SPECIAL REPORT

TAX ANALYSTS

SOFTER MONEY: EXEMPT ORGANIZATIONS AND CAMPAIGN FINANCE

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In this report, Hill examines the complex role of exempt organizations in political fundraising.

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I. Introduction: Deconstructing Political Money

Political money comes in four forms — hard money, soft money, softer money, and independent expenditures. Hard money is limited as to both sources and amounts and its contributors must be disclosed to the Federal Election Commission (FEC) under the Federal Election Campaign Act (FECA).[1] Soft money is unlimited as to both sources and amounts but its contributors must be disclosed to the FEC.[2] Softer money is unlimited as to both sources and amounts and, with one exception, its contributors need not be disclosed to any government agency or to the public.[3] Independent expenditures are not limited in amount but are subject to certain limitations on sources and to disclosure requirements.[4] In effect, political money has been deconstructed.

Deconstruction of political money has brought with it the fragmentation of political structures. Each of these forms of political money is associated with a particular form of recipient organization. Hard money is a contribution to a political party or a candidate committee. Soft money is contributed to political parties. Softer money is contributed to tax-exempt organizations.[5] Funding for independent expenditures can be collected by political parties or by separate segregated funds or may be provided by an individual.

Each of these four types of political money is also ostensibly used for a distinctive type of activity. Hard

[1]2 U.S.C. section 431 *et seq.*, as amended. Hard money is discussed *infra* at Part III.

[2]Soft money was created by the FEC in a series of advisory opinions beginning in the late 1970s. For an analysis of soft money, see *infra* at Part V.

[3]Softer money arises from the intersection of tax law and federal election law. The nondisclosure provisions are derived from tax law and the lone disclosure requirement is also a tax law provision. Softer money is analyzed *infra* at Part VI.

[4]Independent expenditures as a type of political money were created by the Supreme Court in *Buckley v. Valeo*, 424 U.S. 1 (1976). For an analysis of independent expenditures, see *infra* Part IV.

[5]These organizations are defined under the Internal Revenue Code of 1986, as amended, and their activities are regulated by the Internal Revenue Service.

money can be used for any type of political activity; independent expenditures are used to expressly advocate the election or defeat of a candidate; soft money is ostensibly used for party-building; and softer money is used for activities that do not jeopardize exempt status. As a practical matter, hard money is used for campaign communications that rarely contain the magic words of express advocacy and both soft money and softer money are used for communications that voters perceive as efforts to influence their vote.

Distinctions among the four types of political money are blurred not only by their virtually indistinguishable uses but also by the ease with which the four types of political money can be transformed into each other.[6] The movement and transformation of types of political money means that campaign finance is not a simple jigsaw puzzle in which the pieces retain their shape but a much more mind-bending enterprise in which the shapes of the pieces change at the direction of the large contributors and the candidates in ways that citizens and ordinary contributors can discover only with great difficulty, if at all.[7] Political money has been deconstructed into mutable forms.

The deconstruction of political money into mutable forms and the fragmentation of political money structures obscures the unitary reality of political money. The quality of officeholders' and candidates' political gratitude is based not on the form of political money but on the amount.[8] From the perspective of officeholders, the multiple forms of political money and the structures through which it is raised are simply tactical conveniences or inconveniences, as the case may be. Citizens do not perceive differences among types of political money or the structures for raising and deploying different types of political money but tend to see all of these efforts as campaign activity.[9]

The unity of political money, and the public perception of political money as unitary, puts tax-exempt organizations in a curious position and perhaps leaves some citizens and some in the exempt community wondering how they got there. The essence of the current system is to use the exempt form derived largely from tax law and also from state nonprofit law to avoid the requirements and limitations applicable to other forms of political money under federal election law while, at the same time, using concepts from election law to broaden the activities that can be funded with softer money without jeopardizing an organization's exempt status, at least not before the election. Exempt nonprofit organizations are virtually perfect structures for raising and deploying softer money because the exempt form is malleable, exempt purposes are plastic, and exempt organization structures lack accountability and transparency. These characteristics reached their most complete development in the "new section 527 organizations" designed for the express purpose of avoiding the limits of both tax law and election law.[10] These organizations cannot receive deductible contributions, which meant that the only benefit they offered compared with other political structures was avoidance of disclosure. This benefit disappeared with the enactment of disclosure requirements during the summer of 2000.[11]

The legislative battle over disclosure by the new section 527 organizations linked softer money with other forms of political money. In so doing, it offered valuable lessons for other exempt organizations, particularly those described in section 501(c)(3) and section 501(c)(4). These organizations found themselves in the eye of the legislative storm. Some members of Congress wanted to extend the same disclosure provisions to these organizations, while other members were counting on exempt organizations to derail any disclosure at all. This experience forced exempt organizations to face the complexities and ambiguities of their positions in the larger controversies over campaign finance. Any reform that addresses soft money without also addressing softer money will not have the intended consequences. The result would be to replace unregulated but disclosed soft money with unregulated and undisclosed softer money. Meaningful campaign finance reform cannot be achieved without understanding the complex roles of exempt organizations and the implications of the deconstruction of political money. The very complexity of this undertaking is the primary barrier to embarking on it. This article is intended to serve as at least an initial guide to understanding the multiple relationships between exempt organizations and political money.

[6]The reasons for moving political money in these ways and changing its character in particular ways are discussed *infra* at Part VII.

[7]There is a certain "X-Files" quality to political money. It takes multiple forms, often appears in guises that conceal its true nature, and can change form with little effort for tactical advantage. The hopeful premise that "the truth is out there" may be unduly optimistic when applied to political money.

[8]Were Portia to observe the contemporary scene without the benefit of a contemporary Shakespeare to update her speech, she might well be moved to remark: "The quality of political gratitude is not constrained by legal distinctions but floweth from the corridors of power proportionate to the amount of the contribution, if it so pleaseth the holders of public office."

[9]Important research has been conducted by a number of organizations, and they report similar results on voter perceptions. For innovative research on activity other than television or radio advertising in the 1998 mid-term election, see David B. Magleby, ed., *Outside Money: Soft Money and Issue Advocacy in the 1998 Congressional Elections* (2000). For similar research by David Magelby and his team on the 2000 election, see the project's Web site, www.byu. edu/outsidemoney. For research on elections from 1996 forward showing that voters tend to see all ads as efforts to influence their votes, see the Annenberg Public Policy Center at www.appcpenn.org and the Brennan Center at New York University, www.brennancenter.educ.

[10]For an analysis of these organizations, see Frances R. Hill, "Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle," *Tax Notes*, Jan. 17, 2000, p. 387.

[11]H.R. 4762 became law on July 1, 2000.

II. Rationales for Participating in Campaigns

To play their current expansive roles in political campaigns exempt organizations have had to craft elaborate and subtle legal arguments and, in the process, to risk their exempt status. This process of using tax law to craft arguments that permit contributors to avoid the limitations and requirements of federal election law is at the heart of the creation of softer money. The question of why exempt organizations have developed these arguments and assumed these risks remains largely unexplored, often even by the organizations themselves. This section of the paper discusses three rationales for exempt organizations' involvement in political campaigns. These three rationales are analytical constructs and not descriptions of the terms used by exempt organizations.[12] Each of the rationales raises different perspectives on political money, on exempt organizations, and on the political system in which exempt organizations operate.

A. Necessity: Achieving Exempt Purposes

The necessity rationale is based on the argument that exempt organizations cannot achieve their exempt purposes unless they also participate in electoral campaigns. In asserting a necessity rationale, exempt organizations treat participation in electoral campaigns as a means to an end, a way of gaining access to and influence in the policy process. Participating in campaigns is necessary for lobbying, for advancing an issue agenda in legislative and executive branch decision-making. The necessity rationale focuses on the policy process in which exempt organizations seek to achieve their exempt purposes.

The necessity rationale is generally advanced in a weak form that focuses less on election campaigns than on lobbying. When they are lobbying, exempt organizations are focusing directly on the issues that define their exempt purpose. When they are participating in political campaigns their issue message is filtered through the interests of candidates and parties in winning public office. Candidates and parties take stands on multiple issues, and exempt organizations are gambling that their issues will remain important to the winners once they have taken office.

To provide the predicate for softer money, the necessity rationale must show how and why influencing policy through lobbying is either insufficient or inadequate or impractical or ineffective unless the organization becomes involved in electoral campaign activities. The idea that any one exempt organization can defeat its enemies and elect its friends is illusory for even those exempt organizations with massive war chests for electoral politics. If electoral activities are not realistically about electing or defeating candidates and thereby increasing the prospects for enacting legislation related to an organization's exempt purpose or defeating legislation inconsistent with an organization's exempt purpose, why do some exempt organizations argue that they must participate in electoral campaigns?

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The answer is found not in election campaigns but in the public policy process. The missing link is the ability of officeholders in the legislative and executive branches to demand that groups that want access to the policy process pay for that access. Economists call this process rent-seeking.[13]

Rent-seeking is a process of auctioning public policy, a two-way transaction through which private sector interests seek influence and officeholders either promise action or, more commonly, promise not to take action contrary to the interests of a particular private sector actor. This is a well-established pattern in all political systems both historic and contemporary. Older forms of rent-seeking were means of personal enrichment. This led to the observation that an honest politician is one who stays bought, which was developed in the era of political machines, but could have applied as well to leaders from the Roman Empire to European monarchies of a more recent vintage. Max Weber wrote of the United States as a system of "professional politicians" who live both "for" and "off" politics.[14]

The current form of rent-seeking is inextricably bound up with the campaign finance system.[15] Political money in its various forms provides the means of paying officeholders and potential officeholders for ac-

[12]These terms have been developed over an extended period based on conversations with exempt organization managers, lawyers who are experts in tax law or election law, and participants in the policy process.

[13]George J. Stigler, "The Theory of Economic Regulation," 2 *Bell J. of Economics and Management Science* 3 (1971); James M. Buchanan, Robert D. Tollison, Gordon Tullock (eds.), *Toward a Theory of Rent-Seeking Society* (1980); Gordon Tullock, *The Economics of Special Privilege and Rent Seeking* (1989); Fred S. McChesney, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion* (1997).

[14]Max Weber, "Politics as a Vocation," in H. H. Gerth and C. Wright Mills (eds.), *From Max Weber: Essays in Sociology* (1946).

[15]Some of the more illuminating investigations of this system include Elizabeth Drew, *The Corruption of American Politics: What Went Wrong and Why* (1999); Elizabeth Drew, *Whatever It Takes: The Real Struggle for Political Power in America* (1997); Charles Lewis and the Center for Public Integrity, *The Buying of the Congress: How Special Interests Have Stolen Your Right to Life, Liberty and the Pursuit of Happiness* (1998); Charles Lewis and the Center for Public Integrity, *The Buying of the President 2000* (2000).

cess and influence without running afoul of the ethics rules. When a politician oversteps and takes money that is not packaged as political money, investigations and public condemnation escalate. When a politician extracts soft money or softer money in amounts that far surpass the amounts involved in most corruption cases, it is business as usual and some argue it represents democracy at work because the soft money contributors are exercising their First Amendment rights to speak. The Supreme Court's position that money is speech has been distorted by rent-seeking officeholders into the proposition that payment should be the precondition for the right to speech in the policy process, a right that should carry no price tag. Cases protecting the right of citizens to speak by collecting and deploying money in political campaigns have become the foundation for rent-seeking, the system through which citizens are priced out of the policy process and thereby lose their voice in public policy.

Rent-seeking officeholders offer two types of policy benefits. One type is a promise of beneficial action. This is a bribery-type transaction in which an influence-seeker seeks to guarantee an outcome. This is difficult and dangerous. The greatest danger to the officeholder is if he or she succeeds and in the process leaves a record that establishes the connection between the money and the outcome. This is the inquiry currently being undertaken in the Marc Rich matter.

The second type of rent-seeking is a threat of adverse action. This is an extortion-type transaction in which the officeholder threatens to take some action, whether to introduce a bill or to take a regulatory action, that will be adverse to some person's interest. This is much safer for an officeholder because it is much more difficult to trace political money to inaction. It is also simpler and more lucrative for the officeholders, since they can always think of a threatening policy initiative, especially one they will not have to persuade others to support. Extortion-type rent-seeking works as long as powerful interests do not call an officeholder's bluff. The reason that so few interests resist extortion-type rent-seeking is that they know that at some point they will need to engage in bribery-type rent-seeking. Both sides to the rent-seeking transactions have an interest in keeping the system in place. Overturning the entire system might be in the true interest of both parties to rent-seeking transactions, but this poses the exquisite dilemma explored by game theory, the problem of taking action based on incomplete information and thus an incomplete basis for trusting the process or the other players, even if trust would produce the best outcome for all players rather than a relative advantage for some players.[16]

Soft money and softer money are the currency of rent-seeking. Campaign contributions made to a candidate carry greater risks of creating a link to a particular vote or to a particular threat of adverse action. Soft money given to a political party obscures the connection, but it has to be disclosed. Softer money does not in most cases have to be disclosed, and, if the soft money organization is controlled by reliable allies of an officeholder or candidate, it gives that politician greater control of the political money than any one person is likely to have over soft money.

Some members have risen to prominence through the control over the rent-seeking system, and have used their skill in this arena to exert considerable control over their colleagues and considerable influence over the policy process. Legislative battles over campaign finance reform are in part struggles between the masters of rent-seeking and those who have not been able to use it to their relative advantage. At the same time, this is not a clear contest in which positions are easily predicted. Those who have not been able to raise sufficient soft money to gain influence over their colleagues are in some cases the most dependent on the money that the successful rent-seekers raise and then allocate to them, making them dependent on the rent-seeking system mastered by others.

Soft money and softer money are the currency of rent-seeking.

It is fanciful to think that exempt organizations can stand outside this system of rent-seeking and influence-seeking. Rent-seekers will not permit exempt organizations to stand outside the rent-seeking system because more money is always welcome. Rent-seeking is not a process with inherent limitations. Softer money is attractive to rent-seeking officeholders for the same reasons that it is attractive to candidates. At one level, softer money is simply an additional source of money. Indeed, to the extent that exempt organizations raise money from the same individuals and corporations that have already made soft money contributions, exempt money simply provides a means of multiple extractions from the same deep pockets. Softer money is also desirable because it is even more private than soft money. It does not have to be reported to any government agency, contributors are not disclosed, there are no limits on the nature of contributors or the amount that they may contribute. Softer money is even more desirable than soft money, provided only that it can be raised in sufficiently large amounts to justify the transaction costs of seeking it.

Some exempt organizations have no prospect of raising the desired amount of money on their own. This reality does not place them outside the rent-seeking system. Instead of raising money, such organizations perform selected services for one or more of the masters of rent-seeking.[17] For example, a section 501(c)(3) organization may receive a contribution from

[16]Thomas C. Schelling, *The Strategy of Conflict* (1963) (*see* especially the discussion of the prisoners dilemma game).

[17]The concept is illustrated by the scene in "Godfather I" when the Don asks the undertaker whether he is prepared to do him a service, in that case, to repair enough of the bullet damage done to Sonny at the toll plaza so that his mother will be able to view him in his casket. This is the one service that the Don will require, but refusal is not an option for the undertaker.

a contributor who wants a section 170 charitable contribution deduction and then pass the amount along to a section 501(c)(4) organization for an issue advocacy effort. The section 501(c)(3) organization simply performs this "service" for the master of rent-seeking and never engages in any public activity that jeopardizes its exempt status. These accommodations typically occur near elections when even large donors have been approached so many times that they expect some "sweetener" apart from good government for their contributions. Both Newt Gingrich and Bill Clinton turned to these kinds of charitable contribution enticements when they detected signs of contributor fatigue in their core contributors. Gingrich turned to a variety of section 501(c)(3) organizations when GOPAC's core contributors expressed reluctance to fund the Gingrich lectures. In the closing days of the 1996 campaign Harold Ickes revealed that he had a list of exempt organizations that were available to act as campaign finance intermediaries offering contributors charitable contribution deductions.

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Other exempt organizations that cannot offer contributors charitable contribution deductions offer them anonymity. The central role of section 501(c)(4) organizations in the 1996 campaign and the importance of the new section 527 organizations in the 1998 elections and the 2000 presidential primaries provide strong evidence that the "service" may be a means of avoiding the disclosure requirements applicable to soft money under the FECA.

The preceding discussion of rent-seeking is not meant to suggest that this system works to mutual satisfaction or benefit. The rent-seeking and influence-seeking system is built on both mutual advantage and a mutual struggle for control. Rent-seeking incumbents have an obvious interest in controlling the system of campaign finance that provides the material base for their careers. Influence-seeking contributors have an equally obvious interest in controlling the flow of money so that their investments are not made without results. One can think of this tension in terms of the normal risk allocation issues that arise in any contract for the provision of goods or services. Will the policy outcome be the equivalent of conforming goods? Does the seller provide warranties? What remedies are available in the case of default by either party?

Even if these questions could be answered to the satisfaction of the parties to the rent-seeking contracts, where does this system leave third parties, including the vast majority of exempt organizations that cannot afford to enter into rent-seeking transactions? This is the question that proponents of a necessity rationale have not yet addressed.

B. Representational: Achieving Democratic Purposes

The representational rationale is based on the claim that exempt organizations make a distinctive contribution to American democracy because they are distinctive in their representative qualities. Exempt organizations claim, in effect, that they are distinctively suited to roles as intermediary organizations in a system of democratic pluralism.[18]

The representational rationale is frequently asserted as a self-evident proposition but has never been developed in a way that takes account of the structure and operation of those types of exempt organizations that are most involved in campaign finance. Although section 501(c)(5) labor organizations and section 501(c)(6) trade associations are membership organizations, section 501(c)(3) public charities and section 501(c)(4) social welfare organizations are generally not membership organizations but are controlled by self-perpetuating boards of directors. State nonprofit corporation law does not require that nonprofit corporations have members and generally gives members, even where they exist, little scope for participation beyond electing the directors.

Some organizations claim, in effect, that it is not necessary to represent actual members because they represent an idea or a policy position that people can associate with, commonly by contributing money.[19] This was the form of representation that the Supreme Court endorsed in *Massachusetts Citizens for Life*.[20] The Court held that individuals had voice through the organization because they had chosen to affiliate with it for the sole purpose of supporting its position on abortion and that the same persons could leave the organization if they disagreed with the organization's positions on the issue.[21]

The Court has taken a different position when exit from the organization carries with it a cost not related to political representation. For example, the Court held in *Austen v. Michigan Chamber of Commerce* that a trade association could not make independent expenditures with its treasury funds because members who disagreed with the choice of candidates to support or oppose could leave the organization only at a significant cost to their economic interests.[22] These economic interests defined the exempt purpose of the trade association and were the reason the members had joined the organization.

In *Beck*, the Court held that nonmembers who paid dues to section 501(c)(5) labor organizations because they were covered by collectively bargained employ-

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[18]Those advancing a representational rationale generally ignore rent-seeking even when their organizations are engaged in it.

[19]For a critical discussion of this kind of reasoning, see Theda Skocpol, "Advocates Without Members: The Recent Transformation of American Civic Life," in Theda Skocpol and Morris Fiorina (eds.), *Civic Engagement and American Democracy* (1999).

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

[21]For a similar analysis on types of influence within organizations, see Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (1970).

[22]*Austin v. Michigan State Chamber of Commerce*, 494 U.S. 652 (1990).

ment contracts must be given the option of not having their payments used to support the union's election activity.[23] The ensuing debate over this case has been largely a tactical debate over the allocation of transaction costs. What the Court did in *Beck* was to establish that some activities of exempt organizations may be common interests and some may not be. In effect, this rationale is consistent with the reasoning in *MCFL*, where the Court found advocacy of a particular issue the common interest and found that the opportunity to leave without cost to other interests protected the supporter.

The Court in *Beck* did not have before it the issue of the use of members' dues for softer money forms of participation in political campaigns. This issue is the heart of the debate over the representational rationale. This brings the discussion back to *Austin v. Michigan Chamber of Commerce*, where the Court refused to allow members' dues to be used for independent expenditures because doing so burdened the right to associate for the purpose that the organization was formed and that the members joined. This line of reasoning has a paradoxical result that may constitute a moral hazard. In effect, membership organizations that have some purpose other than softer money issue advocacy would be less able to engage in political activity than would organizations that have no members and no other exempt purposes.

C. The Rights Rationale

A rights rationale is based on an assertion of the rights of speech and association under the First Amendment without reference to any benefits to the organization or to the public from the organization's exercise of these rights. To some exempt organizations, this rationale is complete in itself, an unchallengable basis for broad participation in electoral campaigns. On closer consideration, however, the rights rationale requires a complex argument that exempt organizations have not yet developed. Developing such an argument would be unnecessary only if the First Amendment guaranteed absolute rights to all speakers, a position that the Supreme Court has never accepted. Indeed, *Buckley* stands for the proposition that Congress may limit the rights to participate in electoral campaigns based on the nature of the speaker and the amount of money devoted to such speech.[24]

Once such limitations are acknowledged, a rights rationale must address specific activities and their relationships to specific rights. For exempt organizations seeking to maintain the current softer money system, a rights rationale must address at least four issues. First, exempt organizations need to confront the subsidy theory on which the Court has relied to limit lobbying by certain exempt organizations. Second, exempt organizations need to explain why they should not be subject to disclosure of contributors in the same manner as other political speakers. Third, a strong form of a rights rationale would be based on the rights of the organization itself and not on rights the organization derives from its members. Fourth, a rights rationale would distinguish the rights of exempt organizations from those of taxable entities. This article provides only an introduction to these elements of a rights rationale but, in so doing, it seeks to move the discussion of rights away from a talismanic invocation of rights toward a reasoned discussion of a rights rationale.

The Supreme Court has never addressed limits on campaign activity in terms of their relationship to exempt status.[25] The Court has, however, held that limits on lobbying are not impermissible burdens on First Amendment rights of speech and association because exemption is a subsidy.[26] Subsidy analysis can be traced to Judge Learned Hand's opinion in *Slee v. Commissioner*, a case involving the deductibility of contributions to Margaret Sanger's American Birth Control League.[27] In language that has become the foundation for the subsidy theory, Judge Hand wrote for a unanimous court that the organization's lobbying and political activities were inconsistent with exemption. In Judge Hand's words, "[c]ontroversies of that sort must be conducted without public subvention; the Treasury stands aside from them."[28] The Supreme Court applied subsidy theory to lobbying in *Cammarano v. United States*, a case raising the question of whether a taxable liquor wholesaler could deduct expenses incurred in opposing a state ballot measure that would have restricted alcohol sales.[29] There was no question that the expenditures were connected with the trade or business of operating a liquor wholesale business. The question was whether the denial of a deduction for such expenses was an impermissible burden on the taxpayer corporation's First Amendment rights. The Court invoked a subsidy rationale to hold that "[p]etitioners are not being denied a tax deduction because they engaged in constitutionally protected activities, but are simply required to pay for those activities entirely out of their own pockets, as everyone else engaging in similar activities is required to do under the provisions of the Internal Revenue Code."[30] The Court found the denial of a deduction under section 162 analogous to the restriction on lobbying by exempt organizations, concluding that "[t]he regulations here contested appear to us to be but a further expression of the same sharply defined policy."[31] The Court also noted that a government subsidy was inconsistent with maintaining a level playing field, or at

[23] *Communications Workers v. Beck*, 487 U.S. 735 (1987).

[24] *See* the discussions of *Buckley* at *infra* Parts III and IV.

[25] In *Massachusetts Citizens for Life* the Court did not address exempt status as such.

[26] *Regan v. Taxation With Representation*, 461 U.S. 540 (1983).

[27] *Slee v. Commissioner*, 42 F.2d 184 (2d Cir. 1930).

[28] *Id.*

[29] *Cammarano v. United States*, 358 U.S. 498 (1959).

[30] *Id.* at 513.

[31] *Id.* at 512, *citing* Judge Hand's opinion in *Slee* on the importance of government neutrality in subsidizing political speech.

least with avoiding a government subsidy that favored some over others.[32]

The Supreme Court held that the lobbying limitation as applied to section 501(c)(3) organizations violated neither the organization's speech rights nor its right to equal protection and based its holding on both claims on subsidy theory. In its analysis the Court reasoned that both the charitable contribution deduction and the entity-level exemption from taxation are tax-based subsidies and not unconstitutional conditions, stating:

> Both tax-exemption and tax deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax that it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contributions. The system Congress has enacted provides this kind of subsidy to those charitable organizations generally, and an additional subsidy to those charitable organizations that do not engage in substantial lobbying. In short, Congress chose not to subsidize lobbying as extensively as it chose to subsidize other activities that nonprofit organizations undertake to promote the public welfare.[33]

The response to subsidy theory has been based on unconstitutional conditions theory based on *Speiser v. Randall*.[34] In this case, the Court held that exemption from California property tax could not be conditioned on taking an oath not to overthrow the government. The Court refused to apply the unconstitutional conditions theory of *Speiser v. Randall* in its consideration of lobbying limitations in *Taxation With Representation*. The concurrence in *Taxation With Representation* was based on the principle that a section 501(c)(3) organization should be able to control a section 501(c)(4) organization that may lobby without limits. Such control did not include the transfer of treasury funds from the section 501(c)(3) organization to the section 501(c)(4) organization. The dual structure approach required that each organization be separately funded.

In upholding the revocation of the exempt status of a church that expressly advocated the defeat of then-Governor Clinton less than a week before the 1992 election, the Court of Appeals for the District of Columbia took the position that the dual structure reasoning of *Taxation With Representation* applied in cases involving the political prohibition.[35] Whether these cases will provide a basis for restricting or eliminating the subsidy analysis remains to be seen.

Even if exempt organizations succeed in eliminating the subsidy theory, they will then need to find a rights rationale for not disclosing their contributors. Under current tax law, exempt organizations are required to report their largest contributors to the Service but they are not required to disclose them to the public. Election law imposes broad contributor disclosure, and extends such requirements to those section 501(c)(4) organizations excepted from the corporate ban on independent expenditures. Separate segregated funds maintained by taxable corporations, labor unions, and section 501(c)(4) organizations are subject to disclosure requirements.

The Supreme Court has never addressed the section 501(c)(3) prohibition on participation or intervention in a political campaign.

Exempt organizations rest their defense against disclosure on a series of cases involving demands by state governments that civil rights organizations list all members as a condition for registering as entities organized under the laws of a particular state.[36] The Court struck down all of these state laws as impermissible burdens on the right of speech and association. Exempt organizations argue that these cases give them a right to participate in election campaigns without revealing their contributors.

The Supreme Court refused in *Buckley* to use the civil rights organization cases to strike down the disclosure requirements of the FECA. The Court noted that the right of association, including the "right to pool money," is a fundamental constitutional right[37] and noted that "[w]e have long recognized that significant encroachment on First Amendment rights of the sort that compelled disclosure imposes cannot be justified by a mere showing of some legitimate government interest."[38] In the context of election campaigns, however, the Court held in *Buckley* that the government's interest in providing information to voters, deterring corruption and avoiding the appearance of corruption, and protecting the integrity of the contribution limitations

[32]In his concurring opinion Justice Douglas treated subsidy analysis as settled constitutional doctrine, writing: "Deductions are a matter of grace, not of rights. . . . To hold that this item of expense must be allowed as a deduction would be to give impetus to the view favored in some quarters that First Amendment rights must be protected by tax exemptions. But that proposition savors of the notion that First Amendment rights are somehow not fully realized unless they are subsidized by the state. Such a notion runs counter to our decisions . . . and may indeed conflict with the underlying premise that a complete hands-off policy on the part of government is at times the only course consistent with First Amendment rights." *Id.* at 515.

[33]*Regan v. Taxation With Representation*, 461 U.S. 540, 544 (1983).

[34]*Speiser v. Randall*, 357 U.S. 513 (1958).

[35]*Branch Ministries Inc. v. Rossotti*, 211 F.3d 137, *Doc 2000-13779 (13 original pages), 2000 TNT 95-17* (D.C. Cir. 2000), *aff'g* 40 F. Supp.2d 15, *Doc 1999-12077 (21 original pages), 1999 TNT 62-9* (D.D.C. 1999).

[36]*NAACP v. Alabama*, 357 U.S. 449 (1958); *Bates v. Little Rock*, 361 U.S. 516 (1960); *Shelton v. Tucker*, 364 U.S. 479 (1960); *NAACP v. Button*, 371 U.S. 415 (1963); *Gibson v. Florida Legislative Committee*, 371 U.S. 539 (1963).

[37]*Buckley v. Valeo*, 424 U.S. 1, 63 (1976).

[38]*Id.* at 64.

were, in general, sufficient to justify the disclosure requirements.[39] The Court expressed concern about the potential impact of disclosure requirements on minor parties and independent candidates, but the Court rejected any blanket exception for any particular type of organization.[40] Instead, the Court left open the possibility that organizations might be excepted from the disclosure requirements if they can establish "a reasonable probability that the compelled disclosure of a party's contributors' names will subject them to threats, harassments, or reprisals from either government officials or private parties."[41] The Court subsequently held that the Socialist Workers Party established the requisite likelihood of harassment, but the majority opinion elicited a strong dissent.[42]

A strong form of the rights rationale would include a third element explaining why organizations have political participation rights as entities and not just as the representative of the members. If the organization itself has rights, then shell organizations, the alter egos of candidates or contributors, enjoy the same rights as any other organization or individual. In the extreme case, a sole member corporation has protected political speech rights apart from those enjoyed by the sole member as an individual. If an organization itself does not have rights but derives rights from the individual rights of its members, then the claim for shell organization is far more problematic.

The difficulty of the strong form of the rights rationale is that it would encompass business corporations as well as exempt organizations. There is no obvious way to limit a rights rationale to exempt organizations. Efforts to do so become especially problematic for exempt organizations that accept contributions from taxable corporations, as the Court held in *Austin v. Michigan State Chamber of Commerce*.[43]

Exempt organizations seeking a rationale for their roles in the softer money system without opening the same right to business entitites will have to base their claims on elements from either the necessity rationale or the representation rationale or both. In so defining the rationale for their roles in electoral campaigns, exempt organizations will unavoidably also rationalize the current system of rent-seeking.

III. Hard Money

Hard money is a shorthand term distinguishing contributions subject to the most comprehensive regulation under the FECA from independent expenditures, soft money, and softer money, which are subject to lesser degrees of regulation or none at all. This section of the article focuses on the FECA requirements that make contributions hard money. No one is currently suggesting that the *Buckley* Court was incorrect in holding that the hard money limitations are consistent with the First Amendment. The reason to consider the hard money structure in the FECA is to understand what officeholders and candidates are attempting to avoid and why political money has been deconstructed and why political money structures have been fragmented.

A. Defining Hard Money

The FECA defines a contribution broadly to encompass all forms of direct and indirect transfers of value. Section 431(8)(A) provides that a "contribution" includes —

> (i) any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office; or
>
> (ii) the payment by any person of compensation for the personal services of another person which are rendered to a political committee without charge for any purpose.[44]

This broad definition of a contribution transaction is limited by the explicit exclusion of 14 transactions from the definition of a contribution.[45]

Current controversies center on whether these contribution limitations should be increased and whether they should be indexed for inflation. The Supreme Court declined to make such changes constitutional requirements when it held that a Missouri state law limiting political contributions to $1,000 did not violate

[39]*Id.* at 65-68.

[40]*Id.* at 70-74.

[41]*Id.* at 74.

[42]*Brown v. Socialist Workers '74 Campaign Committee*, 459 U.S. 87 (1982).

[43]*Austin v. Michigan State Chamber of Commerce,* 494 U.S. 652 (1990).

[44]FECA section 431(8)(A).

[45]FECA section 431(8)(B) provides for the following exceptions: (1) Services provided to a candidate or a political committee by an individual without compensation; (2) use of real or personal property, including a home or community center or church, and associated costs, provided that the costs do not exceed stated amounts; (3) sale of food or beverages by a vendor at cost, provided that the cumulative value of the profit foregone does not exceed stated amounts; (4) unreimbursed travel by an individual on behalf of a candidate or political party; (5) preparation by a state or local committee of a political party of a sample ballot or slate card or other printed listing but not the cost of publishing these in newspapers or periodicals or through broadcast media; (6) any payment or obligation by a corporation or a labor organization that would not be treated as an expenditure within the meaning of FECA section 441b(b); (7) a loan from a bank made on ordinary commercial terms; (8) amounts used to acquire party headquarters facilities; (9) provision of regular legal or accounting service; (10) payment by a state or local committee of a political party for the cost of such campaign materials as bumper stickers and yard signs to be used by volunteers; (11) payments made by a candidate for campaign materials including reference to or information on any other candidate; (12) payment by state or local committees of a political party for "voter registration and get-out-the-vote activities conducted by such committee on behalf of nominees of such party for president and vice-president"; (13) payments for ballot access; and (14) any "honorarium" within the meaning of FECA section 441i.

the rights of speech and association guaranteed in the First Amendment.[46] The Court in *Buckley* posited a direct causal relationship between the amount of money available and the quality of representative democracy. The Court reasoned that:

> A restriction on the amount of money a person or group can spend on political communication during a campaign necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of audience reached. This is because virtually every means of communicating ideas in today's mass society requires the expenditure of money. The distribution of the humblest handbill or leaflet entails printing, paper, and circulation costs. Speeches and rallies generally necessitate hiring a hall and publicizing the event. The electorate's increasing dependence on television, radio, and other mass media for news and information has made these expensive modes of communication indispensable instruments of effective political speech.[47]

This reasoning might well be challenged in light of subsequent developments and a more careful consideration of relevant facts. Most importantly, it is far from clear that more money means "more expression" in any sense meaningfully related to representative democracy. The amount of speech and the diversity of speech are not the same factor. Indeed, rent-seeking means more money for campaigns and greater barriers to access to the policy arena for those who cannot provide campaign cash.

B. Sources, Recipients & Uses: Defining Limits

Individual citizens or residents of the United States have the broadest scope for making political contributions,[48] but they are subject to limitations on the sources of the funds contributed and the amounts that may be contributed. An individual contributor is required to make contributions from his or her own funds, not funds received from another person with the understanding that the individual will contribute a designated sum to a particular candidate or political committee.[49] The prohibition in FECA section 441a on using a conduit is reinforced by the prohibition in FECA section 441f on serving as a conduit or accepting a contribution from a conduit.[50] A person who transfers earmarked funds is commonly referred to as a "straw donor" and is subject to civil and criminal penalties. Such conduit transactions are one avenue around the limitations on individual contributions as well as the limitations on contributions by entities.

An individual may contribute an aggregate amount of $25,000 in hard money during any calendar year.[51] Contributions may be made to political committees, which include candidate committees and political party committees and other political committees. An individual may contribute up to the following amount to the enumerated recipients:

(1) $1,000 to any one candidate or that candidate's political committees with respect to any election for federal office;[52]

(2) $20,000 during any calendar year to the political committees established and maintained by a national political party which are not authorized political committees of any candidate;[53]

(3) $5,000 during any calendar year to any other political committee.[54]

Corporations have been prohibited from making contributions to candidates using corporate treasury funds since 1907.[55] The early justification for this pro-

[46]*Nixon v. Shrink Mo. Gov't PAC*, 528 U.S. 377 (2000). Senator Mitch McConnell, the point man of the political class on opposition to campaign finance reform, filed an *amicus* brief urging the Court to declare the limit unconstitutional. *See* Brief of Senator Mitch McConnell, Missouri Republican Party, Republican National Committee, and National Republican Senatorial Committee, *Amici Curiae* in Support of Respondent (June 7, 1999).

[47]*Buckley v. Valeo*, 424 U.S. 1, 19 (1976). The use of the Internet may reduce the cost of some elements of political communication, but the present access to the Internet correlates with education and economic status, and thus, paradoxically, enables candidates to reach the more affluent at the least cost.

[48]FECA section 441e prohibits the making of a political contribution by a foreign national as well as the receipt of a political contribution by a foreign national.

[49]FECA section 441a(8) provides: "For purposes of the limitations imposed by this section, all contributions made by a person, either directly or indirectly, on behalf of a particular candidate, including contributions which are in any way earmarked or otherwise directed through an intermediary or conduit to such candidate, shall be treated as contributions from such person to such candidate. The intermediary or conduit shall report the original source and the intended recipient of such contribution to the Commission and to the intended recipient."

[50]FECA section 441e provides that "[n]o person shall make a contribution in the name of another person or knowingly permit his name to be used to effect such a contribution, and no person shall knowingly accept a contribution made by one person in the name of another person."

[51]FECA section 441a(3).

[52]FECA section 441a(1)(A).

[53]FECA section 441a(1)(B).

[54]FECA section 441a(1)(C).

[55]The corporate contribution ban was enacted in the Tillman Act of 1907, 34 Stat. 864 (1907). The first disclosure requirements were enacted in the Publicity Act of 1910, 36 Stat. 822 (1910), which applied only to elections to the House of Representatives. These requirements were extended to elections to the Senate, to primaries, and to political conventions in amendments to the Publicity Act, 37 Stat. 25 (1911), which also imposed the first spending limitations. The Federal Corrupt Practices Act, 43 Stat. 1070 (1925) broadened the contribution and spending limitations and disclosure requirements. Amendments to the Hatch Act, 54 Stat. 767 (1940) imposed limits on individual contributions to federal candidates or national political parties. Amendments to the Taft-

(Footnote 55 continued on next page.)

hibition was to protect the electoral system from the effects of concentrated wealth.[56] The FECA imposes this prohibition on "any corporation whatever."[57] It is also unlawful for any corporate officer or director to "consent" to the making of any prohibited hard money contribution.[58] In addition, it is unlawful "for any candidate, political committee, or other person knowingly to accept or receive any contribution prohibited by this section."[59] In other words, the FECA applies the prohibition on corporate contributions to all participants in the campaign finance transaction. The FECA provides for a separate prohibition on hard money contributions by corporations that are government contractors.[60]

The ban on corporate contributions applies to any tax-exempt nonprofit corporation, not solely to taxable corporations. The ban on contributions by labor unions was enacted in 1947.[61] Other exempt nonprofit corporations are subject to the general ban on corporate contributions, which makes them subject to the same penalities for violating the ban. In addition, federal income tax law imposes limitations on section 501(c)(4) organizations and a prohibition on section 501(c)(3) organizations. Section 501(c)(5), which applies to labor unions, contains no explicit ban or limitation. It should also be noted that the exception for certain section 501(c)(4) organizations crafted by the Supreme Court in *Massachusetts Citizens for Life* is not an exception to the ban on contributions but an exception to the ban on independent expenditures.[62]

Corporations may establish a political action committee (PAC) that can make hard money contributions.[63] A PAC is funded by contributions from the corporation's salaried employees but not its employees earning hourly wages. The corporation may not contribute treasury funds to the PAC, but it may use corporate treasury funds to pay the PAC's administrative expenses. The hard money contribution is then made in the name of the PAC, which name incorporates the name of the corporation with which it is associated. Labor unions and section 501(c)(4) organizations may also establish PACs, but section 501(c)(3) organizations may not establish PACs that engage in activities that jeopardize the exempt status of the section 501(c)(3) organization itself under tax law.[64]

There are currently no efforts to eliminate the corporate contribution prohibition because a combination of the provisions permitting corporate and union PACs to make contributions and independent expenditures, the soft money provisions, and the softer money possibilities mean that a direct challenge to the corporate contribution limitation is unnecessary. The Supreme Court's holding in *Bellotti* that a corporation could use its treasury funds for contributions to a fund to defeat a referendum on a state income tax did not become the basis for claims that corporations have a constitutional right to make contributions to candidates for public office.[65] In this sense, *Bellotti* is a road not taken, or at least not taken yet.

Hard money may be used for any lawful activity that influences the outcome of an election. The exclusions from the definition of a contribution do not mean that such activities cannot be funded with hard money but that they do not have to be. In practice, hard money is used primarily for the activities that have not been excepted from the definition of a contribution and other types of political money are used for activities that are not limited to hard money funding.

C. Disclosure of the Sources and Uses of Hard Money

The FECA imposes substantial reporting and disclosure requirements on political committees,[66] including authorized committees of a candidate,[67] a candidate's principal campaign committee,[68] and any other political committees.[69] Political committees must report their receipts and disbursements, whether or not they are used for express advocacy.[70] Express advocacy is irrelevant to the treatment of contributions.[71]

Hartley Act, 61 Stat. 136 (1947) amended the Federal Corrupt Practices Act of 1925 to extend the ban on corporate contributions to labor unions.

[56]The Supreme Court endorsed this reasoning in a series of cases dealing with the ban on contributions by labor unions. *See Pipefitters v. United States*, 407 U.S. 385 (1972); *United States v. Automobile Workers*, 352 U.S. 567 (1957); *United States v. C.I.O.*, 335 U.S. 106 (1948).

[57]FECA section 441b(a).

[58]FECA section 441b(a).

[59]FECA section 441b(a).

[60]FECA section 441c(a).

[61]The Taft-Hartley Act of 1947, 61 Stat. 136 (1947) amended the Federal Corrupt Practices Act of 1925 to extend to labor unions the same ban that applied to contributions by corporations.

[62]*FEC v. Massachusetts Citizens for Life*, 479 U.S. 238 (1986). *See infra* Part IV for a discussion of independent expenditures and the MCFL exception.

[63]A PAC is for federal income tax purposes a section 527(f)(3) separate segregated fund.

[64]Treas. reg. section 1.527-6(g) provides that a section 501(c)(3) organization may organize a PAC to conduct political activities that fall outside the political prohibition. In GCM 39694 (Jan. 22, 1988) the Service took the position that a section 501(c)(3) organization may form a PAC to support or oppose the nomination or confirmation of a judicial nominee.

[65]*First National Bank v. Bellotti*, 435 U.S. 765 (1978).

[66]Defined in FECA section 431(4).

[67]Defined in FECA section 431(6).

[68]Defined in FECA section 431(5).

[69]FECA section 434.

[70]The reporting requirements applicable to the principal campaign committee of a candidate for House of Representatives or Senate are set forth in FECA section 434(a)(2); reporting requirements applicable to the principal campaign committee of a candidate for president are set forth in section 434(a)(3); and reporting requirements applicable to all political committees other than the authorized committee of a candidate are found in section 434(a)(4). In addition, a candidate's principal campaign committee must notify the FEC of any contribution of "$1,000 or more" received by any authorized committee of the candidate within 48 hours of its receipt. FECA section 434(a)(6)(A).

[71]*See infra* Part IV. B. for a discussion of express advocacy and independent expenditures.

A political committee must identify the nature and amount of its receipts, the disbursements it makes, and the amounts on hand at the beginning and end of the reporting period.[72] In addition, it must identify both the sources of its receipts[73] and the recipients of its disbursements.[74]

The *Buckley* Court upheld the disclosure requirements applicable to contributions.[75] The case did not involve a claim that these requirements are per se unconstitutional but claims that the disclosure requirements were overbroad with respect to minor party candidates, independent candidates, and with respect to small contributions.[76] The Court rejected these claims but required that the language of the statute be narrowly construed.[77]

Hard money may be used for any lawful activity that influences the outcome of an election.

The Court recognized that "compelled disclosure, in itself, can seriously infringe on privacy of association and beliefs guaranteed by the First Amendment."[78] The Court nevertheless found that "[t]he disclosure requirements, as a general matter, directly serve substantial government interests."[79] The Court found a general government interest "in deterring the 'buying' of elections and the undue influence of large contributions on officeholders."[80] In addition, the Court found three specific government interests of sufficient substance to sustain the disclosure requirements. First, disclosure permits voters to gain access to the information that they require "to place each candidate in the political spectrum more precisely than is often possible solely on the basis of party labels and campaign speeches."[81] Second, disclosure deters corruption and the appearance of corruption since "[a] public armed with information about a candidate's most generous supporters is better able to detect any post-election special favors that may be given in return."[82] Third, disclosure was essential to enforce the contribution limitations that the Court had found constitutional.[83] The Court concluded that "[t]he disclosure provision is responsive to the legitimate fear that efforts would be made, as they had been in the past, to avoid the disclosure requirement by routing financial support of candidates through avenues not explicitly covered by the general provisions of the Act."[84]

The Court did find, however, that the language of section 434(e) as then in effect "raises serious problems of vagueness" that are of particular concern because this provision carried the possibility of criminal penalties.[85] The problem arose from defining contributions and expenditures for disclosure purposes in terms of the use of money or other assets "for the purpose of . . . influencing" the nomination or election of candidates.[86] The Court found that "[i]t is the ambiguity of that phrase that poses constitutional problems."[87] While the Court noted the "ambiguity" of the phrase, it held that disclosure of contributions defined broadly was consistent with the purposes of the FECA:

> We construed that term to include not only contributions made directly or indirectly to a candidate, political party, or campaign committee, and contributions made to other organizations or individuals but earmarked for political purposes, but also expenditures placed in cooperation with or with the consent of a candidate, his agents, or an authorized committee of the candidate. The definition of "contributions" in section 431(e) for disclosure purposes parallels the definition in Title 18 almost word for word, and we construe the former provision as we have the latter. So defined, "contributions" have a sufficiently close relationship to the goals of the Act, for they are connected with a candidate or his campaign.[88]

The Court thus based its position upholding disclosure of contributions on the nexus with a candidate or a political committee. It did not look through the political committee to trace the amount contributed to particular activities and to limit disclosure to those amounts used for express advocacy of the election or defeat of a clearly identified candidate for public office. In the case of contributions, the nexus with the candidate or a political committee was sufficient.

The Court found no problem in requiring that candidates disclose their expenditures or that "organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate" disclose their expenditures.[89] The Court held:

> Expenditures of candidates and of "political committees" so construed can be assumed to fall within the core area sought to be addressed by Congress. They are, by definition, campaign related.[90]

[72]FECA section 434(b)(1), (2), and (4).

[73]FECA section 434(b)(3).

[74]FECA section 434(b)(5) and (6).

[75]*Buckley v. Valeo*, 424 U.S. at 60.

[76]*Id.* at 60.

[77]As originally enacted, FECA section 434(e) required disclosure of contributions or expenditures made "for the purpose of . . . influencing" the nomination or election of candidates for public office. The Court held that this provision was impermissibly vague, especially since violation of the disclosure requirement could subject the person to criminal penalties.

[78]*Buckley v. Valeo*, 424 U.S. 1, 64 (1976).

[79]*Id.*

[80]*Id.* at 70.

[81]*Id.* at 66-67.

[82]*Id.* at 67.

[83]*Id.* at 67.

[84]*Id.* at 76, footnote omitted.

[85]*Id.* at 76.

[86]*Id.* at 77, *citing* FECA section 434(e) as then in effect.

[87]*Id.*

[88]*Id.* at 78.

[89]*Id.*

[90]*Id.* at 79.

The Court thus held that a nexus with a candidate or a campaign was sufficient to support the disclosure requirements.

IV. Independent Expenditures

As originally enacted, the FECA contained limits on expenditures as well as on contributions. The *Buckley* Court struck down the limitations on independent expenditures on First Amendment grounds but upheld the provisions that treat expenditures coordinated with a candidate as contributions subject to the general contributions limitations. Expenditures do not have recipients in the same sense as contributions do. Expenditures do, however, have beneficiaries, and the presence of beneficiaries provides the basis for analyzing expenditures in transactional terms as one of the deconstructed forms of political money. The focal point of planning in this area is to avoid the kind of coordination that transforms an independent expenditure into a regulated contribution. The most controversial success in this area has been the ability of political parties to make independent expenditures without having those amounts count against the contribution limits applicable to party support for individual candidates.[91] A second planning consideration is a more tactical matter, depending on the type of political communication that is considered most useful. An independent expenditure is subject to disclosure requirements if the communication involves express advocacy. If the effective political communication does not require the direct language of express advocacy, the political communication falls entirely outside the FECA and becomes a softer money communication.

A. Definitions and Limitations

For purposes of the FECA, an expenditure is defined to include "any purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value made by any person for the purpose of influencing any election for federal office,"[92] and "a written contract, promise, or agreement to make an expenditure."[93] The FECA excludes 10 transactions from the definition of an expenditure.[94] The general definition of an expenditure remains important with respect to the remaining limitations on expenditures and the disclosure requirement applicable to expenditures.

The Court in *Buckley* distinguished expenditures from contributions and held that expenditures were generally not subject to the limitations and disclosure requirements applicable to contributions. Based on *Buckley*, FEC regulations define an independent expenditure as "an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate which is made without cooperation or consultation with any candidate, and which is not made in concert with, or at the request or suggestion of, any candidate, or any authorized committee or agent of such candidate."[95] Any expenditure that is made in coordination with a candidate is treated as a contribution and subject to all of the limitations applicable to contributions.[96] Avoiding coordination enables those permitted to make independent expenditures to avoid the limitation applicable to contributions.

The *Buckley* Court struck down aggregate limits on campaign expenditures, suggesting that they were not needed to prevent the potential corrupting influence of a candidate's dependence on large contributions because this government interest was served by the contribution limits and the disclosure requirements.[97] The Court also held that a candidate's contributions to his or her own campaign were to be treated as expenditures and, as such, were not subject to limitations.[98] While the Court found that a candidate could not corrupt himself or herself, it found that a candidate's spouse or children might exert a corrupting influence on the candidate by making independent expenditures.[99]

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[91]See *infra* Part IV. C.

[92]FECA section 431(9)(A)(i).

[93]FECA section 431(9)(B)(ii).

[94]FECA section 431(9)(B) lists the following exclusions: (1) press coverage of campaigns by news organizations "unless such facilities are owned or controlled by any political party, political committee, or candidate"; (2) nonpartisan voter registration and get-out-the-vote activities; (3) communications by a membership organization or corporation with members or shareholders or executive or administrative personnel; (4) payments by state or local committees of a political party for sample ballots or slate cards provided that these are not distributed through the mass media; (5) "any payment made or obligation incurred by a corporation or labor organization which, under section 441b(b) of this title, would not constitute an expenditure by such corporation or labor organization"; (6) costs incurred by a candidate or a candidate's authorized committees in soliciting contributions up to 20 percent of the section 441a(b) expenditure limitation; (7) payment of compensation for legal or accounting services; (8) payments by state or local committees of a political party for such campaign materials as "pins, bumper stickers, handbills, brochures, posters, party tabloids, and yard signs" that are used "in connection with volunteer activities" and not either disseminated through the mass media or paid for with contributions subject to the FECA; (9) payment by a state or local committee of a political party for the costs of voter registration and get-out-the-vote activities "on behalf of" the party's nominees for president and vice-president; and (10) payments that a political party receives for ballot access fees that are transferred to another political party committee or to the appropriate state official.

(Footnote 94 continued in next column.)

[95]FECA section 431(17). *See also* 11 CFR 100.23.

[96]FECA section 441a(a)(7)(B)(i).

[97]*Buckley v. Valeo*, 42 U.S. 1, 55 (1976).

[98]*Id.* at 52. The Court in *Buckley* held that "[t]he candidate, no less than any other person, has a First Amendment right to engage in the discussion of public issues and vigorously and tirelessly to advocate his own election and the election of other candidates." *Id.*

[99]The Court reasoned: "[a]lthough the risk of improper influence is somewhat diminished in the case of large contributions from immediate family members, we cannot say that the danger is sufficiently reduced to bar Congress from subjecting family members to the same limitations as nonfamily contributors." *Id.* at 53, n.59.

The Court in *Buckley* held that there was no government interest that supported limitations on independent expenditures, including the government interest in preventing corruption or the appearance of corruption which the Court had held supported the limitations on contributions.[100] Indeed, the Court saw little danger of such problems arising from independent expenditures, asserting:

> Unlike contributions, such independent expenditures may well provide little assistance to the candidate's campaign and indeed may prove counterproductive. The absence of prearrangement and coordination of an expenditure with the candidate or his agent not only undermines the value of the expenditure to the candidate, but also alleviates the danger that expenditures will be given as a *quid pro quo* from the candidate.[101]

Despite its distinction between expenditures and contributions, the Court in *Buckley* retained limitations on expenditures for presidential or vice presidential candidates who accepted federal matching funds.[102] A candidate may choose not to accept matching funds, in which case the expenditure limitations do not apply.[103] Limits apply to the expenditures a national political party may make "in connection with" the general election campaign of that party's candidate for president.[104] These limitations apply whether or not the candidate accepts federal matching funds.[105] Limitations also apply to national or state party expenditures "in connection with" the general election campaign of that party's candidates for the United States Senate or House of Representatives.[106]

In addition to these limitations on amounts, the FECA provides that corporations and labor organizations may not make expenditures of any kind in any amount using their treasury funds.[107] *In Austin v. Michigan Chamber of Commerce*, the Supreme Court held that section 501(c)(6) trade associations could not use their treasury funds to make independent expenditures.[108] Section 501(c)(3) organizations cannot make independent expenditures due to the political prohibition of section 501(c)(3). Section 501(c)(4) organizations were originally subject to the general corporate ban on independent expenditures under the FECA.

The Supreme Court crafted an exception to the prohibition on use of corporate treasury funds for independent expenditures in *Massachusetts Citizens for Life*.[109] This exception, which is generally known as the "*MCFL* exception," permits section 501(c)(4) organizations that do not receive any funding from corporations or unions and which do not have income from business activities to make independent expenditures using treasury funds. In crafting this exception, the Court emphasized the small scale of the organization in question and the consequent absence of any danger of corruption or the appearance of corruption arising from the effects of concentrated wealth on electoral processes. In addition, the Court noted that persons joined such an organization for the sole purpose of supporting its advocacy and could leave the organization without any cost if they disagreed with the organization's advocacy positions.

Despite its distinction between expenditures and contributions, the Court in Buckley retained limitations on expenditures for presidential or vice presidential candidates who accepted federal matching funds.

Other corporations and labor unions could make independent expenditures through their PACs. The Court observed in *Austin v. Michigan Chamber of Commerce* that the Chamber of Commerce had a PAC and thus was not denied its First Amendment right to speak. PACs, however, are limited in both the sources of their contributions and in the amount that any contributor can contribute to the PAC. The use of certain funds for independent expenditures did not mean that PACs enjoyed any relaxation of the general limitations applied to them.

Political committees other than a candidate's principal campaign committee or a candidate's authorized committees or political committees related to a candidate committee may make independent expenditures. Political committees making independent expenditures must be funded by individuals, not by unions or corporations. Individuals may, however, make unlimited contributions to such political committees just as individuals can make independent expenditures directly without limitation.

Disclosure became the *Buckley* Court's means of addressing the ambiguities arising from its creation of the distinction between contributions and expenditures. The Court held that preventing corruption or the appearance of corruption, would be insufficient to sustain the disclosure requirements.[110] The Court, however, found that the disclosure requirements served the additional purpose of providing "information concerning those who support the candidates."[111] The Court supported a broad interpretation of the disclosure requirements based on the government's interest in providing

[100] *Id.* at 45-46.

[101] *Id.* at 47. It is unclear how the Court reached this conclusion.

[102] FECA section 441b(b).

[103] In the 2000 Republican Party presidental primary, George W. Bush did not accept federal matching funds.

[104] FECA section 441b(d)(2).

[105] FECA section 441b(d)(1).

[106] FECA section 441b(d)(3).

[107] FECA section 441b(a).

[108] *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652 (1990).

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

[110] *Buckley v. Valeo*, 424 U.S. 1, 80-81 (1976).

[111] *Id.* at 81.

information about those who support candidates, writing of the information interest:

> It goes beyond the general disclosure requirements to shed the light of publicity on spending that is unambiguously campaign related but would not otherwise be reported because it takes the form of independent expenditures or of contributions to an individual or group not itself required to report the names of its contributors. By the same token, it is not fatal that section 434(e) encompasses purely independent expenditures uncoordinated with a particular candidate or his agent. The corruption potential of these expenditures may be significantly different, but the informational interest can be as strong as it is in coordinated spending, for disclosure helps voters to define more of the candidates' constituencies.[112]

Expenditures by individuals or by organizations that are not "political committees" as defined above were a different matter.[113] In the absence of a clear nexus, the Court observed that "the relation between the information sought and the purposes of the Act may be too remote."[114] In this case, the Court did not rely on a nexus with a candidate or a campaign but defined an expenditure for disclosure purposes in terms of express advocacy, just as it had defined an expenditure for purpose of the limitations of the FECA.[115] The disclosure provisions as applied to independent expenditures by individuals and organizations other than political committees "reach only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate for public office."[116] The Court concluded that "[t]his reading is directed precisely to that spending that is unambiguously related to the campaign of a particular federal candidate."[117]

B. Contesting Express Advocacy Standards

Independent expenditures are expenditures for express advocacy. This much-litigated concept was created by the Supreme Court in *Buckley* to define the scope of independent expenditures and the scope of disclosure requirements with respect to independent expenditures by individuals. Express advocacy plays no role in defining contributions or the disclosure requirements applicable to contributions. Similarly, express advocacy plays no role in defining soft money. Express advocacy is not the defining concept of political speech despite the resources devoted to litigating limitations on this concept. Paradoxically, perhaps, the effort devoted to litigating the meaning of express advocacy has its primary implications not for independent expenditures but for softer money. As will be discussed below, the primary application of express advocacy is as a framework for excluding certain political communications from the type of political speech that can be funded by undisclosed softer money. In this light, the desire to limit the scope of express advocacy and thus the effort to limit the scope of independent expenditures is in fact a strategic effort to broaden the role of softer money in federal elections.

The debate over express advocacy turns on a footnote in *Buckley* that sets out certain phrases the Court found indicative of express advocacy.[118] In *Massachusetts Citizens for Life* the Court subsequently found communications that did not use any of the "magic words" in its *Buckley* footnote nevertheless constituted express advocacy.[119] The FEC regulations on express advocacy take the same approach.[120] Those who wish to limit the scope of the definition of an independent expenditure have litigated several cases in which courts of appeals have held that the "magic words" of *Buckley* are required elements of express advocacy.[121] The issue remains in dispute. The central point is that express advocacy is only one element of the definition of an independent expenditure and that it has no role in defining a contribution. Similarly, express advocacy is not an element in determining whether an expenditure is coordinated with a candidate.

> ***The central point is that express advocacy is only one element of the definition of an independent expenditure and that it has no role in defining a contribution.***

C. Transforming Expenditures Into Contributions

The FECA treats expenditures coordinated with a candidate or a candidate's authorized committee as contributions, stating that "expenditures made by any person in cooperation, consultation, or concert, with, or at the request or suggestion of a candidate, his authorized political committees, or their agents, shall be considered to be a contribution to such a can-

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[112] *Id.*

[113] *Id.* at 79. The Court's reasoning touched on the uncertainty in the definition of a "political committee" in terms of receiving contributions or making expenditures during a calendar year in an aggregate amount exceeding $1,000. The Court implicitly acknowledged that a contribution could be used for activities other than express advocacy and that the disclosure requirements were not limited to funds used for express advocacy.

[114] *Id.* at 80.

[115] *Id.* at 79-80.

[116] *Id.* at 80, including in note 108 a cross reference to the comments on express advocacy in note 52.

[117] *Id.*

[118] *Buckley v. Valeo*, 424 U.S. 1, 44, n.52 (1976).

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

[120] 11 C.F.R. 100.22.

[121] *See, e.g., Vermont Right to Life Committee v. Correll*, 216 F. 3d 264 (2d Cir. 2000); *North Carolina Right to Life Inc. v. Bartlett*, 168 F.3d 705 (4th Cir. 1999); *Virginia Society for Human Life Inc. v. Caldwell*, 152 F.3d 268 (4th Cir. 1998); *Iowa Right to Life Committee v. Williams*, 187 F.3d 963 (8th Cir. 1999); *Maine Right to Life Committee v. FEC*, 914 F. Supp. 8 (D. Me. 1996), *aff'd per curiam* 98 F.3d 1178 (4th Cir. 1996).

didate."[122] This result was approved by the Court in *Buckley*.[123] The FECA also imposes special limitations on expenditures made by political parties "in connection with" candidates for public office.[124] This is the issue before the Court in the Colorado Republican Party litigation.[125]

Controversy and litigation have centered on what constitutes "coordinate" and whether the standard is the same for all persons. This issue was addressed in the *Christian Coalition* case, where issues involved alleged instances of coordination between the Christian Coalition and certain candidates for public office.[126] The court held that a communication

> . . . becomes "coordinated" where the candidate or her agents can exercise control over, or where there had been discussion or negotiations between the campaign and the spender over a communication's (1) contents; (2) timing; (3) location, mode or intended audience (e.g., choice between newspaper or radio advertisements); or (4) "volume" (e.g., number of copies of printed materials or frequency of media spots). "Substantial discussion" or "negotiation" is such that the candidate and the spender emerge as partners or joint venturers in the expressive expenditure, but the candidate and the spender need not be equal partners.[127]

The FEC has recently promulgated regulations based on this standard.[128] The current standard for coordination is thus unrelated to express advocacy. This means that softer money can become a contribution even if it is not used for express advocacy provided that its expenditure is coordinated with a candidate for public office.

The Supreme Court had held that a political party may make independent expenditures with respect to a campaign in which it had or planned to have a candidate for public office.[129] The Supreme Court held that the Colorado Republican Party had made independent expenditures when it paid for a series of radio advertisements attacking the likely Democratic candidate for the United States Senate. While three justices[130] found the limitation on political party expenditures facially unconstitutional, the plurality chose to remand the case for evidentiary findings on the question of coordination. On remand, the district court held that there was no coordination in this case.[131] The issue has recently again been argued in the Supreme Court. [132]

V. Soft Money

Soft money is political money given to a political party for "party-building" activities. There are no limits on the sources of soft money or the amounts that any contributor can give, but soft money must be disclosed by the recipient party committees. By the 1996 election cycle, soft money had become the central feature of the campaign finance system and the central issue in controversies over campaign finance reform. By the 2000 election, soft money had come to rival hard money not just for political parties but for overall share of campaign spending.

It is far from clear precisely what soft money is and how it fits into the statutory structure of the FECA. The FEC has used soft money to refer to all "[c]ontributions that are not permissible."[133] In the same notice of proposed rulemaking the FEC states that such contributions "are to be used exclusively for state and local campaign activity or other party committee activities that do not influence federal elections."[134]

It is far from clear precisely what soft money is and how it fits into the statutory structure of the FECA.

Much of the difficulty of identifying soft money arises not when it is contributed but when it is used. Activities commonly benefit both federal and nonfederal candidates, and so-called party-building activities build parties and enhance the electoral prospects of a party's candidates.[135] In Advisory Opinion 1975-21, the FEC treated administrative expenses and voter registration activities of a local party committee as the kind of activities that must be funded with hard money contributions because "these functions have an indirect effect on particular elections, and since monies contributed to fulfill these functions free other money to be used for contributions and expenditures in connection with federal elections."[136] In Advisory Opinion 1976-72 the FEC took the position that the Illinois State Party could not use funds contributed

[122]FECA section 441a(a)(7)(B)(i).

[123]*Buckley v. Valeo*, 424 U.S. 1, 46-47 (1976).

[124]FECA section 441a(d).

[125]*Colorado Pepublican Federal Campaign Committee v. FEC*, 518 U.S. 604 (1996).

[126]*FEC v. Christian Coalition*, 52 F. Supp.2d 45 (D. D.C. 1999).

[127]*Id.* at 92.

[128]65 Fed. Reg. 76138 (Dec. 6, 2000).

[129]FECA section 441a(d). *See also Colorado Republican Federal Campaign Committee Commission*, 518 U.S. 604 (1996).

[130]Justices Rehnquist, Thomas, and Scalia.

[131]*FEC v. Colorado Republican Federal Campaign Committee*, 41 F. Supp.2d 1197 (D.D.Col. 1999), *aff'd* 213 F.3d 1221 (10th Cir. 2000.)

[132]For reports on the oral argument, see the Brookings Institution Web site, www.brookings.org.

[133]Notice 1998-12, Prohibited and Excessive Contributions; Soft Money, Notice of Proposed Rulemaking, 63 *Fed. Reg.* 37722 (July 13, 1998).

[134]*Id.*

[135]*Id.* The FEC presents the examples of party administrative costs and party voter registration costs.

[136]Advisory Opinion 1975-21 served as the basis for the requirements in 11 CFR section 106.1 and section 106.5 relating to the allocation rules, which are discussed in this subpart.

by corporations or labor unions from their treasury funds to support voter registration or get-out-the-vote activities even though state election law permitted such uses of contributions from these sources.[137] The FEC did, however, permit the use of such funds for party overhead and administrative expenses, but required the parties to allocate such costs between its hard money and soft money accounts.

Soft money as it currently exists is generally traced to two FEC Advisory Opinions that reversed the FEC's initial position on the use of state party money for get out the vote activities. In Advisory Opinion 1978-10, the FEC took the position that costs of voter registration and get-out-the-vote activities could be allocated in the same manner as party administrative expenses.[138] In Advisory Opinion 1979-17 the FEC took the position that national party committees, not just state or local party committees, could accept corporate contributions from the corporation's treasury funds "for the exclusive and limited purpose of influencing the nomination or election of candidates for nonfederal office."[139] Advisory Opinion 1979-17 is the key to contemporary soft money because it provided the legal basis for soft money solicitations by the national parties, including not simply the national committees but also the House and Senate campaign committees, which are also treated as political parties under the FECA. In effect, members of Congress, through their House or Senate committees, and the presidential candidate working with his party's national committee need not depend on state party committees but have *carte blanche* to solicit soft money directly from corporations, unions, foreign nationals, and individuals who had reached their contribution limit.[140] Both political parties embraced soft money, which began to appear in the 1980 election.[141]

The FEC addressed the use of soft money by requiring that certain expense be allocated between hard money and soft money accounts "on a reasonable basis."[142] Common Cause challenged this allocation provision in a petition for rulemaking on the grounds that it permitted a national party committee to use soft money to influence federal elections.[143] After seeking comments from the public and holding a hearing, the FEC denied the petition[144] and Common Cause brought suit seeking, in the alternative, to require that all expenditures be made with hard money or to require that the FEC promulgate an allocation method that prevented the use of soft money in federal elections.[145]

The court in *Common Cause* rejected the argument that no allocation is permissible, pointing to the allocation provisions already enacted by Congress.[146] The court agreed with Common Cause regarding the need for a more precise allocation standard.[147] The court noted that the FECA requires that state committees fund their federal election activities with "contributions subject to the limitations and prohibitions of this act."[148] The court held that "[t]he plain meaning of the FECA is that any improper allocation of nonfederal funds by a state committee would be a violation of the FECA."[149] Based on its interpretation of the FECA, the court held that "[i]t is not for the Commission to evade that mandate by permitting a variety of allocation methods and providing no guidance or supervision to those in whose interest it is to use as much 'soft money' in federal elections as they can."[150] The court did not order the FEC to adopt the allocation formula proposed by Common Cause but to review the Common Cause petition for rulemaking "with an eye to revising" the "reasonable basis" standard of the regulations at issue.[151]

A year later Common Cause filed a motion seeking to enforce the court's order in view of the slow pace of

[137]Illinois Republican State Central Committee in A.O. 1976-72. The FEC took the same position in its response to Advisory Opinion 1976-83.

[138]Republican State Committee of Kansas, A.O. 1978-10. Commissioner Thomas E. Harris wrote a strongly worded dissent that was highly critical of Commissioner Vernon Thomson, the author of A.O. 1976-72, who changed his position in A.O. 1978-10. Commissioner Harris wrote of Commissioner Thomson's and thus the FEC's change of position: "This sort of unexplained and inexplicable change of position on an important issue, which was carefully examined and decided two years ago, confuses those covered by the Act and discredits the Commission." All FEC Advisory Opinions issued in 1977 and subsequent years are available on the FEC Web site, www.fec.gov.

[139]Republican National Committee, A.O. 1979-17.

[140]In 1979 the FECA was amended to define certain "exempt activities" for state and local party committees. FECA section 431(8)(B)(x) and section 431(9)(B)(viii) created an exception for the cost of campaign materials used by volunteers; FECA section 431(8)(B)(xii) and section 431(9)(B)(ix) created an exception for costs of voter registration and get-out-the-vote activities conducted by state and local party committees on behalf of the party's presidential and vice-presidential candidates. These two provisions are similar to the provisions on slate cards and sample ballots, which were in the FECA before 1979. FECA section 431(8)(B)(v) and section 431(9)(B)(iv).

[141]Political scientist Anthony Corrado has estimated that soft money in the 1980 election totaled $19.1 million, with $15.1 million raised by the Republican Party and $4 million raised by the Democratic Party. In 1984 he estimated that the two parties raised $21.6 million, with the Republican Party raising $15.6 million and the Democratic Party raising $6 million. *See* Anthony Corrado, "Party Soft Money," in Anthony Carrado, Thomas E. Mann, Daniel Ortiz, Trevor Potter, Frank J. Sorauf, *Campaign Finance Reform: A Sourcebook* 173 (1997).

[142]11 CFR section 106.1(e), which was promulgated in 1976.

[143]FEC, Notice of Availability, 50 *Fed. Reg.* 477 (Jan. 4, 1985) and Notice of Inquiry, 50 *Fed. Reg.* 51535 (Dec. 18, 1985).

[144]FEC, Notice of Disposition, 51 Fed. Reg. 15915 (Apr. 29, 1986).

[145]*Common Cause v. FEC*, 692 F. Supp. 1391 (D.D.C. 1987).

[146]*Common Cause v. FEC*, 692 at 1394-95.

[147]*Id.* at 1395-96.

[148]*Id.* at 1395, *citing* FECA sections 431(8)(B)(x)(2), 431(8)(B)(xii) (2), 431(9)(B)(viii), and 431(9)(B)(ix)(2).

[149]*Id.* at 1395.

[150]*Id.*

[151]*Id.* at 1396-97, referring to 11 CFR section 106.1(e)(1976).

the FEC's response.[152] The court refused to impose a timetable on the FEC but retained jurisdiction over the matter and held the Common Cause motion in abeyance.[153] Describing the FEC's response to its prior order as "laggard"[154] and noting that the FEC had been considering the issue for some time before the prior litigation, the court reminded the FEC that its inaction had consequences in the form of "the climate of concern surrounding soft money."[155] The court linked these concerns with what the *Buckley* Court had described as "corruption and the appearance of corruption"[156] by which the *Buckley* Court had found "the integrity of our system of representative democracy is undermined."[157] It is noteworthy that the court regarded this issue as a systemic issue, not a question of individual misbehavior. It rejected the FEC suggestion that the allocation question could be dealt with through adjudication of individual instances of alleged improper allocations rather than through rulemaking.[158]

Despite its relatively firm stance on allocation of costs, the court in *Common Cause* consolidated the role of soft money in federal elections by holding that the FECA did not prohibit the use of soft money.[159] In addition, the court confirmed that national party committees, not just state or local party committees, could receive soft money.[160] The court stated that:

> "Soft money" denotes contributions to federally regulated campaign committees in excess of the aggregate amounts permitted for federal elections by the FECA; those contributions, even if directed to national campaign entities, are permissible if the money is not to be used in connection with federal elections.[161]

This language is so broad that it would seem to encompass multicandidate committees and perhaps even authorized committees of a candidate. These issues are likely to be litigated, possibly successfully, in the foreseeable future. If use is the criterion, then the nature of the recipient should be either irrelevant or at least quite secondary.

The allocation rules that resulted from the *Common Cause* litigation imposed both an allocation requirement and a disclosure requirement.[162] The allocation provisions vary according to the specific entity receiving the soft money. These allocation rules are sufficiently restrictive to serve as one of the reasons for transferring soft money to exempt entities so that the soft money becomes softer money and is no longer subject to the allocation requirements.[163]

The expansion of soft money from contributions to state or local party committees to contributions to national party committees has been matched by the expansion of its use. Initially, the FEC based the soft money provisions on so-called party-building activities, principally administrative expenses, voter registration, and get-out-the-vote activities, although it never stated that soft money was confined to such uses. The rise of issue ads brought with it the use of soft money to fund issue ads. In 1995 the FEC issued Advisory Opinion 1995-25, which permits the use of soft money for so-called issue ads, but subjects these costs to allocation formulae.[164]

Soft money was originally rationalized in terms of making political parties stronger by permitting them to engage in such grassroots activities as voter registration and voter education. The implicit predicate of this argument was that political parties were participatory and representative structures and with a meaningful connection to ordinary voters.[165] The paradox is that soft money has strengthened the legislative parties by making them the principal agents of rent-seeking. These legislative parties have no relationship with voters, but they do assiduously cultivate relationships with major donors.[166] The legislative parties serve as the regulatory structures for rent-seeking, seeking to ensure the competition among rent-seekers does not undermine the interests of those who control the rent-seeking in each legislative party. The issue of reforming soft money is thus inextricably related to the rent-seeking system, and it is this relationship that makes reform so difficult. While the discussion of soft money has focused on the technical basis for soft money, the case for reform rests on far broader issues of democratic theory-participation, representation, and accountability.

VI. Softer Money: Avoiding the FECA

Softer money is political money designed to avoid the limitations and disclosure requirements of the FECA. Soft money also avoids the limitations on the sources of money, but it is subject to disclosure. Softer money is not subject to disclosure provided that it is

[152]*Common Cause v. FEC*, 692 F. Supp. 1397 (D.D.C. 1988).

[153]*Id.* at 1398.

[154]*Id.* at 1400.

[155]*Id.* at 1401.

[156]*Id.* at 1401, *citing Buckley v. Valeo*, 424 U.S. 1, 25 (1976).

[157]*Id.* at 1401, *quoting Buckley v. Valeo*, 424 U.S. 1, 26-27 (1976).

[158]*Id.* at 1400. The opponents of campaign finance reform commonly argue that enforcement proceedings relating to particular cases are the only actions required to maintain or restore the integrity of the electoral system. Proponents of campaign finance reform argue that the problems are systemic and require a systemic response.

[159]*Id.* at 1391.

[160]*Id.* at 1397.

[161]*Id.* at 1398.

[162]FEC, Methods of Allocation Between Federal and Non-Federal Accounts; Payments; Reporting, 55 *Fed. Reg.* 26058 (June 26, 1990).

[163]Such metamorphoses of types of political money are discussed *infra* at Part VII.

[164]Republican National Committee, A.O. 1995-25.

[165]*See* William Greider, *Who Will Tell the People: The Betrayal of American Democracy* (1992).

[166]Lizette Alvarez, "Race Is Under Way for Campaign Cash Before New Limits," *New York Times*, Feb. 11, 2001, at A1.

collected and deployed by a section 501(c) organization. Maintaining the exempt status of the recipient organization is thus the crucial factor in avoiding disclosure of the sources of the political money and thereby maintaining the primary advantage that softer money offers when compared with soft money. This section of the article begins with a discussion of the commonly used softer money structures and then analyzes the non-statutory issue advocacy construct used to describe, quite imperfectly, softer money activities.

A. Softer Money Structures

Softer money structures are defined by tax law, but their primary benefits are not tax benefits but election law benefits. Only section 501(c)(3) organizations offer any tax benefit not available to political parties and candidate committees, which are exempt under section 527.[167] Contributions to section 501(c)(3) organizations are deductible to contributors under section 170, but uncertainty over the scope of the political prohibition means that section 501(c)(3) organizations may be used less frequently than other softer money structures. However, the absence of information means that any such observation is not based on reliable data. Achieving deductibility for contributors seems less important than the ability to accept contributions from any sources without limitation while at the same time avoiding disclosure.

Until July 1, 2000, the perfect softer money vehicle had been the "new section 527 organizations" because they did not jeopardize their exempt status by engaging in softer money activities but they were not subject to any disclosure requirements.[168] Once disclosure requirements were applied to these structures, softer money collected and deployed by new section 527 organizations became equivalent to soft money.[169] It is still possible to use new section 527 organizations if contributors are not deterred by disclosure. The advantage of new section 527 organizations compared with party soft money structures is that they permit the candidate to have a closer relationship to the money. The candidate or officeholder should not be an officer or director of the organization or have his or her name on the bank account. But, every candidate has family, former staff, and loyal supporters who can be trusted to operate the new section 527 organization just the way the candidate would if he or she were directly in charge. No candidate has this kind of control over party committees.

If avoiding disclosure is important to contributors, then the softer money structure will be either a section 501(c)(3) organization or a section 501(c)(4) organization. Although section 501(c)(3) contains an explicit and absolute prohibition on participation or intervention in political campaigns in support of or opposition to an candidate for public office, it is far from clear what is absolutely prohibited. Section 501(c)(3) organizations argue that they are not intervening in a political campaign but educating the public with respect to certain important issues. Education is, of course, an exempt activity for a section 501(c)(3) organization. In addition, section 501(c)(3) may engage in lobbying consistent with applicable limits. Uncertainty regarding the meaning of education, politics, and lobbying provides the raw material for the issue advocacy construct.

Softer money is political money designed to avoid the limitations and disclosure requirements of the FECA.

If a section 501(c)(3) organization is not publicly supported under the tests set forth in section 509, it will be treated as a private foundation. The absence of public support means, among other things, that the organization cannot participate in either lobbying or electoral campaigns and that special rules apply to activities that might be considered exempt educational activities for a publicly supported organization.[170] These private foundation rules have the effect of limiting the usefulness of section 501(c)(3) organizations as alter egos of one contributor, but they do not mean that section 501(c)(3) organizations cannot be used as conduits if they can qualify as publicly supported despite having received one or more large contributions that are then passed to some other organization. The private foundation rules do not apply to section 501(c)(4) organizations.

Section 501(c)(4) organizations may participate or intervene in political campaigns without jeopardizing their exempt status provided that such activity is not their primary activity. The activities that are limited for section 501(c)(4) organizations are the same as the activities that are prohibited for section 501(c)(3) organizations.[171] Section 501(c)(4) organizations are also subject to regulation under the FECA, which prohibits contributions by section 501(c)(4) organizations consistent with the ban on corporate contributions. Under the FECA section 501(c)(4) organizations may, however, make independent expenditures that expressly advocate the election or defeat of one or more clearly identified candidates for public office.

To engage in softer money activities, section 501(c)(4) organizations can claim that the activities are education or lobbying. While education is not an

[167]For a discussion of section 527 as it applies to political committees, including political parties and candidate committees and political action committees, see Milton Cerny and Frances R. Hill, "The Tax Treatment of Political Organizations," *Tax Notes*, Apr. 29, 1996, p. 651.

[168]For a discussion of these organizations, see Frances R. Hill, "Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle," *Tax Notes*, Jan. 17, 2000, p. 387.

[169]Analyses of reports filed with the Service by the new section 527 organizations have been developed by Tracy Warren of Campaign for American and are available at www.campaignforamerica.org.

[170]Sections 4941-4945.

[171]Rev. Rul. 67-368, 1967-2 C.B. 194, and Rev. Rul. 60-193, 1960-1 C.B. 195.

enumerated exempt purpose for a section 501(c)(4) organization, the Service has so blurred the distinction between section 501(c)(3) and section 501(c)(4) that it treats the section 501(c)(3) exempt purposes as exempt purposes for section 501(c)(4) organizations as well. Unlike section 501(c)(3) organizations, section 501(c)(4) organizations can treat lobbying as an exempt activity, which allows such organizations to argue that their softer money activities are properly characterized as lobbying and not as political campaign intervention.

Section 501(c)(5) labor organizations may also engage in softer money activities. Because labor unions are membership organizations subject to applicable labor law, section 501(c)(5) does not offer the malleability characteristic of section 501(c)(3) and section 501(c)(4). Labor organizations are prohibited from making hard money contributions under the FECA, but this prohibition is limited by an exception for member communications. The same exception applies to any membership organization. Likewise, member communications will not be treated as independent expenditures. Labor organizations may make and do make soft money contributions. But, labor organizations also air the kind of issue ads in major media markets that have come to be called the campaign air war. These efforts are funded by softer money to which disclosure requirements do not apply. As in the case of section 501(c)(4) organizations, it is not clear that educating the public is an exempt activity for a labor union, but the Service has interpreted the statute in a manner that makes education an exempt activity for a section 501(c)(5) labor union. In addition, lobbying will not jeopardize the exempt status of a section 501(c)(5) organization provided it does not constitute the organization's primary activity.

Section 501(c)(6) trade associations also engage in softer money activities during political campaigns. Like other exempt organizations, trade associations are prohibited from making contributions under the FECA general corporate ban. In addition, however, the Supreme Court has held in *Austin v. Michigan Chamber of Commerce* that section 501(c)(6) trade associations cannot make independent expenditures using their treasury funds. The Court reasoned that the members of trade associations are taxable corporations and that permitting trade associations to make independent expenditures would permit corporations to do indirectly what they cannot do directly. In addition, the Court held that businesses join trade associations for reasons related to their business and that political campaign activity that a business opposed would present an unacceptable choice between the economic reasons for membership and opposition to campaign activities. Trade associations can and do contribute soft money to party committees. They also engage in softer money campaign activities. Although educating the public is not an exempt purpose for trade associations, the Service has never ruled that public education is inconsistent with the exempt status of a trade association. In this sense, education may be a permissible activity but not an activity that would support exemption by itself. Trade associations may lobby provided that lobbying is not their primary activity.

Like other corporations, section 501(c)(4) social welfare associations, section 501(c)(5) trade unions, and section 501(c)(6) trade associations may form a political action committee (PAC), which is a section 527(f)(3) separate segregated fund. A section 501(c)(3) organization may form a section 527(f)(3) separate segregated fund but may not use the money in it for activities prohibited to the section 501(c)(3) organization.

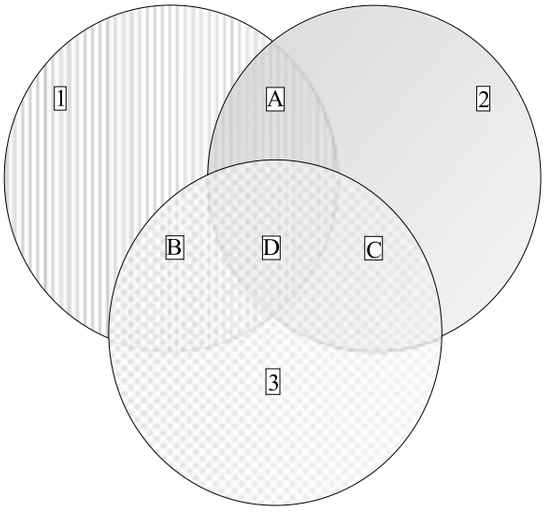
This overview of softer money structures suggests the broad opportunities for engaging in softer money activities. Some organizations, particularly section 501(c)(3) organizations and section 501(c)(4) organizations, are well-adapted to being structured as conduits for undisclosed political money or as alter egos of one contributor. Membership organizations like section 501(c)(5) organizations and section 501(c)(6) organizations may be conduits for large contributions made for softer money activities but they are not mere alter egos of contributors. For all of these exempt organizations, the softer money will not remain undisclosed if the organization is not exempt and if the activities are not designed to avoid the disclosure requirements of the FECA. The next subsection discusses the creation of the concept of issue advocacy to satisfy these requirements for effective use of softer money.

B. Elements of Issue Advocacy

Although issue advocacy has become a rhetorical construct in tax law, it is not a statutory concept. Issue advocacy is a null concept in election law, the catch-all concept for activities that do not constitute express advocacy.

1. Overview of issue advocacy. Issue advocacy has been developed for election law purposes in the context of independent expenditures but has no relationship to defining what constitutes a contribution. For tax law purposes, issue advocacy cannot be defined simply as the obverse of express advocacy, which also is not a tax law concept. Instead, issue advocacy has come to be used for tax purposes as a shorthand rhetorical device for a mixture of education and lobbying that comes as close to supporting or opposing candidates for public office as an organization can come without jeopardizing its exempt status. In this amalgam, education is an exempt activity but lobbying is, for all exempt organizations except section 501(c)(4) organizations, a permissible activity. The obverse of issue advocacy in tax law is participation or intervention in a political campaign in support of or opposition to a candidate for public office. The obverse concept in tax law is more inclusive than is the obverse concept in election law, which is express advocacy. Using the election law concept of issue advocacy as the template of issue advocacy for tax law purpose is thus a statutory mismatch that imports a broad concept into a narrower space. Indeed, the use of the rhetorical device of issue advocacy in tax law represents an attempt to create a space that does not exist in section 501(c). The use of issue advocacy suggests that issue advocacy is a blend of education and lobbying that does not constitute prohibited or limited political participation. This blend is created at points of overlap among the three concepts, as illustrated by the Venn diagram on the next page.

Advocacy Activities of Exempt Organizations



1 Education
2 Lobbying
3 Participation or Intervention in a Political Campaign

A Education -- Lobbying
B Education -- Politics
C Lobbying -- Politics
D Education -- Lobbying -- Politics

The diagram of the three intersection elements of issue advocacy on which softer money is based suggest the complexity of the issue advocacy construct. This complexity is integral to the success of the issue advocacy construct as the basis for softer money. While the three discrete elements of the issue advocacy construct are grounded in the tax law applicable to tax-exempt organizations, the construct arising from their intersections does not have a statutory basis. The Venn diagram permits consideration of the three building blocks of the issue advocacy construct and consideration of the issues arising from particular points of intersection. The following propositions serve as an introduction to the effort to craft the concept of issue advocacy from the three statutory elements of education, lobbying and political participation:

(1) If issue advocacy is education and only education, then it is the part of 1 that does not overlap with either lobbying or politics, or 1 without A, B, and D.

(2) If issue advocacy is any activity that includes an education element, then it encompasses all of 1, including A, B, and D, areas where education overlaps lobbying or politics or both.

(3) If issue advocacy encompasses both education and lobbying but not politics, then it is 1 without B or D and 2 without C or D but including A, the overlap between education and lobbying.

(4) If issue advocacy is an activity that includes elements of education or lobbying, then it includes all of 1 and 2, including A, B, C, and D.

(5) If issue advocacy as defined for tax law purposes excludes political activity, then all of 3 will be excluded from issue advocacy.

(6) If issue advocacy encompasses all activities except those that consist solely of political activity, then issue advocacy includes all of the areas in the diagram except the area where 3 does not overlap 1 or 2 or both.

Softer money is not coterminous with issue advocacy. Rather, softer money exists in the areas where political activity overlaps with education or lobbying or both, areas B, C, and D. Even the most ardent softer money enthusiasts would agree that current law defines some area as purely political activity that is prohibited for section 501(c)(3) organizations and limited for section 501(c)(4) organizations. There are passionate disputes over how this area of prohibited or limited political activity is to be defined and identified. Softer money becomes more expansive to the extent that this area of prohibited or limited political activity can be confined to a very limited set of activities. Softer money does not exist in areas of pure issue advocacy or pure lobbying, Neither of these activities in themselves is of any particular benefit to one or more candidates for public office. Softer money exists in areas where political activity overlaps with either education or lobbying or both, areas B, C, and D in the diagram. Softer money adds a political element to activities that are either exempt activities themselves or activities that are consistent with exemption. Softer money exists only if the organization retains its exempt status, at least until the election, because exempt status under section 501(c) is the defense against disclosure and the basis for the argument that the organization is not a political committee.

Softer money is facilitated by the complexity and uncertainty of current law and the failure of either Congress or the Service to clarify this area. The absence of guidance relevant to the conduct of modern campaigns means that the problematic distinction between issue ads and express advocacy is assumed to describe the actual conduct of political campaigns. In fact, even candidates are no longer likely to use the language of express advocacy but to use softer language of concern for particular issues and for the well-being of the voters in their campaign communications. The issue advocacy construct serves the creation of softer money so well because it helps to perpetuate misleading assumptions about how campaigns are conducted. At the same time, candidates are likely to convey in their speeches the kind of information that would support characterization of their speeches as education. None of these real world elements of modern political campaigns have been addressed in the available guidance, and this failure of guidance sustains the development of softer

money and the use of the exempt organization form for softer money structures. The limitations of the guidance which is currently available emerge from the following discussions of the three elements of the issue advocacy construct.

2. Issue advocacy as education. The strongest claim is that issue advocacy is a form of education.[172] This claim is based on numerous cases and rulings that provide that taking a stand on controversial issues constitutes education within the meaning of section 501(c)(3). The difficulty in determining whether a particular activity constitutes education arises in the first instance from the difficulty in distinguishing education, including advocacy of a point of view, from advocacy that does not support exemption. This distinction remains elusive and the grounds on which the distinction is to be made remain unsettled.

The regulations under section 501(c)(3) attempted to avoid content-based distinctions by focusing on whether the message presents a "full and fair exposition" of the issue.[173] The touchstone of the full and fair exposition test was whether the message presented sufficient information to permit the listener to make an independent determination with respect to the issue. The rationale for the full and fair exposition test was that providing the requisite information constituted a public benefit while simply presenting a point of view did not.

The full and fair exposition test was held to be unconstitutionally vague in *Big Mama Rag*.[174] This case involved a lesbian feminist newspaper that challenged the patriarchy in language at least some at the Service found unsettling. It did not lobby and it did not support candidates for public office, directly or indirectly. The Service pointed to the vivid language as evidence of a presentation of a point of view without a full and fair exposition. The court held that the standard was unconstitutionally vague.

In a subsequent case, the Service introduced a "methodology test" to support its denial of exemption for a white supremacist organization that did not lobby or support candidates for public office. The District Court applied the reasoning of *Big Mama Rag* and held that the Service erred in denying exemption.[175] The court of appeals reversed, holding that the Service had properly applied its "methodology test" to determine that the National Alliance was not engaged in exempt educational activities but in the kind of advocacy that did not support exemption.[176] The court did not rule on whether the methodology test cured the vagueness of the full and fair exposition test but did find that "[t]he test reduces the vagueness found in the *Big Mama* decision."[177] The court also found that "[a]lthough the test requires the exercise of judgment, abuses of such judgment are checked both by extensive administrative review and by prompt post-determination access to the courts."[178] The Service subsequently issued Rev. Proc. 86-43, which sets forth the methodology test.[179] In this document the Service took the position that a communication "will not be considered educational if it fails to provide a factual foundation for the viewpoint or position being advocated, or it fails to provide a development from the relevant facts that would materially aid a listener or reader in a learning process."[180] The Service also stated that "[i]t has been, and it remains, the policy of the Service to maintain a position of disinterested neutrality with respect to the beliefs advocated by an organization."[181]

The Service relied on the methodology test to deny exemption for the Nationalist Movement, a white supremacist organization that published a newspaper asserting the superiority of the white race. The organization appealed the denial to the Tax Court, which rejected its claims that its activities constituted the kind of educational advocacy that is consistent with exempt status.[182] The Tax Court found that the methodology test does not require constitutionally impermissible content scrutiny and that it is based on constitutionally permissible methodological grounds.[183] This issue did not arise on appeal since the court of appeals affirmed the Tax Court on public policy grounds.

The methodology test has not been considered by any other court. The obvious difficulty of separating methodology from content in making determinations with respect to exemption remains unresolved.

3. Issue advocacy as lobbying. Issue advocacy also draws on concepts from lobbying. This is particularly useful for section 501(c)(4) organizations for which lobbying is an exempt purpose while political activities are not. It is also useful for section 501(c)(3) organizations for which lobbying is a permissible activity but not an activity that supports exemption. Under this reasoning, section 501(c)(3) organizations may engage in limited lobbying without jeopardizing their exempt status. Arguments that issue advocacy can be used to argue that activities that violate the political prohibition should be characterized as lobbying create an exception to the political prohibition, which is absolute under the statute.

The lobbying rules and the political prohibition overlap in those common cases in which a candidate is closely identified with a particular issue. In these

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[172]Two studies of issue ads by the Annenberg Public Policy Center of the University of Pennsylvania suggest that such a claim would be inconsistent with the negative tone and absence of content in many issue ads. *See Issue Advocacy During the 1996 Campaign* (1997) and *Issue Advocacy Advertising During the 1997-1998 Election Cycle* (1998).

[173]Treas. reg. section 1.501(c)(3)-1(d)(1)(i).

[174]*Big Mama Rag Inc. v. United States*, 631 F.2d 1030 (D.C. Cir. 1980).

[175]*National Alliance v. United States*, 81-1 USTC section 9464 (D.D.C. 1979).

[176]*National Alliance v. United States*, 710 F.2d 868 (D.C. Cir. 1983).

[177]*Id.* at 875-76.

[178]*Id.* at 876.

[179]Rev. Proc. 86-43, 1986-2 C.B. 729.

[180]*Id.*

[181]*Id.*

[182]*Nationalist Movement v. Commissioner*, 102 T.C. 558 (1994).

[183]*Id.*

cases, an organization will argue that its issue ads on a particular topic should be treated as lobbying. Running issue ads timed to coincide with electoral cycles will be defended on grounds that the public is more likely to be paying attention to public policy debates and thus more receptive to the lobbying message.

4. Political participation or intervention. Explicit endorsements of particular candidates constitutes prohibited direct participation or intervention. Endorsing a particular slate of candidates in a school board election,[184] publishing editorials opposing the election of John Kennedy on grounds that the election of a Roman Catholic was inconsistent with the separation of church and state,[185] explicitly endorsing Pat Robertson for president as Jimmy Swaggert did in 1986,[186] and purchasing full-page advertisements in *USA Today* and *The Washington Times* four days before the 1992 election urging Christians not to vote for then-Governor Clinton[187] are examples of campaign activities that violate the political prohibition of section 501(c)(3).

Candidate rating systems raise many of the same issues with respect to the overlap between politics and education and the neutrality of the organization that claims its activities constitute permissible voter education.[188] Because rating systems involve distinctions among candidates, they are generally treated as prohibited participation or intervention on behalf of or in opposition to a candidate for elective office.

The Service has rejected the position that participation or intervention does not occur unless the activity in question satisfies the "express advocacy" standard[189] applied under federal election law.[190] The Service illustrated the impossibility of adopting the express advocacy standard by posing the hypothetical case of corporate contributions to a picnic for senior citizens.[191] Members of the candidate's staff planned the picnic and attended the event to distribute literature on the candidate's positions on issues of particular interest to senior citizens. There was, however, no express advocacy of the candidate's election or his opponent's defeat nor was there any solicitation of campaign contributions. The court held that the Federal Election Commission had correctly determined that the event was nonpolitical and the corporate donations were not political contributions.[192] The Service said of this fact pattern:

> What would be our decision, however, if an section 501(c)(3) organization rather than a corporation, had financed the picnic? The language of section 501(c)(3) indicates a much broader scope to the concept of participation or intervention in a political campaign. The statute clearly states that participation or intervention in a political campaign includes publication or distribution of statements, which denotes that prohibited political campaign activity is not to be limited to statements. It would do violence to 40 years of interpretation to adopt the "express advocacy" standard. Therefore, the "express advocacy" standard may not be adopted for purposes of the political campaign prohibition of section 501(c)(3).[193]

The Service has consistently taken the position that an organization might participate or intervene even if it does not explicitly endorse one or more candidates for public office. These cases pose particular problems for organizations and their professional advisers. The Service has issued no precedential guidance in this area since 1980, and that guidance related to voter guides and not to the broader area of issue advocacy.[194] There is no one test that the Service will use to determine whether an organization's activities, including its statements relating to policy matters, constitute prohibited participation or intervention in a political campaign. Instead, the Service has advised its own field personnel:

> In situations where there is no explicit endorsement or partisan activity, there is no bright-line test for determining if the section 501(c)(3) organization participated or intervened in a political campaign. Instead all the facts and circumstances must be considered.[195]

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[184]Rev. Rul. 67-71, 1967-1 CB 125.

[185]GCM 34267 (Feb. 20, 1970).

[186]Pursuant to a closing agreement with the Service that reinstated the organization's exemption, the organization issued Public Statement of Jimmy Swaggart Ministries (Dec. 27, 1991). These statements by Jimmy Swaggart were attributed to the organization because Swaggart had verbally endorsed Robertson at an official function of the organization and issued a written endorsement in the organization's newspaper. As a condition to entering into the closing agreement under section 7121, the Service required that the organization adopt procedures and structures designed to prevent future political participation or intervention. Jimmy Swaggart Ministries established an Audit and Compliance Committee of its board to enforce future compliance, but no details were provided with respect to the composition or duties or authority of this committee.

[187]The Service announced revocation of the church's exempt status in Announcement 95-29, 1995-15 IRB 30, which was upheld by the courts in *Branch Ministries Inc. v. Rossotti*, 40 F. Supp.2d 15 (D.D.C. 1999), *aff'd* 211 F.3d 127 (D.C. Cir. 2000).

[188]*Association of the Bar of the City of New York v. Commissioner*, 858 F.2d 876 (2d Cir. 1988).

[189]*Federal Election Comm'n v. Massachusetts Citizens for Life Inc.*, 479 U.S. 238 (1986).

[190]TAM 8936002.

[191]Kindell and Reilly, *Election Year Issues*, Exempt Organizations Technical Continuing Professional Education Text 400, 415 (1992), *94 TNT 70-28*.

[192]*Orloski v. Federal Election Comm'n*, 795 F.2d 156 (D.C. Cir. 1986).

[193]Kindell and Reilly, *Election Year Issues*, Exempt Organizations Technical Continuing Professional Education Text 400, 413 (1992), *94 TNT 70-28*.

[194]Rev. Rul. 80-282, 1980-2 C.B. 178.

[195]Kindell and Reilly, *Election Year Issues*, Exempt Organizations Technical Continuing Professional Education Text 400, 410 (1992), *94 TNT 70-28*.

Taking positions on issues during an election campaign is certainly not in itself prohibited as per se participation or intervention in the campaign. The Service has taken the position in nonprecedential guidance:

> On the one hand, the Service is not going to tell section 501(c)(3) organizations that they cannot talk about issues of morality or social or economic problems at particular times of the year, simply because there is a campaign occurring. On the other hand, the Service is aware that an IRC 501(c)(3) organization may avail itself of the opportunity to intervene in a political campaign in a rather surreptitious manner. The determination centers on whether a label or other coded language is used as a proxy for a reference to one or more identifiable candidates. The concern is that an IRC 501(c)(3) organization may support or oppose a particular candidate in a political campaign without specifically naming the candidate using code words to substitute for the candidate's name in its messages, such as "conservative," "liberal," "pro-life," "pro-choice," "anti-choice," "Republican," "Democrat," etc., coupled with a discussion of the candidacy or the election. When this occurs, it is quite evident what is happening — an intervention is taking place.[196]

In light of this use of coded language in communications about issues, the Service has stated that "the fundamental test that the Service uses to decide whether a section 501(c)(3) organization has engaged in political campaign intervention while advocating an issue is whether support for or opposition to a candidate is mentioned or indicated by a particular label used as a stand-in for a candidate."[197]

The Service has consistently taken the position that an organization might participate or intervene even if it does not explicitly endorse one or more candidates for public office.

The Service found that coded language is used precisely so that particular candidates can be identified, reasoning that

> [c]ode words, in this context, are used with the intent of conjuring favorable or unfavorable images — they have pejorative or commendatory connotations. When combined with discussions of elections, the code words also make specific candidates identifiable — the organization would not use up air time or newspaper space with a code word if the word was not intended to communicate to the viewer, listener, or reader a specific elective choice.[198]

[196]*Id.* at 411.

[197]*Id.* at 412, which cites TAM 9117001 for its analysis of the use of coded language.

[198]*Id.* at 412 n.6.

The Service has taken the position that it is not necessary to call a candidate by name in order to influence voters.[199] This issue arose with respect to an advertising campaign timed to coincide with televised debates during a presidential campaign. The advertisements were not treated as prohibited participation or intervention simply because they did not mention either candidate by name or refer to either of the two major political parties by name. Describing the case as "a very close call," the Service concluded that

> While the ads could be viewed as focusing attention on issues of war and peace during the 1984 election campaign, individuals listening to the ads would generally understand them to support or oppose a candidate in an election campaign. The timing of the release of the ads so close to the November votes, even though the reference was changed to "join the debate," is also troublesome. Taking into account all the facts and circumstances, especially that it is arguable that the ads could be viewed as nonpartisan, we reluctantly conclude A, through its C project, probably did not intervene in a political campaign on behalf of or in opposition to a candidate for public office.[200]

In 1996, the Service ruled that a fundraising letter that did not explicitly urge readers to support or oppose any particular candidate constituted impermissible political participation or intervention.[201] Quoting excerpts from the letters, the Service found that the language, which "implied condemnation of a particular candidate who holds a different ideological view," changed statements that would by themselves have been permissible advocacy regarding an issue into impermissible political participation or intervention.[202] The Service described the letters as "replete with jargon and catch phrases that create the impression that [organization] and [organization's] activity are [political ideology] in orientation and that a contribution to them will help [political ideology] candidates for public office and favorably influence public policy on issues of concern to [political party] voters."[203] The Service expressed particular concern over the statement in the letter that "[t]ogether we can change the shape of American Politics."[204] The ruling stated that "intervention in a political campaign may be subtle or blatant" and that the "express advocacy" standard applied for election law purposes does not apply for tax law purposes.[205] The Service cited as an example the exhortation to register so that new voters could provide the winning margin in a particular electoral contest that the communication described as "dead even."[206]

[199]TAM 8936002.

[200]*Id.*

[201]TAM 9609007.

[202]*Id.*

[203]*Id.*

[204]*Id.*

[205]*Id.* The express advocacy standard was set forth by the Supreme Court in *Buckley v. Valeo*, 424 U.S. 1 (1976).

[206]*Id.*

The ruling also noted that the letters appeared on stationery with a masthead including the organization's board of advisers, who were nationally prominent exponents of a particular political ideology. The Service rejected the organization's argument that the language and the identification of these prominent individuals was required to raise money for the organization among a particular segment of the population. The Service rejected this fundraising defense, stating:

> [Organization] would have us believe that providing politically oriented statements to [organization's] intended audience had no meaning except for giving a sense of urgency to fund raising appeals. In other words, [organization's] dialogue with its [political orientation] audience was equivalent to a pastor preaching to the choir. Under such reasoning, the logical conclusion would be that ideological entities could directly communicate with their memberships or selected audiences on political candidate preference (or in the section 501(c)(3) lobbying context, direct calls to action on specific legislation) so long as such communication was not to a general audience. The federal tax laws specifically reject this contention.[207]

The Service also rejected the organization's argument that only a limited number of the letters were sent to the electoral districts at issue by noting that significant financial support generally comes from outside an electoral district. Describing the elections as "contests that commanded national attention," the Service reasoned:

> It is common knowledge that in recent times the primary source of a candidate's support in such elections is often derived from out-of-state sources. Although a particular reader may not have been eligible to actually vote for the described candidate, he or she could have been charged by [organization], in our view, to participate in the candidate's campaign through direct monetary or in-kind support, volunteerism, molding of public opinion, or the like.[208]

There is some indication that the Service now looks for targeting to particular congressional districts as an element in a finding that a communication constitutes participation or intervention in a political campaign.[209] The Service ruled that an organization's "I'm Fed Up With Congress" communication did not violate the political prohibition based on the following reasoning:

> . . . Additionally, there is no indication in the file that the letter was sent only to specific states or congressional districts in which congressional elections targeted by the organization were occurring. Our determination with respect to this case might be different if evidence in the file indicated that the communication was aimed at a specific candidate, specific candidates, or a specific ticket of candidates.[210]

These facts and circumstances determinations in nonprecedential guidance all involve the overlap between education and participation in an electoral campaign. On this issue there is little guidance and little agreement.

5. Education and politics. The relationship between education as an exempt purpose and the political prohibition is one of the most difficult and the most contested in exempt organization law. The Service has taken the position in nonprecedential guidance that activities that qualify as educational activities under the methodology test can violate the political prohibition depending on all the facts and circumstances of a particular case.[211] The distinction rests on the intended consequences of the communication. If the communication is intended to persuade voters or contributors to support one or more candidates for public office, the communication violates the political prohibition. The Service cited as an example of a communication that satisfied the methodology test but violated the political prohibition the candidate rating system at issue in *Association of the Bar of the City of New York*.[212] The Service also cited the case of an organization that endorsed a slate of candidates in school board elections and provided a detailed analysis of its reasons for doing so.[213] These cases pose questions about the meaning of intent and its role characterizing certain communications as participation or intervention in a political campaign.[214] The available guidance supports the view that the Service is treating purpose or intent here as it does in other areas of tax as a facts and circumstances determination.

Speeches by candidates for public office routinely satisfy the methodology test. This is a common occur-

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[207] *Id.*

[208] *Id.* It is unclear from the ruling whether the Service revoked the organization's exempt status, based on its finding that "[organization's] fund raising letters demonstrate evidence of a pattern of intervention in political campaigns over the course of many years," or whether it simply levied the excise taxes of section 4955.

[209] TAM 199907021.

[210] *Id.*

[211] Kindell and Reilly, *Election Year Issues*, Exempt Organizations Technical Continuing Professional Education Text, 400, 415 (1992), *94 TNT 70-28*.

[212] *The Association of the Bar of the City of New York v. Commissioner*, 858 F. 2d 876 (2d Cir. 1988), *rev'd* 89 T.C. 599 (1987).

[213] Kindell and Reilly, *Election Year Issues*, Exempt Organizations Technical Continuing Professional Education Text 400, 416 (1992), *94 TNT 70-28*, *citing* Rev. Rul. 67-71, 1967-1 C.B. 125.

[214] For an exchange of views on this topic, see Hill, "The Role of Intent in Distinguishing Between Education and Politics," 9 J. *Tax'n of Exempt Orgs. 9* (July/August 1997); Yablon and Coleman, "Intent Is Not Relevant in Distinguishing Between Education and Politics," 9 *J. Tax'n of Exempt Orgs.* 156 (January/February 1998); Hill, "Can Arguments About Subjective Intent Eliminate the Political Prohibition Under Section 501(c)(3)?" 10 *J. Tax'n of Exempt Orgs.* 1 (January/February 1999).

rence, probably the most common form of speech that candidates give. Presidential candidates' acceptance speeches at national party nominating conventions seem likely to satisfy the methodology test. Does this mean that candidates could, if they chose, run their campaigns as section 501(c)(3) organizations? No one has yet suggested that educational content should support this result. What, then, is the relationship between education and political participation?

The Service has taken the position in nonprecedential guidance that an activity can be both education and politics and that, when it is, the activity will be treated as prohibited political activity. The Service stated:

> The most common question that arises in determining whether a section 501(c)(3) organization has violated the political campaign prohibition is whether the activities constitute political intervention or whether they are educational, one of the purposes for which a section 501(c)(3) organization may be formed. Sometimes, however, the answer is that the activity is both — it is educational but it also constitutes intervention in a political campaign.[215]

Voter guides fall into this overlap area. The Service has issued no precedential guidance in this area for two decades.[216] The existing guidance focuses on such factors as the absence of rating-like elements and inclusion of a broad range of issues. This guidance seems to assume that voter guides will appear on paper, not on television screens or computer screens, each of which presents quite different opportunities which are becoming more common in campaign efforts.

The Service is not responsible for the confusion in election law, but it is responsible for the dearth of guidance with respect to exempt status. The absence of relevant guidance in this difficult area has been one of the major factors, if not the major factor, in establishing issue advocacy as a de facto part of tax law and thereby creating softer money as one of the elements of political money.

VII. Moving and Transforming Political Money

Raising money through exempt organizations offers a tax benefit only if the organization is a section 501(c)(3) organization eligible to receive contributions deductible as charitable contributions under section 170.[217] None of the other exempt organizations offer any tax advantage to contributors. All exempt organizations do, however, provide complete anonymity to their contributors and may accept contributions from any individual or entity, domestic or foreign. None of the limitations applicable to contributions, expenditures, or soft money apply to contributions to exempt organizations.[218] Exempt organizations receive substantial campaign funds from political parties. This may seem counterintuitive; since the money has been reported to the FEC and disclosed to the public, transfers to exempt organizations help obscure particular uses of the money.[219] If, for example, a particular candidate would benefit, it is thought, from a particularly negative or highly personal ad being run against her opponent, a special purpose exempt organization created especially for the campaign is perfect for the assignment. The candidate who benefits and the political party that financed the ad both have deniability. The same considerations apply when an exempt organization receives funds from another exempt organization, which may or may not have raised the money itself from individuals. The transferor exempt organization maintains deniability. In some cases, special purpose exempt organizations appeal to voters in a particular demographic segment of the voting population. An organization with an appealing name and no past record to dilute the current message is perfect for this assignment. Raising money from individuals is the most difficult way for exempt organizations to finance their campaign activities. Most cannot offer any tax benefits and most cannot claim that the contributions will have any direct impact on the issues with which the organization is identified. In short, the difficulties of presenting a persuasive necessity rationale have operational consequences for fund-raising. All exempt organizations except section 501(c)(3) organizations may establish separate segregated funds, or political action committees (PACs), to raise hard money for direct support of particular candidates. It is more difficult to raise money for a PAC than for the organization itself, largely because ordinary individual contributors do not see the connection between the actions of the PAC and achievement of the organization's exempt purposes and because they may prefer to give directly to candidates. Ordinary contributors place little or no value on anonymity, and are thus not particularly inclined to give political money to exempt organizations. For these reasons, exempt organizations seek ways to move and deploy treasury

[215]Kindell and Reilly, *Election Year Issues*, Exempt Organizations Technical Continuing Professional Education Text 400, 414 (1992), *94 TNT 70-28*.

[216]Rev. Rul. 76-456, 1976-2 C.B. 151, which modified and superseded Rev. Rul. 66-258, 1966-2 C.B. 213; Rev. Rul. 78-248, 1978-1 C.B. 154, which revoked Rev. Rul. 78-160, 1978-1 C.B. 153; Rev. Rul. 80-282, 1980-2 C.B. 178.

[217]Section 501(c)(19) war veterans organizations may also receive deductible contributions, but restricting the membership to war veterans means that these organizations have not become general-purpose campaign finance conduits. The permissible rules on lobbying and political activity arise from veterans' special relationship to government and their unique service to the country.

[218]For a discussion of the limitations and requirements of election law, see *infra* Part VII.

[219]Another explanation of these transfers from political parties is that a powerful or well-connected exempt organization can threaten to break with the party on a particular issue considered important in the pending election. Or, the exempt organization can threaten to expose facts about the party or one or more candidates that might be harmful. Certain of the most powerful exempt organizations have some capacity to rent-seek on their own behalf. This aspect of funding exempt organizations' activities deserves greater attention.

funds if the organization or its leaders seek to become involved in electoral politics. Money from contributors who do value anonymity and freedom from the limitations of election law will give to the organization, not to its PAC, because PACs are subject to FEC reporting and disclosure.

Moving political money is facilitated by exempt organizations' permeability, primarily their freedom from entity-level tax. The exemption itself is more broadly valuable than is the chance for a charitable contribution deduction. Money passes through exempt organizations with no public record. It can be directed to one or more other exempt organizations, increasing the difficulty of tracing the money.

Section 501(c)(3) public charities are also subject to constraints on transferring money, and these constraints apply to all transfers, not just those that involve political activity. The general principle is that a section 501(c)(3) public charity can transfer money to other types of exempt organizations provided that the recipient uses the money for activities that would be consistent with the section 501(c)(3) organization's exempt status if it conducted the activity directly. The code and regulation are silent on the steps, if any, that the transferor organization must take to ensure that the recipient uses the money in this way. However, the Service has issued a public ruling providing that a section 501(c)(3) organization may transfer money to organizations other than public charities provided that the transferor organization retains "control and discretion over the use of the funds" and maintains records establishing that it has done so.[220] In effect, this ruling creates an expenditure responsibility requirement for public charities analogous to that applicable to private foundations.[221] The guidance is incomplete since it establishes no compliance mechanism and offers no guidance for the donor organization. It is unclear, for example, whether the ruling anticipates a tracing approach or an allocation approach to determine how the recipient organization in fact uses the transferred amounts in the likely event that the recipient conducts more than one activity.

A section 501(c)(3) organization may not transfer treasury funds to another organization that uses some or all of the transferred amounts for activities that violate the political prohibition. This means that efforts to use a section 501(c)(3) organization to collect deductible contributions which it then transfers to a section 501(c)(4) organization can work only if the section 501(c)(4) organization uses the amount for the kind of activities that the section 501(c)(3) organization could have conducted directly. The characterization strategies discussed above are asserted to expand the range of activities that can be funded in this way.

One of the unsettled questions is whether a section 501(c)(3) organization may transfer funds to a section 527 organization. The idea would be for the section 501(c)(3) organization to collect deductible contributions and then to transfer the funds to a political organization. One argument is that this should be permissible under current law provided that the political organization uses the money for activities consistent with the transferor organization's exempt status. The question is whether a section 501(c)(3) activity would qualify as a political expenditure within the meaning of section 527(e). The same issue ads that are funded with soft money might be funded with softer money.

One of the unsettled questions is whether a section 501(c)(3) organization may transfer funds to a section 527 organization.

Section 501(c)(4) organizations provide many of the same benefits of permeability as do section 501(c)(3) organizations, but there are important differences. Section 501(c)(4) organizations may receive funds from any person with the possible exception of a political organization. Section 527 provides for transfers to other section 527 organizations and to section 501(c)(3) organizations, but is silent on transfers to section 501(c)(4) organizations. The major limit on the permeability of section 501(c)(4) organizations is that contributors are subject to gift tax on their contributions to section 501(c)(4) organizations.[222] The gift tax makes giving large contributions subject to the gift tax to section 501(c)(4) tax inefficient.[223]

There is no direct guidance on the movement of money from a section 501(c)(4) organization to any other exempt organization. Section 501(c)(4) organizations may operate PACs, but PACs sacrifice the opacity that other exempt entities provide. There appears to be no barrier to transfers from section 501(c)(4) organizations to section 501(c)(3) organizations. These are tax inefficient transfers since contributions to the section 501(c)(4) organization are not deductible and are subject to the gift tax if they reach the gift tax limit.

Transfers from section 501(c)(4) organizations to section 527 organizations are uncertain. Because section 501(c)(4) organizations may engage in some amount of direct political activity provided that such direct activity is not the organization's primary activity, transfers of the same amounts to one or more section 527 organizations would seem consistent with the structure of the applicable code provisions.

[220]Rev. Rul. 68-489, 1968-2 C.B. 210.

[221]Section 4945 sets forth the expenditure responsibility requirement for private foundations.

[222]Section 2501(a)(5).

[223]Gregory Colvin, Comments at the American Bar Association Annual Meeting, Panel on Political Activities of Exempt Organizations (San Francisco 1997), reprinted in *The Exempt Organization Tax Review*, October 1997, p. 89.

VIII. Reform Proposals

This article has focused on the deconstruction of political money and the fragmentation of structures through which political money is raised, moved, recharacterized, and ultimately deployed. The complexity of this system is in itself a barrier to the kind of inclusion of voters in campaigns and elections that is the policy basis for the analysis and for the proposals arising from it. Complexity serves the interests of the rent-seeking officeholders who are the only persons who benefit from the current system. Few candidates manage to get elected without raising huge amounts of money from a relatively small number of contributors to whom they owe large debts of political gratitude. These obligations of political gratitude may well trump the bonds of gratitude to voters and the duty owed to constituents. Even if a candidate can avoid such obligations, his or her career in Congress will be tied to success in rent-seeking for his or her colleagues in the legislative party. Those who become the masters of rent-seeking control the flow of party soft money and even interest group softer money. Successful rent-seekers set the legislative agenda.

Reform proposals should aim primarily at breaking the link between rent-seeking and public policy and at reestablishing the primacy of voters in elections and in policy deliberations. The following proposals thus focus on reducing the obfuscating complexity of the current system by reconstructing political money and reducing the fragmentation of political money entities. Disclosure in itself is insufficient without other simplifying changes. Voters should not have to function like lawyers or investigative journalists or social science researchers to learn who is financing the candidates among whom they will choose. Ordinary citizens should not have to "follow the money" through a maze, even if that maze is, in part, on the Internet, which, in any case, is not yet available to a majority of voters.

A soft money ban is the basic element of any campaign finance reform proposal. Soft money is simply the currency of rent-seeking. Rationalizing soft money as the basis for strengthening political parties raises questions well beyond the scope of this paper. Little in recent experience suggests that the flood of soft money has enhanced the capacity of political parties to involve ordinary citizens in party deliberations.[224] During the 2000 campaign those members of Congress who did not face close races, a very few did, remained in Washington, apparently because they felt neither a duty nor an obligation to treat the month before the election as an appropriate time to listen to their constituents. Soft money in unlimited amounts means that parties are becoming less about voters than about fundraising.

[224]Indeed, the Republicans in the House of Representatives seem so detached from the voters that they had to rely on Washington lobbyists to dress up as working Americans to fill out the tableau of support for the president's tax proposals. *The Washington Post*, Mar. 8, 2001.

Political money should mean hard money. The current limitations on amounts might be debated, but the limitations on contributors should remain. The companion proposal is that every candidate for public office should have one campaign committee, what is called the principal campaign committee under current law, but not the current authorized committees. There is no good reason for having more than one committee other than complexity for the sake of obfuscation. Hard money should be directed to a candidate's sole committee or to a political party.

> ***Voters should not have to function like lawyers or investigative journalists or social science researchers to learn who is financing the candidates among whom they will choose.***

Political party fragmentation should also end. Under current law there are two forms of political party fragmentation. The first is the fragmentation of parties into a national party committee plus two legislative parties, one for each house of Congress. The legislative parties in the House and the Senate operate as the equivalents of multicandidate committees. They have no role for voters. Their primary function is to manage rent-seeking to avoid competition among members of the same party. The second form of political party fragmentation is the maintenance of different accounts for hard and soft money. A soft money ban would mean that separate accounts are no longer necessary.

The most useful reform relating to independent expenditures would confine the exception for section 501(c)(4) organizations to the facts in *Massachusetts Citizens for Life* by adding a small organization requirement. Small section 501(c)(4) organizations are less likely to participate in rent-seeking transactions because the transaction costs make them unappealing targets for rent-seekers.

This would leave in place the possibility of large section 501(c)(4) organizations, the more likely participants in rent-seeking transactions, making independent expenditures through their separate segregated funds. Using separate segregated funds is consistent with the reasoning of the Court in *Massachusetts Citizens for Life* and in *Austen v. Michigan Chamber of Commerce*, where the Court emphasized the central importance of not forcing members to choose between supporting a candidate through independent expenditures and enjoying a valuable economic benefit. Congress and the courts should recognize that independent expenditures supporting or opposing a particular candidate may deprive a member of an organization of the benefit of joining and supporting the organization for the purpose of educating the public or lobbying on behalf of a particular issue. As discussed above, nonprofit tax-exempt organizations generally do not have mechanisms for consulting their supporters and contributors with respect to their endorsements of particular candidates. There is no guarantee that organizational leaders will use the

organization's treasury funds to support candidates with the best records on the organization's core issue. The consequences of this absence of consultation became obvious in the 2000 primary campaigns in which both the anti-abortion groups and the pro-choice groups supported candidates whose record on their issue was less impressive than that of the candidate they rejected. At least some members of each of the organizations felt that they had lost their voice on their most significant issue. Another element of the representational dilemma arises when the organization does use its money to support the election of a candidate who has supported the organization's position on its core issue but that candidate also takes positions on other issues that some members do not support and, on that basis, support a different candidate. In this case, too, the use of treasury funds gives such members no choice. Use of the funds of a separate segregated fund would give them the choice of supporting the organization's public education and legislative lobbying while not having their money used to expressly advocate the election of a candidate they do not support.

The remaining issues in a campaign finance reform package relate to softer money and to the section 501(c)(3) and section 501(c)(4) organizations that are the softer money structures. The strategy is to separate advocacy from rent-seeking for which softer money provides such a useful element of political money. Softer money should no longer be an element of political money and exempt organizations should operate as independent advocacy voices free of rent-seeking.

To this end, the section 501(c)(3) political prohibition should be retained and clarified. The political prohibition serves to limit the exposure of section 501(c)(3) organizations to rent-seeking. In this sense, it serves the same purpose as the contribution limit served before the soft money exception destroyed it. The continued integrity of the political prohibition depends in substantial part on the willingness of Treasury and the Service to issue useful precedential guidance relevant to the conduct of modern political campaigns. The absence of useful precedential guidance should not be permitted to continue.

Guidance in this area should be based on the use of one or more candidate's name or likeness or party symbol or other readily understandable identifier. The other factors that the Service has used, including targeting to particular voters and proximity to elections, should also be considered. Indeed, the series of rulings that the Service issued to the new section 527 organizations provide a useful place to begin.

Guidance that preserves broad scope for public education and lobbying by section 501(c)(3) and section 501(c)(4) organizations should be linked with provisions that ensure that exempt organizations speak in their own voices and not in the voice of a very limited number of wealthy contributors who could not otherwise move as much money into the political process. This goal requires a public support test that is also a voter support test. Like the public support test of current law, which is used to distinguish between public charities and private foundations, the public support test here would require that the organization be supported by a minimum number of individuals who are qualified voters, perhaps 100 or perhaps more, and that no one contributor provide more than a certain percentage of the organization's support, perhaps no more than 5 percent. The definition of a voter would be any person eligible to vote for president, which means that the provision would permit contributions to congressional candidates in districts or states other than those in which the individual can vote. These anti-conduit provisions should be based on a voter support test. Only organizations that are supported at some meaningful level by individuals who are eligible voters in federal elections would be counted. This test would determine the nature and extent of disclosure applicable to an organization. If an organization satisfied this voter support test, only substantial contributors would be disclosed. If the organization did not satisfy the voter support test, all of its contributors would be disclosed. Evidence that an organization accepted earmarked contributions that were directed to political committees would be grounds for revocation of exemption.

Contributions from political parties and other political committees would be permitted only if the political party or political committee terminated and did not re-establish itself for at least five years. This liquidation-reincorporation provision would require changes to section 527(d). If the political party or political committee did not satisfy this termination standard, the recipient section 501(c)(3) or section 501(c)(4) organization would lose its exempt status on receipt of the funds.

This article takes the position that reform efforts should not focus exclusively on exempt organizations but should instead focus primarily on the use and abuse of the exempt form for purposes unrelated to exemption. As this article has discussed, exempt organizations are well-designed to serve as conduits for political money and thus as financial intermediaries for rent-seeking. They are also well-designed to serve as alter egos and conduits for contributors who feel that the rules should not apply to them. They should be permitted to do what they are intended to do, which is pursue a broad range of exempt activities, including taking public positions on controversial issues.