & Richard John Neuhaus, *Peter L. Berger and Richard John Neuhaus Respond, in To Empower People: From State to Civil Society*, 145, 148 (Michael Novak ed., 1996) ("[Voluntary associations] stand between the private world of individuals and the large, impersonal structures of modern society. They 'mediate[]' by constituting a vehicle by which personal beliefs and values could be transmitted into the mega-institutions."). Associations are also the "laboratories of innovation" that clear out the civic space needed to "sustain the expression of the rich pluralism of American life." Garnett, *The Story of Henry Adams's Soul: Education and the Expression of Associations*, 85 Minn. L. Rev. at 1853 (quoting Berger & Neuhaus, *Peter L. Berger and Richard John Neuhaus Respond, in To Empower People: The Role of Mediating Structure in Public Policy* 36 (1977)); see also *Roberts*, 468 U.S. at 622 (noting that associations are "especially important in preserving political and cultural diversity and in shielding dissident expression from suppression by the majority.").

Support of the non-profit sector, which serves all of these important purposes, would seem to be beyond reproach because support of pluralism and diversity is the very hallmark of American representative democracy. "'E Pluribus Unum' is not a zero-sum game . . . . [T]he national purpose indicated by the unum is precisely to sustain the plures," and leads not to "balkanization" but to a stronger unum through the creation of "imaginative accommodations." Berger & Neuhaus, *Peter L. Berger and Richard John Neuhaus Respond, in To Empower People: The Role of Mediating Structure in Public Policy* 41-42 (1977). Yet, the proposed rulemaking, rather than recognizing the non-profit sector's different, yet important, functions, indiscriminately turns non-profits into political committees, with all of the same reporting and disclosure requirements, simply because some of their activities are similar to those conducted by political parties and other political organizations, and, therefore, might affect a federal election. While these activities may generally be similar, they should be regulated differently (or not at all) for three reasons. First, the organizations conducting them are different in kind – non-profit organizations, by definition, cannot have the nomination or election of candidates as their major purpose without jeopardizing their tax exempt status. Second, the activities are conducted for different purposes. Third, the activities are required to be conducted in different ways.

A. Section 501(c)(3) Organizations

Different tax rules apply to political campaign and lobbying activities of tax-exempt organizations depending upon the category of § 501(c) under which the organization is described. However, it is no coincidence that the restriction on an organization's lobbying and political campaign activities generally become more stringent as the federal tax benefits potentially available to the organization or its donors increase. Section 501(c)(3) is the category most favored and sought after and, therefore, has the greatest and most detailed restrictions.

In general, although advocacy activities of all sorts are often viewed broadly as "political" in the sense that advocacy may be politically motivated or have political implications, the Internal Revenue Code distinguishes lobbying with respect to legislation from political campaign intervention. Section 501(c)(3) *expressly* provides that tax-exempt organizations described in that section may not, directly or indirectly, participate in, or intervene in, *any* political campaign on behalf of (or in opposition to) any candidate for public office. This statutory prohibition is absolute.[2] The reason for this prohibition is clear. Contributions to § 501(c)(3) organizations are deductible for federal income tax purposes, but contributions to candidates and political committees are not. The use of § 501(c)(3) organizations to support or oppose candidates or political committees would circumvent federal tax law by enabling candidates or political committees to attract tax-deductible contributions to finance their election activities.

The statutory prohibition is interpreted broadly. It applies to "candidates for public office," whether at the federal, state or local level. Under some circumstances, the IRS may consider an individual who has not yet formally announced an intention to seek public office to be a candidate for § 501(c)(3) purposes. Furthermore, an organization may violate the prohibition even if it does not identify a candidate by name. Additionally, a § 501(c)(3) organization does not need to violate the express advocacy standard of *Buckley v. Valeo*, 424 U.S. 1 (1976) for it to violate the political campaign prohibition of § 501(c)(3). Therefore, because the IRS broadly interprets political campaign activity, a § 501(c)(3)'s educational or lobbying communications cannot also be electoral in nature without violating the statutory prohibition. In other words, due to the statutory prohibition on campaign intervention, a communication cannot be both an educational or lobbying

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[2] As observed by the IRS, "intervention in a political campaign may be subtle or blatant. It may seem to be justified by the press of events. It may even be inadvertent. The law prohibits all forms of participation or intervention in 'any' political campaign." PLR 9609007.

communication, which is permitted, and political campaign activity, which is not permitted, without risking loss of tax-exempt status, a death blow to the organization. Creating an exception to the definition of "political committee" for § 501(c)(3) organizations will not create a so-called loophole because the absolute prohibition on campaign intervention does not permit § 501(c)(3) organizations to use their communications to nominate or elect candidates without jeopardizing their tax-exempt status. The IRC's absolute prohibition on campaign intervention prevents § 501(c)(3) organizations from meeting any constitutional definition of "political committee" or "major purpose" requirement.

Furthermore, voter registration, voter identification and get-out-the-vote efforts are subject to stringent requirements when conducted by § 501(c)(3) organizations. At a minimum, these activities must be conducted in a nonpartisan manner. Therefore, assuming compliance with IRS regulations, § 501(c)(3) organizations cannot use their voter registration and identification and get-out-the-vote activities to affect federal elections in a partisan manner.

B. Section 501(c)(4) Organizations

Section 501(c)(4) organizations are also tax exempt, but are focused on promoting the social welfare of the community. Some § 501(c)(4) organizations operate to bring about civic betterments and social improvements and do not qualify as § 501(c)(3) organizations because a substantial part of their activities may involve lobbying.

There are no restrictions under the Internal Revenue Code ("IRC") on the timing or amount of lobbying, whether direct or grassroots, in which § 501(c)(4) organizations may engage. Additionally, under the IRC, § 501(c)(4) organizations may engage in nonpartisan voter education activities, which enhance public awareness of social and political activities. Finally, the IRC permits § 501(c)(4) organizations to intervene in political campaigns so long as the organization is primarily engaged in other activities that promote social welfare.

The "promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office." Treas. Reg. § 1.504(c)(4)-1(a)(2)(ii) (1990). Revenue Ruling 81-95 nonetheless holds that as long as an organization that is exempt from tax under § 501(c)(4) is "primarily engaged in activities [that] promote social welfare," lawful participation in political campaigns is permitted. Rev. Rul. 81-95, 1981-1 C.B. 332. This Ruling based its conclusion, in part, on legislative history of

the enactment of section 527 of the Code, which suggests that § 501(c)(4) organizations may engage in political activities. S. REP. NO. 93-1357, 93d Cong. 2d Sess. 29 (1974), reprinted in 1975-1 C.B. 517, 533. Therefore, a § 501(c)(4) organization may intervene in political campaigns, as long as this activity is not its "primary" activity.[3]

As will be discussed below, both in *Buckley v. Valeo*, 424 U.S. 1 (1976) and in *FEC v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238 (1986) ("*MCFL*"), the Supreme Court has recognized that outside groups are different from political committees and political parties, and has largely protected such groups from regulation. The Commission likewise should recognize the unique role that § 501(c) organizations play in our democratic process and should not adopt any proposed rules at this time. In the alternative, the Commission's rules should exempt § 501(c) organizations from the definition of "political committee."

II. Specific Comments on Proposed Regulations

The proposed regulations are lengthy and detailed, and for that reason, Webster, Chamberlain & Bean will not attempt to comment on every issue raised in the NPRM. Should the Commission so request, we would welcome the opportunity to comment on, or expand upon, any of these issues at the hearing later this month.

A. Congress is the appropriate body to make such a fundamental change; Congress did not do so, and therefore, neither should the Commission.

The proposed rules are such a fundamental change that Congress, rather than the Commission, should be having this debate. Congress did not rewrite the definitions of "expenditure" or "contribution" when it passed the Bipartisan Campaign Reform Act ("BCRA"). The new limits on speech and activity were carefully applied by Congress only to certain groups. For example, limits on "federal election activity" were applied only to political parties and to officeholders soliciting soft money for non-profits. In fact, the limits on "federal election activity"

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[3] Political activities of organizations exempt under the purpose specific mutual benefit provisions of the Internal Revenue Code, *e.g.* § 501(c)(6) organizations, are not similarly limited under the Code. It is this unrestricted political activity, as well as the mission of providing services primarily or exclusively for a limited membership, that distinguishes non-profit organizations operating under these sections from social welfare organizations and charities that qualify for tax exempt status under §§ 501(c)(3) and 501(c)(4).

appears in Title I of BCRA – "Soft Money of Political Parties." These limits were not extended to others.

Congress again had an opportunity to rewrite the definitions when drafting the "electioneering communication" ban. Congress could have expanded the definition of "political committee" or rewritten the definition of "expenditure." Instead, Congress chose to prohibit electioneering communications by some, and allow them by others, subject to reporting and disclosure requirements. The Commission should not attempt to broaden its authority to regulate what Congress left alone.

B. The proposed rules are inconsistent with the letter and spirit of BCRA.

The proposed rules are entirely inconsistent with the letter and spirit of BCRA. BCRA permits federal officeholders to solicit up to $20,000 from individuals for non-profits seeking to conduct federal election activity. Yet, under the proposed rules, spending or receiving $20,000 for federal election activity will most likely turn the non-profit into a political committee. Congress understood that this type of speech was still permitted, as did the Supreme Court. *See McConnell v. FEC*, 540 U.S. ___ (2003) [slip op. at 80] ("Interest groups, however, remain free to raise and spend money to fund voter registration, GOTV activities, mailings, and broadcast advertising (other than electioneering communications.)").

The law also provides that certain § 501(c)(4) organizations ("MCFL organizations" or "QNCs") may engage in certain activities, e.g., independent expenditures, without being deemed political committees, as long as these activities do not become their major purpose. BCRA expressly permits QNCs to make unlimited electioneering communications subject only to reporting and disclosure requirements. The proposed rules would effectively eliminate MCFL organizations and QNCs.

The proposed rules are also inconsistent with the Supreme Court's rationale in upholding Title I in *McConnell*. Section 527 organizations, and certainly § 501(c) organizations, do not share the characteristic of political parties that the Supreme Court found decisive in upholding the "federal election activities" restrictions on political parties.

> Interest groups do not select slates of candidates for elections. Interest groups do not determine who will serve on legislative committees, elect

> congressional leadership, or organize legislative caucuses. Political parties have influence and power in the legislature that vastly exceeds that of any interest group. As a result, it is hardly surprising that party affiliation is the primary way by which voters identify candidates, or that parties in turn have special access to and relationships with federal officeholders. Congress' efforts at campaign finance regulation may account for these salient differences.

McConnell, 124 S. Ct. at 686. Therefore, there is no rationale for the Commission to redefine the definition of "expenditure" to include "federal election activities" when Congress, accounting for the "salient differences" between non-profits and political parties, did not do so.

C. Proposed rules that are so fundamental a change, and provide no notice to the regulated community, should not be adopted at this stage in the federal election cycle.

Webster, Chamberlain & Bean submits that less than seven months before a presidential election is not the time to adopt rulemaking that would drastically change the playing field for non-profits and non-registered § 527 organizations.

The effects of the proposed rulemaking extend far beyond the elections in November. Additionally, the rulemaking extends at least four years into the past. In light of this, and the lack of notice of such a fundamental change, the Commission should not bow to requests to hastily adopt proposed rules that are desired solely to prevent § 501(c) and § 527 organizations from spending money on speech and activities that might have an effect on the elections in November.

In addition to the sea change that the proposed rules would work, adopting rules now could cause a devastating effect on the non-profit sector. In the wake of BCRA and *McConnell*, these non-profits must already revise or eliminate certain of their communications and methods of communicating with the public. Many non-profits are still struggling to learn the new rules under BCRA. Some of the firm's clients have already committed resources and made plans for their activities in 2004 based on BCRA and the Court's settling judgment in *McConnell*. If the Commission changes the playing field yet again, how many non-profits will withdraw from the public debate? How many non-profits will have the resources to continue to pay their attorneys to figure out a new set of rules and how they interact with the IRC? More practically speaking, if the proposed regulations are adopted, non-profits that are contractually obligated to engage in federal election

activities will be forced to either terminate their contracts and face possible damages claims, or go ahead with the activity and risk becoming political committees.

D. Certification of No Effect.

Webster, Chamberlain & Bean would also like to comment briefly upon the Certification of No Effect (Regulatory Flexibility Act). The Commission states that "as a result of the exceptions described above, the proposed rule would not have an economic effect on a substantial number of the small entities." 69 Fed. Reg. at 11755. Furthermore, the Commission states that the "reporting requirements, however, are not complicated and would not be costly to complete." *Id.* "It is highly unlikely that a political committee would need to hire additional staff or retain professional services with the reporting requirements." *Id.* at 11756.

This analysis completely misses the point. While it may not be difficult to comply with the *reporting* requirements once an organization is deemed to be a political committee, the recordkeeping requirements – tracking spending and determining when one meets the major purpose test – will have an economic impact on a substantial number of small entities. A § 501(c) organization would need to set up separate accounting systems to prepare its Form 990 reports to be filed with the IRS, and to track its "categories of non-election spending" for purposes of the major purpose tests. *See* Fed. Reg. at 11747. Furthermore, to make the conversion of federally permissible funds to federal funds, a non-profit would need to go back and contact donors who gave up to two years prior. And, unlike political parties and political committees, § 501(c) organizations are not familiar with federal/non-federal allocation rules. Thus, there would be a significant learning curve for any § 501(c) organization that subsequently became a political committee.

E. Lookback/Retrospective Rule.

Not conceding that the proposed rulemaking is constitutional or necessary, should the Commission adopt rules, they should not contain a lookback provision. Such a rule would be ex post facto, that is, passed after the occurrence of a fact or commission of an act, which retrospectively changes the legal consequences or relations of such fact or deed. Although Article I, Section 9 of the Constitution states that Congress shall pass no ex post facto law, this constitutional prohibition applies only to criminal laws. However, the issue is not that simple and the inquiry does not end there; retrospective civil laws or rules can also be unconstitutional.

First, through the ex post facto prohibition, the Framers of the Constitution sought to assure that legislative Acts "give fair warning of their effect and permit individuals to rely on their meaning until explicitly changed." *Weaver v. Graham*, 450 U.S. 24, 28-29 (1980) (citations omitted). "[T]he presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted." *Landgraf v. USI Film Products*, 511 U.S. 244, 265 (1994). Including a lookback provision in any proposed rule is unfair and would greatly unsettle expectations that existed at the time the speech was made. How could a non-profit know four years ago that a grassroots lobbying ad it broadcast on television, which was free from regulation at the time, could cause it to become a political committee four years later?

The proposed lookback provision is unconstitutional for another reason. "The ban also restricts governmental power by restraining arbitrary and potentially vindictive legislation." *Weaver v. Graham*, 450 U.S. 24, 29 (1981) (citations omitted); *see also City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 513 (1989) ("The constitutional prohibitions against the enactment of ex post facto laws and bills of attainder reflect a valid concern about the use of the political process to punish or characterize past conduct of private citizens."). The legislature's or agency's "responsivity to political pressures poses a risk that it may be tempted to use retroactive legislation as a means of retribution against unpopular groups or individuals." *Landgraf*, 511 U.S. at 266. The Commission should not be persuaded by those who, for political gain, wish to silence certain groups now.

Due process requires that an ordinary citizen be able to know what is proscribed by a law. Barring clairvoyant abilities, the regulated community will not know, at the time of their speaking, what behavior is regulated or proscribed by retroactive rulemaking. "The Due Process Clause protects the interests in fair notice and repose that may be compromised by retroactive legislation; a justification sufficient to validate a statute's prospective application under the Clause 'may not suffice' to warrant its retroactive application." *Landgraf*, 511 U.S. at 266 (citation omitted). While not conceding that the Commission may prospectively apply the proposed rulemaking, it is clear that there is not a sufficient justification for its retroactive application.

Finally, ex post facto laws may violate First Amendment principles. Otherwise, legislatures and agencies could easily use them to transform political

enemies into "criminals" based on previous, then-non-criminal behavior. The "chilling effect" to speech would be severe, which cuts directly against the First Amendment, which is designed, at its core, to allow dissent from existing government policies to flourish. *See Landgraf*, 511 U.S. at 265-66 ("In a free, dynamic society, creativity in both commercial and artistic endeavors is fostered by a rule of law that gives people confidence about the legal consequences of their actions."). The lookback provision destroys the confidence of the regulated community and puts another weapon in the political arsenal. Anyone who wanted to silence or punish critical speech by a non-profit could simply file a complaint alleging that it must now register as a political committee. The non-profit would then be forced to produce and disclose four years' worth of financial information to demonstrate that its spending did not meet the relevant major purpose test. The role of the non-profit independent sector, as a check on the public and private sectors, would be severely curtailed, if not eliminated altogether.

The NPRM provides no reason for the lookback. What is the purpose of the lookback provision here if not to silence and punish those who have previously spoken but are attempting to avoid meeting the major purpose test in the future? *See* 69 Fed. Reg. at 11747 ("the current year spending would not be examined under this major purpose test."); *id.* ("The Commission also seeks comment on the proposal to consider the organization's spending during the previous four calendar years, which could cover groups that are active only during presidential election years.").

As a practical matter, a lookback provision would be nearly impossible to apply and enforce. Most non-profits would not have the information to look back to determine, depending upon which proposed major purpose test is used, whether it was a political committee. Non-profits are, in most cases, required only to file a Form 990 with the IRS, which does not sufficiently break down the information necessary to apply the proposed major purpose tests. Even if the Commission adopted categories of non-election spending, most likely, a non-profit would not be able to sufficiently determine the categories of its spending without pouring over its check ledgers or invoices line by line. This analysis would be cost and time prohibitive, assuming the appropriate financial documents were in existence.

For all of these reasons, should the Commission adopt the proposed rules in any form, they should provide fair notice and contain no lookback provision.

F. The Entire Basis of the Proposed Rulemaking Is Constitutionally Suspect.

The entire basis of the proposed rulemaking is constitutionally suspect. As in *Buckley* and more recently in *McConnell*, the Supreme Court has found that corruption, or its appearance, is a constitutionally permissible basis of regulation. Such corruption, or its appearance, can theoretically be found when federal officeholders raise funds or give access to donors. Therefore, Congress sought to eliminate the link between officeholders and large contributions of both hard and soft money.

However, this corruption rationale does not apply to § 501(c) organizations. The sole basis of regulation in the NPRM is the *effect* these nonprofits allegedly have on federal elections. *See, e.g.*, Fed. Reg. at 11747 ("Could a very large organization that spends less than 50 percent of its funds on election-related disbursements nevertheless have a profound effect on Federal elections?"). Using the effect of a communication or funds spent as the basis for determining when an outside group is a political committee is unconstitutional. Furthermore, Congress has already considered the matter and found that the laws should apply to outside groups *only* when it comes to certain communications. For example, Congress chose to regulate the communications themselves, rather than deem organizations that make independent expenditures or electioneering communications to be political committees.

G. Redefining "Expenditure."

Redefining "expenditure" to include communications that "promote, support, attack or oppose" a federal candidate, would prevent § 501(c) organizations from engaging in much of their education and lobbying activities. Many communications by a non-profit could be said to "promote, support, attack or oppose" a federal candidate, yet that does not mean that the non-profit has the nomination or election of a candidate as its primary purpose. Grassroots lobbying, educating the public about an officeholder's past votes, criticizing an officeholder for his or her votes or behavior – these could all be construed to "promote, support, attack or oppose" a federal candidate.

The proposed rules' redefinition of "expenditure" would take away the non-profit sector's role in serving as a bulwark or hedgerow. During the ever-expanding election season, Federal officials would be free from criticism from § 501(c) organizations because any criticism could be said to be an attack on them. Federal

officeholders would declare their candidacies for office the day after they were sworn in to insulate them from attack or criticism by outside groups. No longer could § 501(c) organizations praise an elected official for his or her work on passage of an important piece of legislation because such praise would be promoting or supporting the officeholder candidate. No longer could § 501(c) organizations criticize an elected official for his or her shortcomings or behavior in office. In short, the non-profit sector's important role would be marginalized at best, and eliminated at worst.

H. The Major Purpose Test.

1. Two of the proposed major purpose tests conflict with *Buckley* and *MCFL*.

The proposed major purpose tests focus on levels of certain activities by non-profits, and would trigger regulation when those thresholds have been exceeded. In short, two of the proposed tests focus on the activities (flat monetary triggers), rather than on the groups themselves. This approach is not consistent with the Supreme Court's approach in *Buckley* and later in *MCFL*.

The "major purpose" test, first announced in *Buckley v. Valeo*, 424 U.S. 1 (1976), and squarely reaffirmed in *FEC v. Massachusetts Citizens for Life, Inc.*, 479 U.S. 238 (1986) ("*MCFL*"), serves to ensure that occasional election-related expenditures do not subject an organization to the comprehensive disclosure requirements, covering all receipts and disbursements, that are applicable to political committees under the Federal Election Campaign Act. In *Buckley*, the Court stated that "[t]o fulfill the purposes of the Act [political committee] need only encompass *organizations* that are under the control of a candidate or *the major purpose of which is the nomination or election of a candidate.*" 424 U.S. at 79 (emphases added). The phrase "major purpose of which" refers neither to expenditures nor to contributions, but to "organizations." The *Buckley* Court construed disclosure requirements for outside groups to be limited to express advocacy because the term "for the purpose of influencing a federal election" was too vague and broad.

The *Buckley* Court did not have the same problem with the phrase "for the purpose of influencing a federal election" as applied to political committees because such groups can be assumed to fall within the core area sought to be addressed by Congress. They are, the Court stated, "by definition, campaign related." Therefore,

a political committee's spending is subject to regulation regardless of whether the spending is for express advocacy.

Because the spending by political committees and political parties is by definition campaign related, Congress chose to regulate federal election activities by these entities. But, when conducted by outside groups, these same activities are not necessarily campaign related. While Congress may be able to regulate certain specific activities, *i.e.*, independent expenditures, contributions, electioneering communications, when done by outside groups, the Supreme Court has clearly said that you cannot regulate outside groups until their major purpose is the nomination or election of candidates.

The *MCFL* Court reaffirmed that the focus of regulation is on the *organization's* major purpose, not the major purpose of an individual disbursement. The Court found that MCFL was not a political committee because "[i]ts central organizational purpose [wa]s issue advocacy," 479 U.S. at 252 n.6, regardless of the fact that it had made independent expenditures of almost $10,000. *Id.* at 249-250. As noted by the majority, "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." *Id.* at 262.

The Supreme Court construed "political committee" narrowly out of concern that small amounts of campaign-related expenditures by an organization primarily engaged in issue advocacy could trigger an obligation to report all of its non-campaign-related income and disbursements. A political committee is required to disclose *all* of its receipts, whether or not they are earmarked for election related activity. A political committee is limited to receiving contributions of $5,000 or less from any one person, and cannot accept contributions from corporations or unions.

Thus, a flat monetary amount is not a trigger for regulation. As shown above, the major purpose test was a judicial gloss applied by the Supreme Court, both in *Buckley* and in *MCFL* to *prevent* an organization that had exceeded the contribution or expenditure threshold from being subject to the onerous political committee reporting and disclosure requirements. If the law required everyone or every group that engages in partisan political activity to register as a political committee, the major purpose test is nonsensical.

Should a major purpose test be adopted, the burden should not be on the organization to demonstrate that it meets an exception. *See* Fed. Reg. at 11749 ("an organization would be considered to be a political committee if its expenditures or

contributions exceed the $1,000 threshold unless the organization has a major purpose other than nominating or electing candidates."). This approach is not consistent with the First Amendment, *Buckley* or *MCFL*.

Note the *MCFL's* Court's reference to "independent spending." There is no reference to "avowed purpose or spending." There is no reference to a dollar threshold. There is no reference to size or wealth. For these reasons, Webster, Chamberlain & Bean urges the Commission to reject the first and third proposed major purpose tests. The first proposed major purpose test makes no reference to a "major purpose" but solely uses an arbitrary $10,000 amount as the threshold. Surely it cannot be said that an organization that makes $10,001 in expenditures, however defined, has as its major purpose the nomination or election of candidates if its total yearly disbursements exceed $1 million (regardless of whatever "public pronouncement" exists). Similarly, the third proposed major purpose test contains no reference to "major purpose" but uses an arbitrary $50,000 amount as the threshold. Again, an organization with a $5 million yearly budget could spend $50,0001 and not be said to have the nomination or election of candidates as it major purpose.

2. Application of the proposed major purposes tests would conflict with the Internal Revenue Code.

Adopting either the first or the third proposed major purposes tests could lead to the incongruous situation where a § 501(c)(4) organization is recognized as such by the IRS, yet is deemed to be a political committee by the FEC. It would be possible for a charity to be recognized as exempt by the IRS under § 501(c)(3) and not engage in any campaign intervention, yet be found by the FEC to have as its major purpose the nomination or election of federal candidates. Similarly, it would be possible for the IRS to recognize that a § 501(c)(4) organization is primarily devoted to social welfare, yet the FEC find that the organization's major purpose is the nomination or election of federal candidates.

This Catch-22 arises because the proposed redefinition of expenditure appears to be broader than the IRS' definition of campaign intervention. If the definition of "expenditure" is expanded, there still could result in organizations being recognized as exempt under § 501(c)(3) or § 501(c)(4) but deemed political committees by the FEC. Therefore, the organization would be required to disclose its donors to the FEC (but not the IRS), and would be limited to raising funds in $5,000 increments, although the IRS would place no limit on the amount of money that could be given.

Application of the first and third major purpose tests could result in finding the non-profit tax scheme unconstitutional because of the constitutionality of restrictions on § 501(c)(3) organizations, and the interplay between § 501(c)(4) and § 527. These provisions of the IRC operate as a whole, and therefore, a change to one portion leads to a fundamental change to the entire system.

As discussed above, lobbying by § 501(c)(3) organizations is limited. *Regan v. Taxation With Representation of Washington*, 461 U.S. 540 (1983) held that the IRC § 501(c)(3) prohibition of substantial lobbying was constitutional, noting that the organization could have used a dual structure with a § 501(c)(4) organization for lobbying and the § 501(c)(3) organization for other activities. The Supreme Court emphasized the importance of the § 501(c)(4) alternative to its *Regan* holding in a subsequent opinion, *FCC v. League of Women Voters of California*, 468 U.S. 364, 399-401 (1984). Therefore, a § 501(c)(3) organization that wishes to engage in substantial lobbying must set up an affiliated § 501(c)(4) organization. If FEC regulations make it impossible or infeasible for a § 501(c)(4) to be formed and to lobby during election years, the rationale under *Regan* fails.

As more fully discussed above, § 501(c)(4) organizations may engage in unlimited lobbying, and well as some campaign intervention. Under the IRC, a § 501(c)(4) organization that makes expenditures for campaign intervention does not jeopardize its tax exempt status unless it is primarily engaged in campaign intervention; however, it must pay a § 527(f) tax on the lesser of the amount of these expenditures or its investment income.

An organization does not qualify under § 527 (whether registered or not with the FEC) unless it is organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function. Section 527(e)(2) defines the term "exempt function" to mean the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any public office or office in a political organization. IRS Reg. § 1.527-2(a)(3) describes activities that are not exempt functions (in the context of stating that they could be pursued by the organization as ancillary to its primary operational function of influencing elections) -- sponsoring nonpartisan educational workshops and carrying on social activities are unrelated to the exempt function. Therefore, direct and grassroots lobbying, influencing a public referendum or ballot measure, and other social welfare activities are not exempt function activities if conducted by a § 527 organization and would result in taxable income as a result of failing the segregated fund

requirement that the fund be used solely for an exempt function. Thus, organizations formed to conduct these activities cannot be exempt political organizations under § 527. This means that they would be taxable entities unless they qualify under § 501(c).

Thus, it is easy to see the dilemma faced by § 501(c) organizations if either the first or third proposed major purpose tests are adopted. The restrictions on lobbying by § 501(c)(3) organizations are only constitutional if they are free to set up § 501(c)(4) organizations. However, if the § 501(c)(4) organization meets one of the proposed major purpose tests as a result of its lobbying communications, it is a political committee for FEC purposes. Yet, if the § 501(c)(4) organization's primary purpose is social welfare for IRS purposes, then it cannot qualify as a § 527 political organization. But, if the FEC finds the § 501(c)(4) organization to be a political committee, then the IRS may find that the organization engaged in illegal activities – failure to register as a political committee – and therefore isn't engaged primarily in social welfare activities.[4] Ultimately, the organization would either be a taxable entity, or a § 527 organization which would have taxable income if the organization engaged in any of the lobbying or social welfare activities for which it was set up.

3. Alternative recommendation if this rulemaking is not terminated.

In the alternative, Webster, Chamberlain & Bean urges the Commission, should any rules be adopted, to adopt "the major purpose" (Alternative 2) as the sole test. This approach is consistent with the IRC, which uses "primary purpose" to determine when the IRS will recognize an organization under § 501(c)(4). However, this alternative is really no better than the other two if the definition of "expenditure" is expanded; a large organization might be able to make more "expenditures" if 50% is used as the threshold, but it is still constrained by the broad definition of "expenditure."

Additionally, because § 501(c)(3) organizations are prohibited from engaging in campaign intervention under the Internal Revenue Code, the Commission could categorically exempt § 501(c)(3) organizations. Likewise, recognized § 501(c)(4)

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[4] IRS General Counsel Memorandum 38,264 (Jan. 30, 1980) questions whether under the Federal Election Campaign Act it is lawful for an incorporated non-profit organization to make political contributions. "Illegal activities are the antithesis of activities that promote social welfare. Stated otherwise, the common good and general welfare of the people of a community is the cornerstone of the social welfare concept and illegal activities cannot be said to benefit the community." Gen. Couns. Mem. 38,264 (Jan. 30, 1980).

organizations, because their primary purpose must be devoted to social welfare, would also not meet "the major purpose" test.

4. Application of the major purpose test to "complex organizations."

The Commission asks about the "proper application of the major purpose requirement to complex organizations that include a political committee within the organization." 69 Fed. Reg. at 11749. No definition of "complex organization" is given. In the context of the Internal Revenue Code, the IRS recognizes affiliated organizations. An increasingly common arrangement is a § 501(c)(3) with an affiliated § 501(c)(4), with a related § 527 political organization or political committee. These affiliations are permitted as long as each organization observes the formalities of their status and confine their activities to those permitted by their respective exempt Code sections.

Why should the § 501(c)(3) in the arrangement described above be deemed to satisfy the major purpose test merely because another of the organizations in the arrangement has satisfied the test? If this were the case, these arrangements would cease to exist. Under this scenario, no longer could a charity affiliate with a § 501(c)(4) organization to accomplish its grassroots lobbying and § 501(c)(4) organizations would have to disaffiliate with its separate segregated funds.

III. Conclusion

Not only is it constitutionally problematic to treat political organizations and the non-profit sector alike, the strength of our democracy demands that non-profits' speech be encouraged, rather than regulated or prohibited. Tocqueville queries, "Is that just an accident, or is there really some necessary connection between associations and equality." Tocqueville, 2 Democracy in America at 514. Tocqueville finds that representative democracy is dependent upon a strong non-profit sector, in part, because of its stabilizing influence:

> Feelings and ideas are renewed, the heart enlarged, and the understanding developed only by the reciprocal action of men one upon another. I have shown how these influences are reduced almost to nothing in democratic countries; they must therefore be artificially created, and only associations can do that.

Id. at 515-16. He concludes,

> Among laws controlling human societies there is one more precise and clear, it seems to me, than all the others. If men are to remain civilized or to become civilized, the art of association must develop and improve among them at the same speed as equality of conditions spreads.

Id. at 517. Not only does the proposed rulemaking fail to recognize the critical distinctions between political organizations and non-profits, the ban hinders the ability of associations to fully contribute to the political debate and thereby foster our democratic system.

Finally, associational activity should be encouraged, rather than prohibited, because it protects citizens from overreaching by the government. Converting non-profits into political committees removes a balancing or stabilizing influence against overreaching by the government.

The non-profit sector is at a critical juncture in America. The proposed rulemaking at issue here, along with the restrictions in the Bipartisan Campaign Reform Act, have chipped away at the non-profit sector's important role in our democracy. For all the reasons stated above, Webster, Chamberlain & Bean respectfully requests the Commission to terminate the proposed rulemaking.

Respectfully submitted,

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