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ANONYMOUS SPEECH AND SECTION 527 OF THE INTERNAL REVENUE CODE

*Donald B. Tobin**

Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.¹

Political campaigns, and the advertisements that accompany them, often resemble children in an argument on the playground. One can imagine a politician responding to an attack advertisement with the popular playground retort “sticks and stones may break my bones but words will never hurt me.” While on the playground words may be harmless, in politics, it is words, not sticks, that do the most harm. Political advertisements, “issue advertising,” and “party building” activities have all been used to attack opponents, shade the truth, and influence the outcome of elections. It is because of this power—the power of words and the political advantage to those who have the financial ability to deliver them—that spending on political advertisements has skyrocketed.²

* Assistant Professor of Law, Michael E. Moritz College of Law, The Ohio State University. In the spirit of section 527 and full disclosure, in my previous employment I was an attorney at the Department of Justice and was part of a team of attorneys involved in crafting the Government’s position in *National Federation of Republican Assemblies v. United States*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001), a case attacking the constitutionality of section 527. I would like to thank Leigh Tobin, Allan Samansky, Edward Foley, Alan Michaels, Marc Spindelman, Douglas Cole, Ruth Colker, Daniel Halperin, Elizabeth Garrett, Christopher Pietruszkiewicz, and Daniel Simmons for their helpful comments and advice, and my research assistants Alicia Chiu, Peter Galyardt, and Michael Lerner. I would also like to thank Debbie Saunders, Michele Whetzel-Newton, Kathy Hall and the reference librarians at the Moritz College of Law for their assistance.

¹ LOUIS D. BRANDEIS, *OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT* 62 (Nat’l Home Library Found. ed. 1933), *quoted in Buckley v. Valeo*, 424 U.S. 1, 67 (1976).

² Ruth Marcus, *Costliest Race Nears End; Bush, Gore Running Close; U.S. Campaigns Fuel \$3 Billion in Spending*, WASH. POST, Nov. 6, 2000, at A1; Michael Trister, *The Rise and Reform of Stealth PACS*, AM. PROSPECT, Sept. 24-Oct. 2, 2000, at 32. According to the Annenberg Public Policy Center of the University of Pennsylvania, independent expenditures on “issue advertising” have risen from \$135-150 million in the 1995-1996 election cycle to \$509 million in the 1999-2000 cycle. DEBORAH BECK ET AL., *ISSUE ADVOCACY ADVERTISING DURING THE 1996 CAMPAIGN* 3 (1997), *available at* <http://www.appcpenn.org/issueads> (last visited June 17, 2002) (stating 1995-1996 figures); KATHLEEN HALL JAMIESON ET AL., *ISSUE*

The integrity of the political process depends on voters being able to judge the merit and accuracy of campaign related speech.³ This is possible when candidates engage in campaign speech, and the voters know its source.⁴ Candidates, however, are not the only ones with an interest in the campaign. Third-party actors—groups or individuals not associated with a specific political candidate or party—have become more active in the political debate. These groups have specific agendas and are often engaged in activities designed to promote candidates that support their agendas. Unlike candidates and political parties, however, these third parties often escape the reach of the Federal Election Campaign Act (FECA)⁵ and therefore are not subject to provisions requiring disclosure of campaign contributions or expenditures.⁶ Absent disclosure provisions, third parties can hide their involvement in a campaign and engage in secret campaign speech.⁷

ADVERTISING IN THE 1999-2000 ELECTION CYCLE 4 (2001), available at <http://www.appcenn.org/issueads> (last visited June 17, 2002) (estimating 2000 cycle spending).

³ See 146 CONG. REC. H5286 (daily ed. June 27, 2000) (statement of Rep. Kasich) ("Give the ordinary citizen the right and the power to know who is behind all of these political organizations, all of them, and they will make the smart decision and they will use the real power in America, which is the power of the ballot box."); MICHAEL X. DELLI CARPINI & SCOTT KEETER, WHAT AMERICANS KNOW ABOUT POLITICS AND WHY IT MATTERS 22-50 (1996) (arguing that democracy functions best when electorate is properly informed).

⁴ See Elizabeth Garrett, *The Future of Campaign Finance Reform Laws in the Courts and in Congress*, 27 OKLA. CITY U. L. REV. 665, 681 (2002) ("Voting cues must provide accurate information to voters in order to empower them.").

⁵ Federal Election Campaign Act of 1971, 2 U.S.C. §§ 431-456 (2000).

⁶ See, e.g., H.R. REP. NO. 106-702, at 13 (2000) (citing unreported contributions of National Education Association as example of lack of disclosure of information by § 527 organizations). House Report 106-702 is the report of a previous attempt to amend § 527 through legislation called the Full and Fair Political Activity Disclosure Act of 2000, H.R. 4717, 106th Cong. (2000). H.R. 4717 did not become law. The provisions at issue here were also included in H.R. 4717, and the report references are to sections that appear in both bills. Under FECA, individuals or groups that engage in express advocacy must disclose contributions in excess of \$200. 2 U.S.C. § 434(c)(1), (c)(2)(C) (2000). For a discussion of the growth of independent expenditure funding of political campaigns, see HERBERT E. ALEXANDER, FINANCING POLITICS: MONEY, ELECTIONS AND POLITICAL REFORM 64 (4th ed. 1992); Richard Briffault, *Issue Advocacy: Redrawing the Elections/Politics Line*, 77 TEX. L. REV. 1751, 1760 (1999).

⁷ But see generally Ian Ayres & Jeremy Bulow, *The Donation Booth: Mandating Donor Anonymity to Disrupt the Market for Political Influence*, 50 STAN. L. REV. 837 (1998) (arguing that mandatory anonymity should replace mandatory disclosure to prevent corruption in campaign contributions). Although mandatory anonymity is theoretically possible, it is practically impossible to ensure. Moreover, anonymity raises further concerns about the electorate's ability to weigh the credibility of the information provided.

In the last twenty years, independent anonymous campaign speech, often referred to as “stealth advertising,”⁸ has become a dominant force in political campaigns in the United States.⁹ This stealth advertising threatens one of the foundations of our democratic system—that election decisions are made by an informed electorate—for it is difficult for voters to fully judge the merit and accuracy of third-party advocacy if they do not know its source.¹⁰

Third-party advocacy groups often avoid campaign finance restrictions because they use “independent expenditures” to engage in only “issue advertising.”¹¹ Third-party advocates argue that since they only engage in issue discussion, they are not subject to campaign finance regulations.¹² These organizations, however, often

⁸ See, e.g., Gail Russell Chaddock, “Stealth” Ads Revive Efforts to Change Election-Finance Laws, CHRISTIAN SCI. MONITOR, June 12, 2000, at 2; Jonah Goldberg, Campaign Reform Threatens Free Speech, ORLANDO SENTINEL, Mar. 5, 2002, at A11; see also 144 CONG. REC. S10145, S10149 (daily ed. Sept. 10, 1998) (statement by Sen. Snowe).

⁹ See generally France R. Hill, *Probing the Limits of Section 527 to Design a New Campaign Vehicle*, 86 TAX NOTES 387 (2000); JAMIESON, *supra* note 2.

¹⁰ See *Nixon v. Shrink Mo. Gov't*, 528 U.S. 377, 414-15 (2000) (Thomas, J., dissenting) (arguing that states are free to require disclosure of large contributions); *Buckley v. Am. Constitutional Law Found., Inc.*, 525 U.S. 182, 223 (1999) (O'Connor, J., dissenting) (noting that disclosure helps voters make intelligent choices in election process); *First Nat'l Bank v. Bellotti*, 435 U.S. 765, 792 n.32 (1978) (observing that disclosure of source of advertising may be required “so that the people will be able to evaluate the arguments to which they are being subjected”); *Viereck v. United States*, 318 U.S. 236, 251 (1943) (Black, J., dissenting) (quoting favorably House and Senate language that “[the statute rests on] the fundamental constitutional principle that our people, adequately informed, may be trusted to distinguish between the true and the false”). For an excellent discussion of voter competence and the need for campaign disclosure, see generally Garrett, *supra* note 4.

¹¹ Independent expenditures are amounts spent on political advertising that are not directed by or associated with a candidate or political party. See, e.g., *Buckley*, 424 U.S. 1, 47-48 (1976). In *Buckley*, the Court held that express advocacy, speech that expressly advocates the election or defeat of a candidate, can be regulated. *Id.* at 44. Some Courts have defined that speech, which is not express advocacy, to be issue advocacy. Under this definition, issue advertising has been defined as advertising that does not expressly advocate the election or defeat of a candidate. See, e.g., *Citizens for Responsible Gov't State Political Action Comm. v. Davidson*, 236 F.3d 1174, 1187 (10th Cir. 2000). More recently, at least one court has recognized that issue advocacy is not defined as the absence of express advocacy, see *Nat'l Fed'n of Republican Assemblies v. U.S.*, 218 F. Supp. 2d 1300, 1324-25 (S.D. Al. 2002) (“It is at best imprecise to employ the term, ‘issue advocacy,’ to denote all political speech other than express electoral advocacy. Use of the term in this manner incorrectly suggests that all political speech falling short of express electoral advocacy is essentially issue discussion (thereby skewing the constitutional analysis), regardless how plain the communication’s electoral purpose. *Buckley* employed no such term, and the Supreme Court later used it to describe a much more limited range of political speech.”).

¹² See *Nat'l Fed'n of Republican Assemblies*, 218 F. Supp. 2d at 1323 (putting forth

engage in advertising designed to influence an election and promote a specific candidate, and do so without identifying their real identity or the identity of their contributors.¹³

For example, during the 2000 presidential primaries, "Republicans for Clean Air" ran the following advertisement:

ON THE SCREEN: Mr. McCain's face is superimposed against a backdrop of smokestacks belching dark clouds.

SCRIPT: "Last year, John McCain voted against solar and renewable energy. That means more use of coal-burning plants that pollute our air. New York Republicans care about clean air. So does Governor Bush Governor Bush: Leading so each day dawns brighter."¹⁴

Republicans for Clean Air was an unknown organization and it did not disclose its sponsors.¹⁵ The advertisement was alleged to be highly inaccurate.¹⁶ The Bush campaign denied any knowledge of the advertisement, and the person who purchased the time from the

argument of plaintiffs that they are not subject to campaign finance regulation because they are engaged in issue advocacy).

¹³ A clear example of just such a case is the advertisement by Republicans for Clean Air that follows this note in the text. For other examples, see Edward B. Foley, "Smith for Congress" and Its Equivalents: *The Important of Chamber of Commerce v. Moore*, 2 ELECTION L.J. 3, 4-7, 22 (2003).

¹⁴ Richard Perez-Pena, *Air of Mystery Clouds Shot at McCain*, N.Y. TIMES, Mar. 3, 2000, at A15. Similar political advertisements ran in New York, California, and Ohio. Adam Nagourney & Richard Perez-Pena, *Bush and McCain Trade Bitter Criticism As Campaigns in New York Gather Steam*, N.Y. TIMES, Mar. 3, 2000, at A15.

¹⁵ See Perez-Pena, *supra* note 14.

¹⁶ Press Release, Sierra Club, *Sierra Club Demands Withdrawal of False Bush Ad* (Mar. 3, 2000), available at <http://lists.sierraclub.org/Archives/ce-scnews-releases.html> (last visited Jan. 14, 2003); *Environmental Front Group Smokescreens Bush Pollution Record*, Press Release, Sierra Club, Environmental Front Group Smoke Screens Bush Pollution Record (Mar. 1, 2000), available at <http://lists.sierraclub.org/Archives/ce-scnews-releases.html> (last visited Jan. 14, 2003); see also *Ad Praising Bush's Record on Air Quality is Called Dirty*, U.S. NEWSWIRE, Mar. 2, 2000 (discussing press release of League of Conservation Voters claiming that then-Governor George W. Bush "has the weakest environmental record of any major presidential contender"). In fact, the environmental groups determined that Senator John McCain's record was slightly better than Bush's on the environment. Perez-Pena, *supra* note 14, at A15.

television networks refused to disclose who paid for the advertisement.¹⁷

After some pressure, Sam and Charles Wyly disclosed that they were the sponsors of the advertisements.¹⁸ The Wyly brothers were Texas billionaires and major contributors to the Bush campaign.¹⁹ However, the Wyllys claimed their political advertisements were independent of the Bush campaign, did not advocate the election or defeat of a candidate for public office, and therefore were not subject to the Federal Election Campaign Act (FECA).²⁰ Because they were allegedly exempt from FECA, Republicans for Clean Air claimed it was not required to disclose its contributors or its expenditures in any manner.²¹

¹⁷ Perez-Pena, *supra* note 14. Governor Bush's advisors denied any connection between their candidate and Republicans for Clean Air. *Id.* The media company that placed the advertisement had a long history of working for Governor George Pataki of New York, a strong Bush supporter, and the address used when placing the advertisements was a post office box that was also used by a Political Action Committee (PAC) led by Congressman Henry Bonilla of Texas, another Bush supporter. *Id.* The executive director of Bonilla's PAC acknowledged that she was a consultant to Republicans for Clean Air. Nagourney & Perez-Pena, *supra* note 14, at A15. For an interesting discussion of the connection between candidates and so-called "independent" organizations, see Andrew P. Buchsbaum, *Campaign Finance Re-Form: The Regulation of Independent Political Committees*, 71 CAL. L. REV. 673, 675 n.15 (1983).

¹⁸ Clay Robinson, *Campaign 2000; McCain Stays on Offensive; Bush Wins Backing of N.J. Governor*, HOUSTON CHRON., Mar. 5, 2000, at A21 (indicating that on March 3, 2000, Wyllys disclosed that they were sponsors of advertisement).

¹⁹ The Wyly brothers spent \$2.5 million on the advertisements praising then-Governor Bush and attacking Senator McCain. *Id.* Charles Wyly's wife, Caroline Wyly, was appointed by President Bush to serve on the John F. Kennedy Center Advisory Committee on the Arts. Digest of Other White House Announcements, 38 Weekly Comp. Pres. Doc. 615 (Apr. 15, 2002). Charles Wyly was also one of President Bush's "pioneer" fund-raisers and raised at least \$100,000 for the President's campaign. Michael Petrocelli, *Bush Names Wife of Campaign Supporter to Kennedy Center*, HOUSTON CHRON., Apr. 11, 2002, at A5. He and his brother also each contributed \$100,000 to the Bush-Cheney Inaugural Committee. *Id.*

²⁰ Federal Election Campaign Act of 1971, 2 U.S.C. §§ 431-456 (2000). At least one scholar believes that Republicans for Clean Air was required to report under FECA. Glenn Moramarco argues that section 527 political organizations are political committees under FECA and thus are subject to disclosure. *Disclosure of Political Activities of Tax-Exempt Organizations: Hearing Before the House Subcomm. on Oversight of the Comm. on Ways and Means*, 106th Cong. 60 (2000) (statement of Glenn J. Moramarco, Senior Attorney, Brennan Center for Justice). Moramarco argues that the fact that the Federal Election Commission does not have the votes to enforce the provision does not mean that political organizations are not in fact subject to it. *Id.* at 62. The FEC voted by a vote of three to three not to investigate whether Republicans for Clean Air violated election law. Fed. Election Comm'n, Executive Session, MUR 4982 (2002).

²¹ Professor Edward Foley has recently suggested that an advertisement that compares

The Republicans for Clean Air advertisement highlights the problem of third-party independent expenditures. The advertisement by Republicans for Clean Air was an obvious attempt to engage in negative advertising designed to influence the election against Senator McCain and to promote then-Governor Bush. Republicans for Clean Air nevertheless was able to avoid federal election campaign disclosure provisions by claiming that the advertisement in question did not expressly advocate the election of Governor Bush.

The proliferation of independent expenditures during political campaigns and the difficulty in identifying the source of those expenditures increased the pressure for the reform of campaign regulations that apply to third-party advocacy.²² After the primary campaign, Senator McCain joined with Senators Joseph Lieberman (then a Vice-Presidential candidate) and Russell Feingold to craft legislation to require the disclosure of the names of contributors to, and the expenditures of, what they termed "stealth PACs."²³ Because the Supreme Court had previously struck down campaign disclosure provisions in FECA associated with issue advocacy,²⁴ Senators McCain, Lieberman, and Feingold took another approach.²⁵

Senators McCain, Lieberman, and Feingold sought to use the tax code as a mechanism for requiring independent third-party organizations to make campaign disclosures similar to those contained in FECA. The senators accomplished this by amending section 527 of the Internal Revenue Code ("Code"), which deals with the tax status of political organizations.²⁶ The reformers amended section 527 and created campaign finance disclosure provisions in

two political candidates should be considered an election advertisement for FECA purposes. See Foley, *supra* note 13, at 3, 4-7, 22. Under this theory, the Wylly advertisement clearly would be an election advertisement subject to FECA.

²² See, e.g., H.R. REP. NO. 106-702, at 12-13 (2000); BECK, *supra* note 2, at 3-6; JAMIESON, *supra* note 2, at 1-2.

²³ 146 CONG. REC. 55995 (daily ed. June 28, 2000) (statement of Sen. Lieberman); see also S. 2582, 106th Cong. (2000) (amending § 527 of Internal Revenue Code to better define term "political organization"); S. 2583, 106th Cong. (2000) (amending Internal Revenue Code to increase disclosure for political organizations exempt under § 527).

²⁴ Buckley v. Valeo, 424 U.S. 1, 43 (1976).

²⁵ For a discussion of issue advocacy, see generally Briffault, *supra* note 6.

²⁶ I.R.C. § 527 (2000).

the tax code by conditioning tax benefits on compliance with the disclosure provisions.²⁷

Soon after the enactment of section 527, reformers enacted a far more sweeping reform of federal election law. The Bipartisan Campaign Reform Act of 2002,²⁸ commonly referred to as "McCain-Feingold," took a different and complimentary approach to that taken in section 527.²⁹ Instead of taking the entity based approach and requiring disclosure based on an entity's status under the Internal Revenue Code, McCain-Feingold takes a "categorical approach." McCain-Feingold requires the disclosure of all "electioneering communication," which is defined as broadcast communication that takes place within sixty days of a general election and refers to a clearly identified candidate for federal office.³⁰ McCain-Feingold has a more limited definition of what communication is covered, but covers all organizations engaged in such communica-

²⁷ I.R.C. § 527(j). The IRS also was required to make the disclosure forms available on the Internet. I.R.C. § 6104(a)(3); see also Internal Revenue Service, Forms and Electronic Filing for Political Organizations, at <http://eforms.irs.gov> (last visited Jan. 16, 2003) (listing disclosure reports for political organizations). This provision also applies to Form 990, which is filed by 501(c)(3) organizations. I.R.C. § 6104(a)(1). As a result of this provision, names and addresses of students receiving financial aid from private schools that are 501(c)(3) organizations were disclosed on the Internet. Valerie Strauss, *Students' Financial Aid Revealed on the Internet*, WASH. POST, May 16, 2001, at B1. The names of donors to section 501(c)(3) organizations may have to be disclosed to the IRS on Form 990, but donors' names are not disclosed to the public. I.R.C. § 6104(d)(3)(A).

²⁸ Bipartisan Campaign Reform Act of 2002, Pub. L. 107-155, 116 Stat. 81 (2002) (to be codified at 2 U.S.C. §§ 431-456).

²⁹ Although outside the scope of this paper, McCain-Feingold does far more than just regulate campaign disclosure. Among other things, it sets expenditure limitations for noncandidates, raises contribution limits to candidates, and clarifies standards for identification of sponsors of radio and television communication. Bipartisan Campaign Reform Act § 201, 116 Stat. at 88-91.

³⁰ Electioneering communication is defined as:

any broadcast, cable, or satellite communication which—

(I) refers to a clearly identified candidate for Federal office;

(II) is made within—

aa) 60 days before a general, special, or runoff election for the office sought by the candidate; or

bb) 30 days before a primary or preference election, or a convention or caucus of a political party that has authority to nominate a candidate, for the office sought by the candidate; and

(III) in the case of a communication which refers to a candidate for an office other than President or Vice President, is targeted to the relevant electorate.

Bipartisan Campaign Reform Act § 434(f)(3)(A)(i), 116 Stat. at 89.

tion.³¹ Section 527 covers fewer actors engaged in political speech, but requires disclosure of all campaign-related communication by those actors.³²

The amendments to section 527 and the McCain-Feingold disclosure provisions have the same goal, requiring the disclosure of third-party independent communication. There is a serious question, however, whether the definition of electioneering communication in McCain-Feingold can withstand constitutional challenge.³³ The disclosure provisions enacted within the tax code will likely survive such challenge and may, in fact, provide support for upholding the disclosure provisions in McCain-Feingold. If disclosure provisions are constitutional within the tax code, the Court may view similar provisions outside the code more favorably.³⁴

The recent campaign finance reform amendments to the tax code raise serious questions involving tax law, election law, and constitutional law. The disclosure provisions contained in section 527 are a first step in limiting anonymous campaign communication by political organizations and providing voters with the information they need to make informed decisions.

The constitutionality of using the tax code as a mechanism for campaign finance reform disclosure provisions has significant ramifications for whether or not Congress will have the ability to limit the proliferation of third-party anonymous campaign communication. Moreover, as third-party tax-exempt organizations proliferate, the constitutionality of using the tax code as a means of regulating those organizations will be of great importance. Increasingly, tax provisions and campaign finance provisions will need to

³¹ I.R.C. § 527(a), (e), (j) (2000).

³² *Id.*

³³ See Plaintiffs' Complaint for Declaratory and Injunctive Relief, *McConnell v. Federal Election Comm'n*, No. 02-CV-582 (D.C. Cir. filed Mar. 27, 2002), available at <http://www.law.stanford.edu/library/campaignfinance> (last visited Nov. 11, 2002).

³⁴ Moreover, McCain-Feingold contains limits on contributions to political parties. In order to avoid the contribution limits, political parties have created separate tax-exempt organizations to raise unlimited campaign funds. See Thomas B. Edsall, *New Ways to Harness Soft Money in Works*, WASH. POST, Aug. 25, 2002, at A1 (discussing new tax-exempt organizations created by political parties and stating that supporters of McCain-Feingold contend that these activities are purposeful evasions of law). Many of these organizations will be subject to disclosure requirements of section 527.

compliment one another in an attempt to achieve coherent campaign finance reform.³⁵

Part I of this Article examines the history and operation of section 527 of the Internal Revenue Code.³⁶ Part II argues that Congress has the authority to condition a political organization's tax-exempt status on the organization's willingness to comply with the disclosure provisions contained in section 527.³⁷ Moreover, it proposes that Congress create a separate entity, a political corporation, for campaign entities wishing to engage in anonymous political advocacy.³⁸ These organizations would not be subject to the disclosure requirements of section 527, but would be subject to tax. Part III discusses the traditional analysis that generally governs campaign finance regulation and argues that the traditional analysis provides an alternative basis for upholding the disclosure requirements of section 527.³⁹ Part III also suggests an alternative approach for mandating campaign finance disclosure, which combines the section 527 model and the traditional model.⁴⁰

³⁵ The tax code may not be the best mechanism for achieving non-tax objectives. While a thorough discussion of this is outside the scope of this Article, the tax code is obviously not the ideal platform for regulating a tax-exempt entity's campaign activities. It appears, however, that placing these provisions within the tax code may be the best way to ensure the constitutionality of the disclosure provisions. The merits of using the tax code as a means of influencing policy has been widely discussed. See, e.g., STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 99-117 (1985); David A. Brennan, *Charities and the Constitution: Evaluating the Role of Constitutional Principles in Determining the Scope of Tax Law's Public Policy Limitation for Charities*, 5 FLA. TAX. REV. 779 (2002) (analyzing use of public policy exception to limit activities of tax-exempt charities); Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165, 1165-84 (1993); Douglas Laycock, *A Survey of Religious Liberty in the United States*, 47 OHIO ST. L.J. 409, 440-41 (1986) (arguing that it is questionable whether Government can use religious institution's exempt status as means of regulating institution); William P. Marshall & Douglas C. Blomgren, *Regulating Religious Organizations Under the Establishment Clause*, 47 OHIO ST. L.J. 293, 329-31 (1986) (same). Moreover, there are also serious concerns that involving the IRS in campaign finance regulation will politicize the IRS and decrease our nation's confidence in tax administration. For an interesting account of presidential attempts to use the IRS as a political tool, see DAVID BURNHAM, *A LAW UNTO ITSELF: POWER, POLITICS, AND THE IRS* 226-54 (1989).

³⁶ See *infra* notes 42-117 and accompanying text.

³⁷ See *infra* notes 118-345 and accompanying text.

³⁸ See *infra* notes 346-53 and accompanying text.

³⁹ See *infra* notes 354-413 and accompanying text.

⁴⁰ See *infra* notes 412-13 and accompanying text.

I. HISTORY AND OVERVIEW OF SECTION 527

A. HISTORY OF THE TAX TREATMENT OF POLITICAL ORGANIZATIONS

Prior to the 1960s, the Internal Revenue Service generally took the position that political organizations⁴¹ did not need to file tax returns.⁴² The IRS apparently did so based on its view that political organizations had no income and that payments to the organization were gifts.⁴³ In the late 1960s, however, it became clear that at least

⁴¹ Prior to 1974 there was no specific definition of a political organization. Section 527 of the Code defines a political organization as an organization operated for the purpose of directly or indirectly influencing the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office. I.R.C. § 527(e)(1), (2).

⁴² S. REP. NO. 93-1357, at 25 (1974), reprinted in 1975 U.S.C.A.N. 7478, 7501-02 (indicating payments were excluded as gifts); see also Tax Treatment of Contributions of Appreciated Property to Committees of Political Parties, 37 Fed. Reg. 22,427, 22,427 (Oct. 19, 1972) (indicating that it is a matter of history that the IRS has never required political committees to file income tax returns because it believed that virtually all of the receipts were from gifts). In at least one instance, however, the IRS claimed that a "membership fee" to a political party was taxable, and asserted that all political parties are taxable associations under the Code. *Communist Party v. Comm'r*, 373 F.2d 682, 684 (D.C. Cir. 1967).

⁴³ See S. REP. NO. 93-1357, at 25; Tax Treatment of Contributions of Appreciated Property to Committees of Political Parties, 37 Fed. Reg. 22,427, 22,427 (Oct. 19, 1972). Whether something of value is determined to be a gift is treated differently for gift tax and income tax purposes. In the estate and gift tax context, a gift tax is imposed on the donor if the donor is not receiving compensation or adequate consideration in money or money's worth. I.R.C. § 2512(b) (2000). The IRS treats payments to section 501(c)(4) organizations as gifts for gift tax purposes, finding that the payments have not been made for money or money's worth. Presumably the logic behind this treatment would also apply to political organizations, except that section 527 organizations are exempt from paying gift tax under section 2501(a)(5) of the Code. The standard for determining whether a payment is a gift for income tax purposes is whether the payment is made with "detached and disinterested generosity." *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960). Although the standard for gift classification is different for gift tax purposes and income tax purposes, it appears that the IRS treats contributions to exempt organizations as gifts for both income and gift tax purposes. See Jeffrey Schoenblum, *The Changing Meaning of "Gift": An Analysis of the Tax Court's Decision in Carson v. Commissioner*, 32 VAND. L. REV. 641, 647-67 (1979) (discussing how *Carson* eroded commonly-accepted meaning of "gift"). Compare I.R.C. § 2512(b) (setting forth standard for gift tax) with *Duberstein*, 363 U.S. at 285. But see *Carson v. Comm'r*, 641 F.2d 864, 864 (10th Cir. 1981) (holding that campaign contributions are not "gifts" within meaning of gift tax law); *Stern v. United States*, 436 F.2d 1327, 1330 (5th Cir. 1971) (finding payment to political organization not gift since payor received something in exchange for payment). Interestingly, in later memoranda, the IRS indicated that the gift theory was never the basis for allowing the exclusion of campaign contributions. See Gen. Couns. Mem. 39,813 n.32 (Mar. 19, 1990) (claiming conduit or quasi-trust rationale was reason for exclusion); Gen. Couns. Mem. 35,499 (Feb. 8, 1974) (claiming precise justification for excluding political campaign contributions from gross income has never been clearly articulated, but that it is clear that justification is

some political organizations were generating taxable investment income. The IRS concluded that if a political organization had income, it was required to file a return and that investment income of a political organization should be reported on a fiduciary tax return.⁴⁴ The tax situation of campaign organizations became even more complicated as organizations started to receive appreciated property in lieu of cash. The sale of appreciable property by a political campaign would normally produce a taxable gain if it were a for-profit corporation, but political campaigns had not been taxed on such gain.⁴⁵ In 1973, the IRS conducted public hearings to determine how political organizations and donations of appreciable property to political organizations should be treated for tax purposes.⁴⁶

In 1974, the IRS issued a revenue ruling designed to explain the tax treatment of political organizations.⁴⁷ Revenue Ruling 74-21 involved an organization formed to engage in activities to influence the nomination and election of individuals to public office.⁴⁸ The organization sought advice from the IRS regarding its tax status, and the IRS determined that the organization "more nearly resemble[d] a corporation than a trust or partnership, and that the tax rules for corporations appl[ied]."⁴⁹ The IRS then set out the relevant tax principles that would apply to the organization.⁵⁰ It required the organization to submit a corporate tax return and pay tax at the corporate tax rate.⁵¹ The IRS concluded, however, that campaign contributions were not includible in gross income and that

not that contributions are gifts).

⁴⁴ S. REP. NO. 93-1357, at 25; Rev. Rul. 68-19, 1968-1 C.B. 810, 811 (indicating investment income should be reported on fiduciary return); I.R.S. Announcement 73-84, 1973-2 C.B. 461, 461 (indicating that political parties will now be required to file appropriate tax returns).

⁴⁵ S. REP. NO. 93-1357, at 25-27; *see also* Tax Treatment of Contributions of Appreciated Property to Committees of Political Parties, 37 Fed. Reg. at 22,427 (indicating that IRS has never required political committees to file income tax returns); I.R.S. Announcement 73-84, 1973-2 C.B. 461, 461-62 (reversing previous position and finding that gains on sale of appreciated property should be included in income, but applying ruling prospectively).

⁴⁶ *See* S. REP. NO. 93-1357, at 25-26 (referencing hearings); I.R.S. Announcement 73-84, 1973-2 C.B. 461, 461 (indicating hearings were held March 1, 1972).

⁴⁷ Rev. Rul. 74-21, 1974-1 C.B. 14.

⁴⁸ *Id.*

⁴⁹ *Id.* at 15.

⁵⁰ *Id.* at 16.

⁵¹ *Id.*

campaign expenditures were not deductible.⁵² The revenue ruling indicated that the IRS would decide the tax status of a political organization on a case by case basis.⁵³

In 1975, Congress absolved the IRS from having to determine the tax status of every political organization and enacted section 527 of the Code.⁵⁴ As enacted in 1975, section 527 provided for a new type of exempt organization, a political organization, and clarified that contributions to a political organization were not subject to tax and that its expenditures were not deductible from income.⁵⁵ The provision defined a political organization as "a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function."⁵⁶ Exempt function was defined as "the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office."⁵⁷ If an entity was considered a "political organization," then its exempt function income—defined as contributions, membership dues, and proceeds from political fundraisers—was exempt from tax.⁵⁸

⁵² *Id.*

⁵³ *Id.* Political organizations rarely had taxable income because of the IRS's conclusion that contributions to political organizations were not includible in income. See Rev. Rul. 74-21, 1974-1 C.B. 14 (indicating that political organization most resembles corporation, and that tax rules for corporations apply; finding that contributions to political organization did not represent income to corporation). Moreover, a determination by the IRS regarding the tax status of an organization only controls its tax status. Whether an organization is a partnership or corporation outside the tax context is determined by state law.

⁵⁴ Act of Jan. 3, 1975, Pub. L. No. 93-625, § 10(a), 88 Stat. 2108, 2116-19.

⁵⁵ I.R.C. § 527(a), (c) (2000); see also S. REP. NO. 93-1357, at 4, 25-37 (1974), reprinted in 1974 U.S.C.C.A.N. 7478, 7481, 7501-13 (discussing modified tax treatment of political organizations).

⁵⁶ I.R.C. § 527(e)(1).

⁵⁷ I.R.C. § 527(e)(2) (1976) (amended 1988).

⁵⁸ I.R.C. § 527(c)(3) (1976) (amended 1978); I.R.C. § 527(e)(1) (2000). Political organizations were still required to pay tax on their investment income. S. REP. NO. 93-1357, at 26, reprinted in 1974 U.S.C.C.A.N. 7478, 7502. Although section 527 applies to state and local political organizations, it does not apply to state and local organizations that already comply with state finance disclosure laws that are similar to those required by FECA. I.R.C. § 527(j)(5)(C). Under previous versions of section 527, state and local political organizations were required to comply with the disclosure provision even if they made disclosures under state campaign finance regulations. See I.R.C. § 527 (prior to November 2, 2002). The amendments to § 527 ensure that state and local political organizations are not subject to

Entities received a significant benefit by organizing as political organizations, and therefore organized themselves as such under section 527 of the Code.⁵⁹ If an organization did not meet the requirements of section 527, it was not entitled to exempt status and its exempt function income would not be exempt from tax.⁶⁰

In enacting the original provisions of section 527, Congress clearly indicated that political organizations should not be taxed on contributions they receive. In the legislative history surrounding the original enactment of section 527, Congress determined that encouraging political activities was an important policy goal, that such organizations were “the heart of the democratic process,” and that such organizations should be encouraged by granting a preferred tax status to qualifying political organizations.⁶¹ Congress thus provided a tax benefit to organizations it believed contributed to the democratic process.⁶²

But when it passed section 527, Congress likely did not imagine the type of political organizations that we now see involved in influencing elections. Within section 527, Congress described organizations whose primary purpose was to influence the election of a candidate for public office.⁶³ At the time this language was included in section 527, such organizations were subject to campaign disclosure requirements in the Federal Election Campaign Act of 1971, as amended in 1974.⁶⁴ FECA was designed to regulate

duplicative reporting requirements. *See generally* Gregory L. Colvin & David A. Levitt, *Political Organization Reporting Requirements Continue to Evolve: Recent Amendments to Internal Revenue Code Section 527*, 2003 TAX NOTES TODAY 19-67 (2003).

⁵⁹ See H.R. REP. NO. 106-702, at 12 (2000) (stating that there is clear trend toward increased use of section 527 organizations); *see also* Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999) (addressing whether organization's diverse activities constitute exempt functions under section 527(e)(2)); Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997) (addressing social welfare organization's maintenance of segregated funds under section 527(f)(3)).

⁶⁰ S. REP. NO. 93-1357, at 26-27. This implies that Congress intended that organizations that did not meet the definition of a political organization would not be exempt from tax on the contributions or payments they received.

⁶¹ *Id.*

⁶² If Congress provided a tax benefit to political organizations because it believed those organizations were central to the democratic process, Congress surely has the power to eliminate the preference if the organizations no longer serve designated purposes, or if, as alleged, the organizations actually degrade the democratic process.

⁶³ I.R.C. § 527(e)(1) (2000).

⁶⁴ Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (as amended in Pub. L. No. 93-443, 88 Stat. 1263 (1974)).

campaign contributions and expenditures, and imposed contribution limits and disclosure requirements on entities that attempted to influence elections.⁶⁵ Since section 527 organizations were organized to influence elections, they were by definition subject to FECA's disclosure requirements. Section 527, as enacted, can be seen as standing for the proposition that those entities properly regulated under FECA are a beneficial part of the campaign process and should be exempt from tax.⁶⁶

The congressional assumption that section 527 organizations would be subject to FECA proved to be erroneous when in *Buckley v. Valeo*⁶⁷ the Supreme Court struck down and limited parts of FECA.⁶⁸ Specifically, in *Buckley* the Court interpreted language almost identical to that contained in section 527 to apply only to contributions and expenditures that expressly advocate the election or defeat of a candidate for public office.⁶⁹ Political organizations argued that as long as they did not expressly advocate on behalf of a candidate they were not subject to the reporting requirements in

⁶⁵ Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974) (codified as amended at 2 U.S.C. §§ 431-456 (2000)). FECA originally limited contributions to a candidate for federal office to \$1,000 with respect to any election, with the primary and general election each constituting a separate election. FECA, 2 U.S.C. § 441a(a) (2000) (amended 2002). The McCain-Feingold campaign reform bill recently increased this amount to \$2,000. Bipartisan Campaign Reform Act of 2002, Pub. L. 107-155, § 307(a), 116 Stat. 81, 102 (2002) (to be codified at 2 U.S.C. § 441(a)). Entities are also required to disclose contributions over \$200 that were for the purpose of influencing elections. 2 U.S.C. § 434(c)(1), (c)(2)(C) (2000). Some scholars argue that these limits are unrealistically low and that increasing them might increase compliance. See Joel Fleishman & Pope McCorkle, *Level-Up Rather Than Level-Down: Toward a New Theory of Campaign Finance Reform*, 1 J.L. & POL. 211, 215 (1984) (stating that current theory of campaign finance reform is impractical and dangerously wrong); Frank J. Sorauf, *Politics, Experience, and the First Amendment: The Case of American Campaign Finance*, 94 COLUM. L. REV. 1348, 1365 (1994) (stating that there is danger of making money supply too small for candidate demand).

⁶⁶ See Federal Election Campaign Act of 1971, 2 U.S.C. §§ 434, 437a (2000) (providing reporting requirements); Hill, *supra* note 9, at 390 (discussing assumption implicit in FECA that section 527 organizations would be subject to FECA).

⁶⁷ 424 U.S. 1 (1976).

⁶⁸ *Id.* at 143.

⁶⁹ *Id.* at 43-44. Section 431(8)(A)(i) of FECA defines contribution as "any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office," and section 431(9)(A)(i) defines expenditure as "any purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value, made by any person for the purpose of influencing any election for Federal office." 2 U.S.C. § 431(8)(A)(i), (9)(A)(i) (2000).

FECA.⁷⁰ Political organizations therefore received the benefit of tax-exempt status even though they were not subject to FECA. There is no indication, however, that Congress intended this result.

In 2000, Congress expressed its displeasure with the fact that many tax-exempt organizations were avoiding the disclosure requirements in FECA by amending section 527 of the Code and providing that political organizations must disclose the names of contributors who donate \$200 or more and disclose expenditures of \$500 or more.⁷¹

⁷⁰ It is still an open question whether specific or so-called magic words of expression like "vote for" or "vote against" are needed in order for an advertisement to constitute express advocacy. See *Chamber of Commerce v. Moore*, 288 F.3d 187, 195-96 (5th Cir. 2002) ("[A] communication constitutes 'express advocacy'—and may therefore be subject to mandatory disclosure regulations—only if it contains explicit words advocating the election or defeat of a clearly identified candidate."); *Fed. Election Comm'n v. Christian Action Network, Inc.*, 110 F.3d 1049, 1051 (4th Cir. 1997) (calling for bright-line test using "magic words," stating, "the Federal Election Campaign Act could be applied consistently with the First Amendment only if it were limited to expenditures for communications that literally include words which in and of themselves advocate the election or defeat of a candidate"); *Fed. Election Comm'n v. Furgatch*, 807 F.2d 857, 864 (9th Cir. 1987) (stating that "express advocacy" is speech that "must, when read as a whole, and with limited reference to external events, be susceptible of no other reasonable interpretation but as an exhortation to vote for or against a specific candidate"); *Fed. Election Comm'n v. Cent. Long Island Tax Reform Immediately Comm.*, 616 F.2d 45, 52-53 (2d Cir. 1980) (calling for bright-line test requiring "magic words" contained in *Buckley v. Valeo*, 424 U.S. at 44 n.52, such as "vote for" or "vote against," not words that are "express or implied, of encouraging election or defeat"). For a discussion of the ramifications of the "magic words" doctrine, see Scott E. Thomas & Jeffrey H. Bowman, *Is Soft Money Here to Stay Under the "Magic Words" Doctrine?*, 10 STAN. L. & POL'Y REV. 33, 35-42 (1998).

⁷¹ President Clinton signed the Act of July 1, 2000, Pub. L. No. 106-230, 114 Stat. 477 (2000) (codified at 26 U.S.C. 527 (2001)), adding disclosure provisions to section 527. The legislation passed the House of Representatives by a vote of 385-39 and the Senate by a vote of 92-6. 146 CONG. REC. S6047 (daily ed. June 29, 2000); 146 CONG. REC. H5289-90 (daily ed. June 27, 2000). Congress chose not to require other 501(c) organizations (e.g., section 501(c)(4) social welfare organizations, section 501(c)(5) labor organizations, or section 501(c)(6) business leagues) to disclose their contributors. 146 CONG. REC. H5288 (daily ed. June 27, 2000) (statement of Rep. Doggett). It appears that there was not support in Congress for extending the disclosure provisions to other 501(c) organizations, so the disclosure provisions only apply to section 527 political organizations. See also Recent Legislation, *Campaign Finance Reform—Issue Advocacy Organizations—Congress Mandates Contribution and Expenditure Requirements for Section 527 Organizations*, 114 HARV. L. REV. 2209, 2214-15 (2001) (arguing that disclosure provisions should apply to all 501(c) organizations). The requirements do not apply to political organizations that already report under FECA, nor do they apply to organizations that receive less than \$25,000 in gross receipts. I.R.C. § 527(i)(5), (i)(6), (j)(5) (2000). Some scholars have argued that section 527 organizations will simply reorganize as 501(c)(4) organizations to avoid the disclosure provisions in section 527. Hill, *supra* note 9, at 400; Daniel L. Simmons, *An Essay on Federal Income Taxation and*

B. TYPES OF EXEMPT ORGANIZATIONS

The tax code provides some type of tax-exempt status for more than twenty-seven different types of entities.⁷² A tax-exempt organization is exempt from tax on income related to its tax-exempt purpose.⁷³ Investment income or income not related to the exempt purpose of the organization, known as “unrelated business income,” is subject to tax.⁷⁴ If the organization is a tax-exempt organization under section 501(c)(3)⁷⁵ of the Code, donations to the organization are tax deductible.⁷⁶ Donations or contributions to other tax-exempt organizations are not deductible by the donor.

Political organizations are not the only exempt organizations that engage in political advocacy. Social welfare organizations,⁷⁷ labor

Campaign Finance Reform, 54 FLA. L. REV. 1, 81 (2002). Although this technique may work for some organizations, 501(c)(4) organizations are not exempt from gift tax, and influencing elections cannot be their primary function. See *supra* note 44. Moreover, if Congress believes that other exempt organizations are being used as a mechanism to avoid the disclosure provisions, Congress can extend the disclosure provisions to other exempt organizations.

⁷² I.R.C. § 501(c) (2000).

⁷³ Section § 501(a) provides that an organization identified in subsection (c) is exempt from tax. I.R.C. § 501(a). Section 511 of the Code, however, provides for the imposition of tax on the unrelated business income of an otherwise exempt organization. I.R.C. § 511.

⁷⁴ I.R.C. § 511.

⁷⁵ Section 501(c)(3) provides an exemption to:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, . . . or educational purposes . . . or for the prevention of cruelty to children or animals

I.R.C. § 501(c)(3).

⁷⁶ Donations to section 501(c)(3) organizations are deductible by operation of section 170 of the Code. I.R.C. § 170. Section 170 provides for the deduction of charitable contributions. I.R.C. § 170(a)(1). Charitable contributions are defined by section 170(c) of the Code as, among other things, a donation to a “corporation, trust, or community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes . . . or for the prevention of cruelty to children or animals.” I.R.C. § 170(c)(2)(B). This definition closely parallels the definition for an exempt organization under section 501(c)(3) of the Code. I.R.C. § 501(c)(3). Section 170(c)(2)(D) provides that no deduction is allowed for contributions to an organization that fails to qualify as a section 501(c)(3) organization because it attempts to influence legislation or participates in any political campaign on behalf of a candidate. I.R.C. § 170(c)(2)(D).

⁷⁷ See I.R.C. § 501(c)(4). Section 501(c)(4) organizations are:

Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons . . . and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

unions,⁷⁸ and business leagues,⁷⁹ all may engage in some political advocacy as long as the political activity is not the organization's primary purpose.⁸⁰ Section 501(c)(3) organizations are not permitted to participate directly or indirectly in any political campaign on behalf of a candidate,⁸¹ but they may engage in voter education activities and attempt to influence legislation as long as it is not a substantial part of their activities.⁸²

Many political organizations did not qualify for tax-exempt status because they were primarily involved in political advocacy. These organizations also did not fit the traditional mold of a for-profit partnership or corporation. Congress's solution was to create a tax-exempt entity under section 527 for organizations whose primary purpose was to influence elections.⁸³ The tax-exempt status of

I.R.C. § 501(c)(4)(A).

⁷⁸ See I.R.C. § 501(c)(5). Section 501(c)(5) organizations are "[l]abor, agricultural, or horticultural organizations." *Id.*

⁷⁹ See I.R.C. § 501(c)(6). Section 501(c)(6) organizations are "[b]usiness leagues, chambers of commerce, real-estate boards . . . not organized for profit and no part of net earnings of which inures to the benefit of any private shareholder or individual." *Id.*

⁸⁰ See Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (as amended in 1990) (providing that organization qualifies as section 501(c)(4) organization if "it is primarily engaged in promoting in some way the common good and general welfare of the people of the community"); Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (as amended in 1990) (providing that "the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office"); see also Rev. Rul. 81-95, 1981-1 C.B. 332 (providing that section 501(c)(4) organization may participate in political campaign as long as its primary function is promotion of social welfare).

⁸¹ Treas. Reg. § 1.501(c)(3)(iii) (as amended in 1990) (stating organization is action organization and does not qualify for section 501(c)(3) status if it "participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office").

⁸² No substantial part of a section 501(c)(3) organization's activity may be for "carrying on propaganda, or otherwise attempting to influence legislation . . . and which does not participate in . . . any political campaign on behalf of any candidate for public office." I.R.C. § 501(c)(3) (2000); see also Treas. Reg. § 1.501(c)(3)(ii) (as amended in 1990) (noting organization is action organization and does not qualify for section 501(c)(3) status if "substantial part of its activities is attempting to influence legislation by propaganda or otherwise"). Although section 501(c)(3) organizations are prohibited from engaging in significant political activity, Daniel Simmons argues that section 501(c)(3) and (c)(4) organizations may still be used as a conduit for campaign activities because the definition of political intervention is very vague. Simmons, *supra* note 71, at 107-08. He also points out that the IRS is often slow to revoke a section 501(c)(3) organization's status. *Id.* Simmons suggests creating an excise tax on contributions to a section 501(c)(3) or (c)(4) organization that are directed to campaign advocacy. *Id.* at 108.

⁸³ I.R.C. § 527(e)(1) (2000).

section 527 organizations was modeled after the tax exemption in section 501(c). Section 527 organizations are exempt from tax on their exempt function income, which is defined as contributions, membership dues, and proceeds from political fundraisers.⁸⁴ They are, however, subject to tax on investment income or on other income that is not exempt function income.⁸⁵

C. CHANGE OF DIRECTION: LEGISLATIVE HISTORY SURROUNDING THE PASSAGE OF SECTION 527

Under section 527 prior to the recent changes, organizations could obtain tax-exempt status while avoiding campaign finance disclosure provisions in FECA. For tax purposes, an organization could qualify as a tax-exempt political organization under section 527 by indicating that the purpose of its activities was to influence the election or nomination of a candidate.⁸⁶ These organizations also could avoid FECA's disclosure requirements by claiming that they were not intending to influence elections because they were engaged only in "issue advocacy" speech that was not subject to FECA under existing Supreme Court jurisprudence.⁸⁷ Since the IRS has a broad interpretation of when an organization is "attempting to influence" the election or nomination of any individual,⁸⁸ and

⁸⁴ I.R.C. § 527(c)(3).

⁸⁵ *Id.*

⁸⁶ I.R.C. § 527(e).

⁸⁷ See H.R. REP. NO. 106-702, at 12 (2000):

These reports make clear that section 527 organizations are being used in ways that were not necessarily contemplated when section 527 was enacted in 1975. Based on recent IRS rulings, the Committee believes that the activities of many of these organizations are being limited to ensure that the organizations are not engaged in express advocacy that would be reported and disclosed under the Federal election laws. Thus, the Committee finds that section 527 organizations are being used to exploit the lack of information reporting and disclosure under the present-law Federal tax rules. This finding is supported by the fact that the IRS Statistics of Income data show a clear trend toward increased use of section 527 organizations in recent years and by the fact that the IRS has been asked to rule on a number of occasions with respect to section 527 organizations that, by their charter, cannot engage in express advocacy.

Id.

⁸⁸ Revenue Rulings 78-248 and 80-282 set forth the test for determining whether an activity constitutes participation or intervention in an election campaign. Rev. Rul. 78-248,

federal courts interpreting *Buckley* have a much more limited definition, organizations can qualify as political organizations under the tax code but still be exempt from FECA's disclosure requirements.⁸⁹ This distinction principally occurs because the IRS bases its determination on whether an organization qualifies as a political organization on factors that are very similar to the ones it uses to determine whether a 501(c)(3) organization has violated campaign restrictions.⁹⁰ The IRS's position appears to be that, if the activity is political enough that a 501(c)(3) organization would be prohibited from engaging in such conduct, the organization qualifies as a political organization under section 527.⁹¹ The IRS does not use the *Buckley* test to determine whether an organization is attempting to influence an election. The distinction has created a strange dynamic where organizations admittedly formed to influence elections claim to be exempt from FECA because their political advertising does not

1978-1 C.B. 154; Rev. Rul. 80-282, 1980-2 C.B. 178; see also Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996) (discussing facts and circumstances test).

⁸⁹ See *Disclosure of Political Activities of Tax Exempt Organizations: Hearing Before the House Subcomm. on Oversight of the Comm. on Ways and Means, 106th Cong. 35* (2000) (statement of Joseph Miknit, Tax Legis. Counsel, U.S. Dep't of Treasury):

The scope of campaign-related activities [under § 527] is broader than the definition of "express advocacy" under the Federal Election Campaign Act (FECA). . . . Thus, the section 527 definition of "political organization" covers not only traditional political parties and candidate committees subject to regulation under the FECA, but also covers other organizations (and unincorporated funds) which are organized . . . primarily to conduct activities in an attempt to influence an election . . . even though these organizations may not engage in "express advocacy" in the FECA sense. In other words, section 527 covers "political organizations" that are commonly referred to as "issue advocacy" organizations for Federal election law purposes, because such organizations conduct (or fund) biased voter education efforts, targeted voter-registration efforts, or grassroots lobbying intended to influence an election.

Id.; see also Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999); Priv. Ltr. Rul. 98-08-037 (Nov. 21, 1997).

Senator Lieberman claims that the language in section 527 was designed to cover only organizations subject to FECA. 146 CONG. REC. S5995 (daily ed. June 28, 2000) (statement of Sen. Lieberman). Under this interpretation, only political organizations that disclosed contributions and expenditures under FECA would be entitled to tax exempt status.

⁹⁰ In Private Letter Ruling 96-52-026, the IRS explained that the factors that govern when voting guides cross the line from educating voters to influencing elections in the section 501(c)(3) context also indicate the types of voting guides that would qualify as exempt function activity under section 527(e)(2). Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996); see also Hill, *supra* note 9, at 391 (discussing Priv. Ltr. Rul. 96-52-026).

⁹¹ Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996).

attempt to influence the election or nomination of an individual for public office.⁹²

The advertisement paid for by Republicans for Clean Air was not unique.⁹³ The following is an excerpt of a television advertisement paid for by United States Chamber of Commerce that ran during a judicial election:

ON THE SCREEN: "An American flag is in the background. The name Jim Smith remains visible throughout the narration, and the scales-of-justice appears in the left part of the screen. While the narrator explains that Jim Smith uses common sense and puts victims' rights first, the words '96% conviction rate' appear on the screen."⁹⁴

SCRIPT: "Judge Jim Smith. He uses common sense and puts victims' rights first. . . . As a district attorney and prosecutor he had a ninety-six percent conviction rate. As a judge, he understands that victims' rights come ahead of criminals' rights. Judge Jim Smith. For ten years on the Rankin County bench he upheld existing laws, instead of trying to make new ones. And he carried that same common sense approach to the Supreme Court in 1993. . . . Judge Jim Smith—common sense on the bench."⁹⁵

⁹² Several entities have sought rulings from the IRS that they qualified as political organizations by acknowledging to the IRS that their primary objective was to influence elections. Priv. Ltr. Rul. 1999-25-051 (Mar. 29, 1999). These same organizations were prohibited in their charters from engaging in express advocacy. *Id.* These organizations were considered political organizations under section 527, but presumably were not subject to FECA. *See id.* (providing that, because material was biased in its presentation and admittedly designed to influence elections, organization qualified as political organization); Priv. Ltr. Rul. 97-25-036 (Mar. 24, 1997) (providing that, although material was educational, facts indicate that timing, content, and targeting of material was designed to influence election); Hill, *supra* note 9, at 387-88 (discussing "the new campaign finance vehicle" based on section 527 instead of section 501(c)(3) or 501(c)(4)).

⁹³ *See supra* notes 13-21 and accompanying text (discussing Republicans for Clean Air advertisement).

⁹⁴ *Chamber of Commerce v. Moore*, 191 F. Supp. 2d 747, 752 (S.D. Miss. 2000), *rev'd* 288 F.3d 187 (5th Cir. 2002).

⁹⁵ The Fifth Circuit determined in *Chamber of Commerce v. Moore*, 288 F.3d 187, 190 (5th

The Chamber of Commerce claimed that this advertisement was only issue advertising because it did not expressly advocate the election of Justice Smith.⁹⁶ These so-called issue advertisements that are really designed to influence elections are prevalent in elections throughout the United States.⁹⁷

Congress apparently became frustrated by the fact that political organizations were not disclosing their contributors or their expenditures.⁹⁸ Members of Congress were particularly concerned

Cir. 2002), that this advertisement was not express advocacy because it did not "contain explicit terms advocating specific electoral action by viewers." It is clear from the advertisement, however, that the Chamber of Commerce was advocating the election of Judge Smith and attempting to influence his election. For a thorough discussion of the *Moore* case and the full text of the Smith advertisement, see generally Foley, *supra* note 13. Because section 527 does not apply to section 501(c)(6) organizations (business leagues), the disclosure provisions in section 527 would not prohibit the Chamber of Commerce from running similar advertisements without disclosure. I.R.C. § 527. The recently passed McCain-Feingold campaign finance reform measure might require disclosure. Bipartisan Campaign Reform Act of 2002, Pub. L. 107-155, § 201, 116 Stat. 81, 88-90 (2002) (to be codified at 2 U.S.C. § 434(a)). McCain-Feingold requires disclosure of "electioneering communication," which is defined as communication identifying a candidate for Federal Office within sixty days of an election. *Id.* § 201(a). Since this definition only applies to federal elections, the Chamber could run anonymous advertisements in local elections. McCain-Feingold contains a "fall back" definition in case the main definition is determined to be unconstitutional. *Id.* The fall back definition defines electioneering communication as "any broadcast, cable or satellite communication which promotes or supports a candidate for that office, or attacks or opposes a candidate for that office . . . and which also is suggestive of no plausible meaning other than an exhortation to vote for or against a specific candidate." *Id.*

⁹⁶ See *Moore*, 191 F. Supp. 2d at 748-49 (detailing Chamber of Commerce's position), *rev'd* 288 F.3d 187 (5th Cir. 2002).

⁹⁷ See JAMIESON ET AL., *supra* note 2, at 14 (indicating that during 2000 election cycle 94% of televised issue spots aired within sixty days of the election made case for or against candidate); Richard L. Hasen, *The Surprisingly Complex Case for Disclosure of Contributions and Expenditures Funding Sham Issue Advocacy*, 48 UCLAL. REV. 265, 265 (2000) (referring to issue advertisements as "sham issue advocacy").

⁹⁸ H.R. REP. 106-702, at 12 (2000); see also 146 CONG. REC. S5995 (daily ed. June 28, 2000) (statement of Sen. Lieberman):

These groups exploit a recently discovered loophole in the tax code that allows organizations seeking to influence federal elections to fund their election work with undisclosed and unlimited contributions at the same time as they claim exemption from both Federal taxation and the Federal election laws. . . . [A] number of groups engaged in what they term issue advocacy campaigns and other election related activity recently began arguing that the near identical language of FECA and section 527 actually mean two different things. In their view, they can gain freedom from taxation by claiming that they are seeking to influence the election[s] of individuals to Federal office, but may evade regulation under FECA, by asserting that they are not seeking to influence an election for Federal office. . . . [N]ewly formed 527 organizations pushing the agenda of

that section 527 political organizations were exempt from paying taxes and were receiving a Government benefit, but their existence could remain a secret.⁹⁹ Section 527 organizations were not required to file any documents with the IRS unless they had income unrelated to their exempt function.¹⁰⁰ Members believed that the current system of allowing secret tax-exempt organizations to be involved in secret electioneering threatened the integrity of the democratic process.

Senator Lieberman, a sponsor of the legislation, expressed his fear that:

None of us should doubt that the proliferation of these groups—with their potential to serve as secret slush funds for candidates and parties, their ability to run difficult-to-trace attack ads, and their promise of anonymity to those seeking to spend huge amounts of money to influence our elections—poses a real and significant threat to the integrity and fairness of our elections. . . .

The risk posed by the 527 loophole goes even farther than depriving the American people of critical information. I believe that it threatens the very heart of our democratic political process. Allowing these groups to operate in the shadows pose[s] a real risk of corruption

political parties are using the ability to mask the identities of their contributors as a means of courting wealthy donors seeking anonymity in their efforts to influence our elections.

Id.

⁹⁹ 146 CONG. REC. H5289 (daily ed. June 27, 2000) (statement of Rep. Houghton).

¹⁰⁰ Prior to the amendments to section 527 in 2000, political organizations were required to file a Form 1120-Pol if they had investment income and exempt function expenditures over \$100. I.R.C. § 6012(a)(6) (2000). The 1120-Pol is a one-page form that does not require disclosure of contributors or expenditures. I.R.S. Form 1120-Pol, U.S. Income Tax Return for Certain Political Organizations (2001), available at <http://www.irs.gov/pub/irs-fill/fl1120pol.pdf> (last visited Jan. 22, 2003). Moreover, the form is not disclosable to the public. See I.R.C. § 6103(a) (barring disclosure of returns and return information); 146 CONG. REC. H5289 (daily ed. June 27, 2000) (statement of Rep. Coyne) (“[S]ection 527s operate in total secrecy outside the view of the public. These organizations do not apply for tax-exempt status with the Internal Revenue Service nor file annual returns with the IRS describing their activities and contributors.”).

and makes it difficult for us to vigilantly guard against that risk.¹⁰¹

In order to close what reformers perceived as a loophole in campaign finance law, Congress amended section 527 to require political organizations to file with the IRS and to make disclosures similar to those required of organizations covered by FECA.¹⁰²

D. HOW SECTION 527'S DISCLOSURE PROVISIONS OPERATE

There are at least three possible ways to interpret section 527's disclosure provisions.¹⁰³ The Government's interpretation views section 527 as an elective provision with two main attributes.¹⁰⁴ Under this interpretation, section 527(i) provides organizations with a choice whether they want the benefits of section 527 tax-exempt status or not. If the organization seeks the benefit of tax-exempt status under section 527, it must file a designation to that effect with the Secretary of Treasury.¹⁰⁵ If an organization fails to file an election to be a political organization under section 527, the

¹⁰¹ 146 CONG. REC. S5995 (daily ed. June 28, 2000) (statement of Sen. Lieberman).

¹⁰² Joseph Lieberman, *Campaign Finance*, 49 CATH. U. L. REV. 5, 7-8 (1999) (stating tax treatment of groups with section 501(c)(3) and 501(c)(4) status reflects Congress's judgment that tax subsidy should not extend to organizations that primarily engage in political campaign work unless those organizations comply with regulation of election laws).

¹⁰³ The interpretation of how section 527 operates is currently being litigated in federal court. See *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300, 1304-05 (S.D. Ala. 2002) ("*NFRA*"), *appeal docketed*, No. 02-16283CC (11th Cir. 2002). Plaintiffs include the National Federation of Republican Assemblies, the Alabama and Mobile Republican Assembly, the Howard Jarvis Taxpayers Association and Political Action Committee, the Libertarian National Committee, and Paul Haughton. Plaintiff's Amended Complaint ¶¶ 67-68, *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300 (S.D. Ala. 2002) (No. 00-0759-RV-C) (claiming section 527 unlawful), *available at* <http://www.527fund.com/complaint.html> (last visited Nov. 11, 2002); Plaintiff's Opposition to Defendant's Motion to Dismiss at 5-6, *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300 (S.D. Ala. 2002) (No. 00-0759-RV-C). The dispute mainly involves whether organizations that influence the election of a candidate *must* comply with section 527, or whether compliance is only necessary if an organization wishes to obtain the benefits of tax-exempt status.

¹⁰⁴ Brief of the United States of America in Support of Its Motion to Dismiss at 4-5, *Nat'l Fed'n of Republican Assemblies*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C).

¹⁰⁵ I.R.C. § 527(i) (2000). An organization meets this requirement by filing Form 8871, which is the Political Organization Notice of Section 527 Status, with the IRS. Rev. Rul. 2000-49, 2000-2 C.B. 430.

organization is taxed on its otherwise exempt function income.¹⁰⁶ Once an entity registers as a section 527 organization, the entity must file quarterly¹⁰⁷ or semi-annual¹⁰⁸ reports, and disclose its expenditures and contributors,¹⁰⁹ in order to be exempt from paying federal taxes. Specifically, subsection (j)(3)(A) conditions the exemption from tax on the disclosure of the amount of each expenditure of \$500 or more, and the name and address of the person to whom the payment was made.¹¹⁰ Also, subsection (j)(3)(B)

¹⁰⁶ I.R.C. § 527(c)(3), (i)(4). The Code defines exempt function income to include, among other things, amounts received as a contribution of money or other property, membership dues, or proceeds from a political fundraiser. I.R.C. § 27(c)(3). Congress has therefore in effect nullified Revenue Ruling 74-21 for political entities that choose not to file for exempt status under section 527. See Rev. Rul. 74-21, 1974-1 C.B. 14.

¹⁰⁷ I.R.C. § 527(j)(2)(A)(i)(I), (II), (III) (requiring political organization to file quarterly report, pre-election report, and post-general election report in calendar year of regularly scheduled election).

¹⁰⁸ I.R.C. § 527(j)(2) (2002). The organization makes this disclosure by filing Form 8872, Political Organizations Reports of Contributors and Expenditures, Rev. Rul. 2000-29, 44 I.R.B. 430. It is unclear how important the disclosure of expenditures is in the campaign context. Section 317 of Title 47 and the accompanying regulations, 47 C.F.R. 73.1212, currently require political television advertisements to carry the name of the sponsor of the advertisement. Therefore, section 527s should already be subject to disclosure when they expend funds on TV advertising. Since this is the major way section 527s influence federal elections, they are already disclosing their major expenditures. To the extent organizations are using aliases to cover their true identity, the statute or FCC rule could be modified to require more accurate reporting. See 47 C.F.R. 73.1212 (requiring licensed broadcast stations to identify the sponsors of paid advertisements). See also *Loveday v. FCC*, 707 F.2d 1443 (D.C. Cir. 1983) (providing an extensive history of section 317 and in *dicta* recognizing that the statute was constitutional); *Lewis Publishing Co. v. Morgan*, 229 U.S. 288 (1913) (upholding over First Amendment challenge statute upon which section 317 was based that required second-class mail to identify advertisements).

¹⁰⁹ I.R.C. § 527(j)(2). The organization makes this disclosure by filing Form 8872, which is the Political Organization Report of Contributors and Expenditures. Rev. Rul. 2000-49, 2000-2 C.B. 430. It is unclear how important the disclosure of expenditures is in the campaign context. 47 U.S.C. § 317 and the accompanying regulations, 47 C.F.R. § 73.1212 (2001), currently require political television advertisements to carry the name of the sponsor of the advertisement. Therefore, section 527 political organizations should already be subject to disclosure when they expend funds on TV advertising. Since this is the major way that section 527 political organizations influence federal elections, they are already disclosing their major expenditures. To the extent organizations are using aliases to cover their true identity, the statute or FCC rule could be modified to require more accurate reporting. See 47 C.F.R. § 73.1212(a)(1), (2) (2001) (requiring licensed broadcast stations to identify the sponsors of paid advertisements); see also *Lewis Publ'g Co. v. Morgan*, 229 U.S. 288, 315-16 (1913) (upholding over First Amendment challenge statute upon which section 317 was based that required second-class mail to identify advertisements); *Loveday v. FCC*, 707 F.2d 1443, 1449-57, 1459 (D.C. Cir. 1983) (providing extensive history of section 317, and in *dicta* recognizing that statute was constitutional).

¹¹⁰ I.R.C. § 527(j)(3)(A). Expenditure is defined as "a payment, distribution, loan, advance,

conditions the exemption from tax on the disclosure of the name and address of each contributor who contributed an aggregate amount of \$200 or more to the organization during the calendar year.¹¹¹

If an entity has elected to be a section 527 political organization and it fails to disclose under subsection (j), the entity is taxed on the amount "to which the failure relates."¹¹² Under the Government's interpretation of the statute, an entity can elect to be a section 527 organization and disclose either all, some, or none of its contributors and expenditures.¹¹³ Under subsection (j), the entity is taxed on those contributions or expenditures that it failed to disclose.¹¹⁴

The plaintiffs in *National Federation of Republican Assemblies v. United States* ("NFRA"),¹¹⁵ however, argue that all entities, even those that choose to opt-out under section 527(i), are subject to the

deposit, or gift, of money, or anything of value." I.R.C. § 527(e)(4) (referencing I.R.C. § 271(b)(3)). If applied literally, this definition would require the disclosure of amounts spent to purchase office equipment.

¹¹¹ I.R.C. § 527(j)(3)(B). Contribution is defined as "a gift, subscription, loan, advance, or deposit, of money, or anything of value." I.R.C. § 527(e)(3) (referencing I.R.C. § 271(b)(2)). The information required in these reports is almost identical to the information required in reports made by organizations pursuant to FECA. See 2 U.S.C. § 434(b) (2000) (listing report requirements under FECA).

¹¹² I.R.C. § 527(j)(1). Plaintiffs in *National Federation of Republican Assemblies* contend that they are not just subject to tax on the nondisclosed amount, but are subject to criminal penalties as well. See Plaintiff's Opposition to Defendant's Motion to Dismiss, *supra* note 103, at 6.

¹¹³ Brief of the United States of America in Support of Its Motion to Dismiss at 4-5, *Nat'l Fed'n of Republican Assemblies v. U.S.*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C).

¹¹⁴ 26 U.S.C. § 527(j)(1) (2000). There is some question whether these organizations can be subject to criminal penalties for failing to file a report. Section 7203 of the Code provides that any person who fails to supply information required by law or regulations is guilty of a misdemeanor and subject to a fine of \$25,000 or imprisonment of not more than one year. 28 U.S.C. § 7203 (2000). Thus, if in fact organizations *must* file these disclosure reports, the failure to do so may subject them to criminal penalties. See Rev. Rul. 2000-49, 2000-2 C.B. 430 (stating that political organization is required to give notice that it is political organization as described in section 527). *But see* 146 CONG. REC. 55996 (daily ed. June 28, 2000) (statement of Sen. Lieberman) (indicating that organizations can continue to do what they are doing without disclosing contributions or expenditures, although they would have to do so without the tax subsidy under section 527). The IRS recently has released several statements indicating that the requirements in section 527 only apply to organizations that wish to be tax exempt. See I.R.S. Notice 2002-34, 2002-21 I.R.B. 990 ("To be tax exempt, a political organization . . . must file Form 8871."); I.R.S. Fact Sheet FS 2002-11 (May 2002) ("The filing requirements . . . apply to those political organizations that . . . wish to be exempt from federal income tax provisions.")

¹¹⁵ 218 F. Supp. 2d 1300 (S.D. Ala. 2002).

disclosure provisions in subsection (j).¹¹⁶ They contend that the disclosure provisions are therefore mandatory on all entities meeting the definition of a political organization.¹¹⁷

A third option, not advocated explicitly by either party, is that an entity has a choice whether to opt into the regulatory scheme or not. If an entity opts-out, its income is taxed. If it opts-in, it agrees to comply with the regulatory requirements of the section and must disclose all contributions and expenditures. Thus, subsection (j) applies to political organizations that file with the secretary under subsection (i), but not to other organizations that choose to opt-out and pay the tax due under subsection (i)(4). Under this interpretation, subsection (j) operates as a penalty to those organizations that opt-in but fail to disclose specific contributions or expenditures. Thus, organizations have a choice whether to opt-in, accept tax-exempt status, and comply with the disclosure provisions in section 527, or to opt-out, pay tax on their income, and not disclose their contributors or expenditures. Organizations may not choose to opt-in and then disclose only some contributions or expenditures. If they do, they will be subject to a penalty under subsection (j).

II. CONGRESS HAS THE POWER TO USE THE TAX CODE TO REGULATE POLITICAL ORGANIZATIONS

Litigants on both sides of the issue have argued whether the recent amendments to section 527 pass constitutional muster, and the courts are currently considering that question.¹¹⁸ The litigation mainly involves the intricacies of the specific wording of the statute. For example, plaintiffs contend that compliance with the statute is mandatory, that they are subject to criminal penalties, and that no real tax subsidy is present so the tax provisions operate as a penalty.¹¹⁹ A discussion of the proper interpretation of the statute and specific meaning of words in the statute is outside the scope of this Article.¹²⁰ The question addressed here is whether Congress

¹¹⁶ *Id.* at 1308.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 1306-07.

¹¹⁹ Plaintiff's Opposition to Defendants' Motion to Dismiss, *supra* note 103, at 2-3, 7-10.

¹²⁰ For a detailed explanation of the district court opinion in *NFRA* see generally Donald

could have written a statute that would have accomplished its goals, and more broadly, whether the tax code can be used as a way to require disclosure of tax-exempt political organizations.¹²¹

In Part II, this Article examines Congress's power to use the tax code as a mechanism for regulating political organizations.¹²² The Supreme Court has repeatedly held that non-content based regulation of tax-exempt entities is permissible and that no entity has a right to a tax deduction.¹²³ Under this line of cases, Congress has the power to regulate tax-exempt entities and condition their exempt status on meeting certain administrative requirements. Moreover, exempt and nonexempt entities are routinely required to disclose information to ensure that the organizations are not violating statutory requirements of either their corporate or exempt status.¹²⁴ Under this theory, there is no constitutional violation if Congress conditions a tax exemption on an organization's willingness to accept certain conditions, even if those conditions otherwise would violate a constitutional right. If this theory is correct, then the subsidy rationale (*i.e.*, conditioning a subsidy on the acceptance of other conditions) controls and the First Amendment campaign

B. Tobin, *Campaign Finance Disclosure: National Federation of Republican Assemblies*, 97 TAX NOTES 407 (2002).

¹²¹ To the extent the Government's more limited reading of the statute resolves the constitutional concerns, the statute should operate the way the Government claims it operates. It is well understood that, when there are two reasonable constructions of a statute, yet one raises a constitutional question, the Court should prefer the interpretation which avoids the constitutional issue. *Gomez v. United States*, 490 U.S. 858, 864 (1989); *Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 341, 346-52 (1936) (Brandeis, J., concurring).

¹²² See *infra* notes 125-343 and accompanying text.

¹²³ See *Leathers v. Medlock*, 499 U.S. 439, 450-51 (1991) (stating that power to discriminate is inherent in power to tax); *Regan v. Taxation With Representation*, 461 U.S. 540, 547 (1983) (stating that legislatures possess "great freedom" in taxation classification, and therefore "the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination"); *Cammarano v. United States*, 358 U.S. 498, 512-13 (1959) (validating nondiscriminatory denials of deductions).

¹²⁴ Organizations formed under sections 501(c), 527, or 4947(a)(1) of the Code are required to file a Form 990 with the IRS. I.R.S. Form 990, Return of Organization Exempt From Income Tax (2001), available at <http://www.irs.gov/pub/irs-pdf/f990.pdf> (last visited Jan. 22, 2003). Parties filing a Form 990 must disclose, among other things, revenue to the organization, including "contributions, gifts, grants, and similar amounts received," and expenditures of the organization, including grants and allocations, specific assistance to individuals, professional fundraising fees, legal fees, and the like. *Id.* The organization also must disclose its officers, directors, trustees, and key employees. *Id.*

finance analysis under *Buckley v. Valeo* is not implicated when the Government conditions tax-exempt status on an entity's willingness to comply with campaign finance regulations.

A. WHAT THE GOVERNMENT GIVETH THE GOVERNMENT MAY TAKETH AWAY: THE SUBSIDY/PENALTY RATIONALE

The Government is given wide latitude as to classifications within a duly enacted tax statute, and there is a strong presumption that tax statutes are constitutional and do not violate the First Amendment.¹²⁵ It is often said that tax deductions and exemptions are a matter of legislative grace and that Congress is granted significant leeway in creating tax schemes.¹²⁶ While this statement is simplistic, it forms the baseline from which tax provisions must be judged.

Tax deductions and exemptions generally operate as a form of subsidy administered through the tax system, and no entity is entitled to tax-exempt status.¹²⁷ Therefore, the constitutionality of a tax statute usually is subject to the "rational basis" standard of review because Congress's decision not to subsidize an organization through the tax code in no sense burdens that organization's free speech rights.¹²⁸ In the tax context, courts have not applied strict scrutiny when a tax statute impacts speech rights, but instead have considered whether the tax statute is "aimed at the suppression of dangerous ideas."¹²⁹

Since the denial of a subsidy does not burden free speech rights, the standard campaign finance free speech analysis under *Buckley* does not apply when the denial of a tax subsidy is at issue.¹³⁰ If the disclosure provisions in section 527 merely deny a tax subsidy to organizations that fail to comply with the regulatory structure, *Buckley's* First Amendment concerns are never implicated because

¹²⁵ *Leathers*, 499 U.S. at 451; *Regan*, 461 U.S. at 547.

¹²⁶ *Interstate Transit Lines v. Comm'r*, 319 U.S. 590, 593 (1943); *Deputy v. du Pont*, 308 U.S. 488, 493 (1940); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934).

¹²⁷ *Leathers*, 499 U.S. at 450 n.3; *Regan*, 461 U.S. at 544.

¹²⁸ *Bob Jones Univ. v. United States*, 461 U.S. 574, 603-04 (1983); *Regan*, 461 U.S. at 546; *Cammarano*, 358 U.S. at 513.

¹²⁹ *Cammarano*, 358 U.S. at 513 (quoting *Speiser v. Randall*, 357 U.S. 513, 519 (1958)).

¹³⁰ For a discussion of *Buckley*, see *infra* notes 353-413 and accompanying text.

the disclosure provisions do not infringe the section 527 organization's First Amendment rights.¹³¹ If the organization does not wish to be subject to disclosure, it may forgo its tax-exempt status.

In attempting to condition tax-exempt status on a person's willingness to give up an otherwise established right, Congress is relying on an argument and line of cases often referred to as the "greater power doctrine." Under this doctrine, it is constitutional for the Government to condition the grant of a nonmandatory benefit on the recipient's willingness to comply with restrictions that otherwise might be unconstitutional.¹³² This doctrine has been used in the tax context to prohibit section 501(c)(3) organizations from lobbying or engaging in campaign activities,¹³³ and to prohibit businesses from deducting lobbying expenses under section 162.¹³⁴ The "unconstitutional condition" doctrine is a competing doctrine, which provides that the Government cannot require a citizen to give up a constitutional right in order to receive a benefit, even if the benefit is one that the Government is not required to provide.¹³⁵ In the tax context, the greater powers doctrine generally has applied except in

¹³¹ See *Regan*, 461 U.S. at 549 ("We have held in several contexts that a legislature's decision not to subsidize the exercise of a fundamental right does not infringe the right, and thus is not subject to strict scrutiny.")

¹³² For an excellent comparison between the unconstitutional conditions doctrine and the greater powers approach, see generally Brooks R. Fudenberg, *Unconstitutional Conditions and Greater Powers: A Separability Approach*, 43 UCLA L. REV. 371 (1995).

¹³³ See *Regan*, 461 U.S. 545-51 (determining that denying tax-exempt status to nonprofit charity where substantial part of its activities was lobbying did not violate First Amendment or equal protection clause).

¹³⁴ *Cammarano*, 358 U.S. at 513; see also Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities*, 71 TEX. L. REV. 1269, 1340 (1993) (arguing that exempt organizations should be permitted to lobby).

¹³⁵ See LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 681 (1988); Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1413, 1415 (1989) (describing doctrine of unconstitutional conditions); see also *Sherbert v. Verner*, 374 U.S. 398, 410 (1963) (holding that state may not condition unemployment benefits on employee's willingness to work on Saturday). See generally Mitchell N. Berman, *Coercion Without Baselines: Unconstitutional Conditions in Three Dimensions*, 90 GEO. L.J. 1 (2001); Mitchell N. Berman, *Commercial Speech and the Unconstitutional Conditions Doctrine: A Second Look at "The Greater Includes the Lesser,"* 55 VAND. L. REV. 693 (2002); Richard A. Epstein, *Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 HARV. L. REV. 4 (1988); Seth F. Kreimer, *Allocational Sanctions: The Problem of Negative Rights in a Positive State*, 132 U. PA. L. REV. 1293 (1984); Laura M. Friedman, Note, *Family Cap and the Unconstitutional Conditions Doctrine: Scrutinizing a Welfare Woman's Right to Bear Children*, 56 OHIO ST. L.J. 637 (1995).

the most extreme circumstances, and the analysis usually centers on whether the provision is the denial of a subsidy or a penalty.¹³⁶ Congress can condition the granting of a subsidy on the forfeiture of a right (the “subsidy rationale”), but it cannot penalize an individual for exercising a right (the “penalty rationale”).¹³⁷

Several commentators have criticized the subsidy/penalty distinction, and it is clearly unsatisfying to anyone struggling with the competing constitutional doctrines of “greater power” and “unconstitutional conditions.”¹³⁸ It often is difficult to determine whether something is a penalty or a subsidy, and the distinction often appears to be whether the court agrees or disagrees with the substantive policy at issue in the case.¹³⁹ It is clear, however, that a provision providing greater “choice” to a recipient has a greater likelihood of being considered a “subsidy” than a provision that provides less choice. Moreover, a subsidy that is narrowly tailored to the benefit received also stands a better chance of success. Thus, the disclosure provisions in section 527 have a greater chance of being considered a subsidy that is constitutional under the greater powers doctrine if (1) they provide a clear tax benefit to the recipient, (2) the denial of the subsidy is narrowly tailored to the benefit received or the provisions provide a clear opt-out option for entities that chose not to accept the subsidy, and (3) they do not attempt to regulate the specific content of the speech. Provisions that meet these requirements are less likely punitive in nature and more likely designed so that Congress will not subsidize activities that it believes are unworthy. Congress likely could design a campaign finance disclosure provision that complies with each of these three conditions, and that requires exempt organizations to disclose contributions to and expenditures of the organization.

¹³⁶ See *Regan*, 461 U.S. at 549.

¹³⁷ *Id.* See also *Speiser v. Randall*, 357 U.S. 513 (1958) (finding tax-exemption for veterans who sign loyalty oath as unconstitutional penalty).

¹³⁸ See *supra* note 135 and see *infra* note 283.

¹³⁹ Robert C. Post, *Subsidized Speech*, 106 YALE L.J. 151, 174-75 (1996) (“The doctrines have become formalistic labels for conclusions, rather than useful tools for understanding.”); see generally Brooks R. Fudenberg, *Unconstitutional Conditions and Greater Powers: A Separability Approach*, 43 UCLA L. REV. 371 (1995) (comparing unconstitutional conditions doctrine and greater powers approach).

1. *Section 527 Organizations Receive a Tax Subsidy.* First, in order for the subsidy doctrine to apply, political organizations that file and are granted section 527 tax-exempt status must receive a concrete financial subsidy in exchange for agreeing to be bound by the disclosure provisions. While the grant of tax-exempt status is not identical to the payment of a subsidy, the Court has treated tax exemptions, deductions, and credits in a manner similar to the way it treats direct payments from the Government.¹⁴⁰ For example, in both *Cammarano v. United States*¹⁴¹ and *Regan v. Taxation With Representation*,¹⁴² the Court recognized that the granting of a tax deduction and the granting of tax-exempt status are Government subsidies that are administered through the tax code.¹⁴³

The finding of a tax subsidy in *Cammarano* and *Regan* is particularly instructive on the question whether a tax subsidy exists in the section 527 context. The finding of a tax subsidy is intuitive when one considers tax expenditures, since tax expenditures, by definition, are the cost to the Government of providing specific tax benefits that reduce the general tax base.¹⁴⁴ A tax expenditure, such as the deduction for home mortgage interest, provides a direct subsidy to the taxpayer.

¹⁴⁰ See *Regan v. Taxation With Representation*, 461 U.S. at 540, 544 (1983) ("A tax exemption has much the same effect as a cash grant."). But see Edward A. Zelinsky, *Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures?*, 112 HARV. L. REV. 379, 433 (1998) (arguing that tax benefits are not always equivalent to direct expenditures and that their similarity should be determined on case-by-case basis).

¹⁴¹ 358 U.S. 498 (1959).

¹⁴² 461 U.S. 540 (1983).

¹⁴³ *Cammarano*, 538 U.S. at 508-09; *Regan*, 461 U.S. at 544.

¹⁴⁴ The idea that tax deductions, exemptions, and credits are similar to Government spending has given rise to the term "tax expenditure." The cost to the Treasury due to the various tax deductions, exemptions, and credits is known as tax expenditures. See JOINT COMM. ON TAXATION OF THE 107TH CONG., STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986, at 68-69 (2001) ("[T]ax expenditures can be viewed as government spending programs that are embedded in the tax laws."); see also STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 2-4 (1985) (discussing tax expenditure concept); RICHARD A. WESTIN, WG&L TAX DICTIONARY 776 (2000) (defining tax expenditure as "a diminution in government tax revenues that results from tax benefits granted for policy reasons and that diminish a comprehensive tax base"); Stanley S. Surrey, *Pathways to Reform* 179-80 (1973) (discussing tax expenditure concept); Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1155 ("The concept of 'tax expenditures' holds that certain provisions of the tax law are not really tax provisions, but are actually government spending programs disguised as tax language.").

The determination that a tax subsidy exists is far more problematic when one is considering a tax provision that is not a direct subsidy and does not reduce what is generally thought to be the tax base. In *Cammarano*, for example, the "subsidy" at issue did not involve a tax expenditure, but instead involved a tax deduction normally thought to be necessary to clearly reflect taxable income.¹⁴⁵ In *Cammarano*, two taxable entities involved in beer distribution sought to deduct, as ordinary and necessary business expenses, amounts paid to organizations whose purpose was to urge the defeat of initiatives that would have restricted liquor sales.¹⁴⁶ The Court rejected the taxpayers' argument and held that the denial of an ordinary and necessary business expense was merely the denial of a subsidy.¹⁴⁷

The Court's conclusion in *Cammarano*, that the ordinary and necessary business deduction is a subsidy,¹⁴⁸ is very troublesome. It is far from clear that the denial of an ordinary and necessary business deduction is really the denial of a subsidy.¹⁴⁹ The tax code generally does not tax the gross income of a business, but instead provides for a tax on the business's net income. To the extent that tougher liquor laws directly impacted taxpayers' businesses, the expenses they paid on lobbying were directly related to their potential income. They were clearly a cost of doing business, the deduction of which was necessary in order to clearly reflect the businesses' income.

The *Regan* case was far clearer because the entity involved in *Regan* was a tax-exempt entity under section 501(c)(3) of the Code.¹⁵⁰ It therefore received both the benefit of tax-exempt status and the secondary benefit that deductions to it were deductible by

¹⁴⁵ *Camarrano*, 358 U.S. at 501.

¹⁴⁶ *Id.* at 500-01.

¹⁴⁷ *Id.* at 504-05.

¹⁴⁸ *Id.*

¹⁴⁹ See George Cooper, *The Tax Treatment of Business Grassroots Lobbying: Defining and Attaining the Public Policy Objectives*, 68 COLUM. L. REV. 801, 838-41 (1968) (arguing subsidy rationale in *Cammarano* is unsatisfactory because both denial of deduction and imposition of tax restrict free speech and act as penalty for that speech).

¹⁵⁰ *Regan v. Taxation With Representation*, 461 U.S. 540, 543 (1983).

the donor.¹⁵¹ The Court, therefore, had no problem finding that a tax subsidy existed in that instance.¹⁵²

Cammarano and *Regan* set a fairly low bar for establishing the presence of a tax subsidy. Section 527 political organizations are tax-exempt organizations with a tax status similar to that of the section 501(c)(3) organization in *Regan*, except that contributions to a section 527 organization are not tax deductible.¹⁵³ Based on *Cammarano* and *Regan*, the granting of exempt status in and of itself would seem to be enough to find the presence of a tax subsidy. But in order for a tax subsidy to exist, the exempt organization must not just be exempt from tax, it also must receive some specific tax benefit due to its exemption. If, for example, the organization had no taxable income, granting it exempt status would not provide any Government subsidy because it would have had no income tax liability.¹⁵⁴ In order to determine whether a subsidy exists, it is important to consider the tax baseline. Once a tax baseline is established, one can then determine whether an exempt organization receives a tax subsidy as compared to that baseline.

For purposes of this analysis, this Article is concerned with whether the exempt organization receives a tax benefit due to its exempt status. Since Congress has the authority to establish the general rules of taxation, the possibility of a subsidy ultimately must be measured against what Congress has the authority to do, not what it should do. Therefore, the ultimate question whether a tax subsidy exists must be analyzed based on whether the tax-exempt organization receives a tax benefit, as compared with

¹⁵¹ *Id.*

¹⁵² *Id.* at 543-44.

¹⁵³ I.R.C. § 527 (2000).

¹⁵⁴ See Boris I. Bittker, *Churches, Taxes and the Constitution*, 78 YALE L.J. 1285, 1290-91 (1969) (arguing that religious organizations would not generally have been subject to income tax even if they were not exempt from tax under § 501(c)(3)); Edward A. Zelinsky, *Are Tax "Benefits" for Religious Institutions Constitutionally Dependent on Benefits for Secular Entities?*, 42 B.C. L. REV. 805, 807 (2001) ("[T]ax exemption does not subsidize churches, but leaves them alone."). *But cf.* Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1381-89 (1991) (arguing that donative theory should be used to explain charitable exemption); Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 58-61 (1981) (suggesting argument that charitable organizations have no income inadequately explains exemptions).

current law, due to its exempt status. This tax baseline will be referred to as the "status-quo baseline."¹⁵⁵ Under this method, existing congressional enactments create the baseline from which one views the benefits of tax-exempt status.

In determining whether a section 527 exempt organization receives a tax subsidy due to its exempt status, there are two possible tax events to consider. First, the exempt organization may receive contributions or payments from third parties. If these payments constitute income, but are not taxed because of the organization's exempt status, the exempt entity receives a tax subsidy. Second, political organizations may receive a tax subsidy because contributions or payments made to section 527 organizations are not subject to gift tax.¹⁵⁶

B. PAYMENTS RECEIVED BY A POLITICAL ORGANIZATION ARE INCOME FOR TAX PURPOSES

Gross income under section 61 of the Code is defined broadly as "income from whatever source derived."¹⁵⁷ Under this expansive definition, payments to a political organization would be income. There are several tax theories, however, including a conduit and capital contribution theory that could potentially be used to argue that payments received by political organizations should not constitute income to the organizations. Each of these theories fails to provide sufficient justification for excluding the payments from income.

1. Conduit Theory. Under the conduit theory, the payments to political organizations are not considered income because the organizations are merely acting as conduits for spending that a taxpayer could have made herself.¹⁵⁸ Two similar arguments, the

¹⁵⁵ An alternative baseline, the tax theory baseline, which considers what should and should not be included in income based on general tax principles and theories, also could be used. The tax theory baseline is not concerned with Congress's power to alter the baseline, or with specific congressional enactments that do so. Under this approach, one would look to see if a tax subsidy exists due to an organization's exempt status as measured against general tax principles and theories.

¹⁵⁶ I.R.C. § 2501(a)(5) (2000).

¹⁵⁷ I.R.C. § 61.

¹⁵⁸ Simmons, *supra* note 71, at 98.

pooling theory and the trust theory, exemplify this approach.¹⁵⁹ Under the pooling theory, when individuals make post-tax payments to a political organization, the political organization is viewed merely as the collector of the individual payments.¹⁶⁰ As such, the payment would be no different than if the individuals themselves made part of the payment for the specific political activity at issue. Clearly, ten people each could pay for one-tenth of the cost of a political advertisement without any entity (except the television station) being involved.

The trust theory relies on the view that payments to a political organization can be viewed as contributions that the payor expects will be used in a certain manner on her behalf.¹⁶¹ The payments would then be held in "trust" in a way that limits the organization's use of the funds.¹⁶² In that context, the organization would be expending funds for the payor at her discretion, so the payment would remain hers and would not constitute income to the political organization.

Prior to the passage of section 527, the IRS arguably endorsed the conduit theory as a basis for excluding payments to political organizations.¹⁶³ Recently, however, the IRS has examined the conduit theory in the context of a charitable organization that lost its exempt status and concluded that the conduit theory does not justify excluding contributions from gross income.¹⁶⁴ The IRS concluded that, since public charities exercise considerable discretion and control of the contributed funds, they are not merely a conduit for the payments.¹⁶⁵ The IRS concluded that charities exercise more than ministerial power over donated funds and that the donations, once made, are controlled by the charity, not the

¹⁵⁹ *Id.* at 96-101.

¹⁶⁰ *Id.* at 98.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ See Gen. Couns. Mem. 35,499 (Feb. 8, 1974) (claiming precise justification for excluding political campaign contributions from gross income has never been clearly articulated, but that it is clear that justification is not that contributions are gifts); Gen. Couns. Mem. 39,813 n.32 (Mar. 19, 1990) (claiming conduit or quasi-trust rationale was reason for exclusion). *But see supra* note 43 (indicating that contributions were considered gifts).

¹⁶⁴ Gen. Couns. Mem. 39, 813 (Mar. 19, 1990).

¹⁶⁵ *Id.*

donor.¹⁶⁶ The IRS has concluded that the conduit theory is reserved for situations in which the organization is clearly an agent, and not the "true owner" of the funds.¹⁶⁷

For the same reasons that the conduit theory does not work for charitable organizations that lose their exempt status, it does not work for political organizations. In the campaign finance context, the pooling theory fails because individuals are not merely pooling money to achieve a specific result. The money is paid to a political organization to promote that organization and its causes. The political organization has almost complete control over the use of the money. The organization can invest it, spend it on salaries or office equipment, or spend it to influence elections.¹⁶⁸ Moreover, political organizations often promote more than one issue or candidate. An individual may contribute money even though she only supports some of the organization's activities.

In his recent article, Daniel Simmons argues further that, in the section 527 context, contributors to section 527 organizations seek to maximize their influence by associating with other like-minded payors.¹⁶⁹ The organization is therefore providing a service, and payments to the organization could be considered compensation for those services.¹⁷⁰

¹⁶⁶ Gen. Couns. Mem. 39,813 (Mar. 19, 1990) (rejecting conduit or quasi-trust rationale); see also *Nat'l Fed. of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300, 1317 (S.D. Ala. 2002) (rejecting conduit or quasi-trust rationale). The theory works, however, when money is collected by a for-profit organization and passed along to a non-profit organization. See Rev. Rul. 58-276, 1958-1 C.B. 23 (stating that money collected by television station in telethon and given to charity is not taxable income to television station).

¹⁶⁷ Gen. Couns. Mem. 39,813 (Mar. 19, 1990).

¹⁶⁸ As the district court noted in *National Federation of Republican Assemblies*, political organizations are not required to give money back to contributors upon dissolution. *NFRA*, 218 F. Supp. 2d at 1317.

¹⁶⁹ Simmons, *supra* note 71, at 97.

¹⁷⁰ *Id.* at 99. In addition, the political organization can be seen as providing a service to the candidate. If A purchases a product from B and gives it to C, B still has taxable income from the purchase. Here an individual (A) is purchasing a product from the political organization (B) for the benefit of C. B is merely providing a service to A for C's benefit. Contributors are in a sense buying a product, which is the political organization's ability to influence policy in a manner that the contributor believes is important. See Tech. Adv. Mem. 91-30-008 (Apr. 16, 1991):

Generally, where an organization supports an individual's campaign for public office, the organization's activities and expenditures in furtherance of the individual's election or appointment to that office are for an exempt

The trust theory similarly fails because political organizations are under no obligation to spend contributors' money in any specific fashion. Once money is given, it is the political organization that has dominion and control over the funds, and it may spend them in any manner it sees fit consistent with its corporate charter.¹⁷¹

2. *Capital Contribution Theory.* Under section 118(a) of the Code, contributions to capital are not included in a corporation's gross income.¹⁷² Thus, if a political organization is considered a corporation, and the payment to it was considered to be a contribution to capital, the political organization would not have taxable income on the payment even if the organization was not exempt under the Code.

Determining whether the payment is a contribution to capital is difficult in the political organization context because the law anticipates a payment to a for-profit corporation. One can, however, extrapolate from those decisions, and apply the for-profit model in the political organization context.¹⁷³ The Court has set out a five-part test for determining whether a payment from a nonshareholder is a contribution to capital.¹⁷⁴ In order for a payment from a

function of the organization. The individual does not have to be an announced candidate for the office. Furthermore, the fact that an individual never becomes a candidate is not crucial in determining whether an organization is engaging in an exempt function. An activity engaged in between elections which is directly related to, and supports, the process of selection, nomination, or election of an individual in the next applicable political campaign is an exempt function activity.

Id.

¹⁷¹ Simmons, *supra* note 71, at 98-99.

¹⁷² I.R.C. § 118(a) (2000).

¹⁷³ *Brown Shoe Co. v. Comm'r*, 339 U.S. 583, 589-90 (1950) (holding payments by community groups to corporation as inducement to locate or expand in their communities were capital contributions); *Edwards v. Cuba R.R. Co.*, 268 U.S. 628, 632-33 (1925) (holding payment by Cuban Government to railroad to promote construction in Cuba was contribution to capital). *But see* *United States v. Chicago, Burlington & Quincy R.R. Co.*, 412 U.S. 401, 413-14 (1973) (holding payments from Government funds to railroad for cost of building railroad facilities were not contributions to capital); *Detroit Edison Co. v. Comm'r*, 319 U.S. 98, 102 (1943) (holding payments by customers to utility for cost of building power lines were not contribution to capital).

¹⁷⁴ *Chicago, Burlington & Quincy R.R. Co.*, 412 U.S. at 413. The Court first held that payments by nonshareholders could be contributions to capital in *Edwards v. Cuba Railroad Co.*, 268 U.S. 628, 632-33 (1925). Edwin G. Schuck, Jr., *The Low-Income Housing Tax Credit for New Construction: Eligible Basis and Planning Possibilities*, 48 TAXLAW 321, 334 (1995). The test in *Chicago, Burlington & Quincy Railroad Co.* clarified the Court's holding in *Cuba*

nonshareholder to be considered a contribution to capital, it must: (1) become a permanent part of the transferee's working capital structure; (2) not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee; (3) be bargained for; (4) result in benefit to the transferee in an amount commensurate with its value; and (5) ordinarily, if not always, be employed in or contribute to the production of additional income and its value assured in that respect.¹⁷⁵

Under this test, payments to political organizations do not qualify as contributions to capital. The payments are not a permanent part of the organization's working capital structure. They are received by the organization and expended on political advocacy. They are not retained by the organization to enhance its capital structure. Moreover, the payments are, in some sense, compensation for services. As previously discussed, the political organization performs a service for the person who makes the payment.¹⁷⁶ The political organization engages in political advocacy. In addition, the payments are not bargained for, and they do not contribute to the production of income for the organization.

3. *Gift Theory.* While the conduit and contribution to capital theories do not provide sufficient reasons for excluding payments to a section 527 organization from income, neither theory appears to be the basis for the IRS's determination that payments to a political organization are not income. It appears from the history behind the IRS's issuance of Revenue Ruling 74-21,¹⁷⁷ which indicates that contributions to a political organization would not be considered

Railroad. *Id.* at 335. It is questionable whether the Court was correct in *Cuba Railroad* in treating payments by communities to a corporation as contributions to capital. See Thomas L. Evans, *The Taxation of Nonshareholder Contributions to Capital: An Economic Analysis*, 45 VAND. L. REV. 1457, 1460 n.6 (1992) (noting paradoxical stance that, while corporation may exclude contributions from income, it is not allowed to enjoy additional benefit of recovering costs of assets when they are later sold or depreciated). The IRS's position is that, in light of intervening case law, payments by communities to corporations generally are not contributions to capital. Gen. Couns. Mem. 37,354 (Dec. 21, 1977); see also Schuck, *supra* at 335.

¹⁷⁵ *Chicago, Burlington & Quincy R.R. Co.*, 412 U.S. at 413; see also JACOB MERTENS, JR., 10 THE LAW OF FEDERAL INCOME TAXATION § 3830 (2002) (noting defining characteristics of nonshareholder contributions to capital as established by Supreme Court).

¹⁷⁶ See *supra* note 170 and accompanying text (discussing theory of contribution as service).

¹⁷⁷ Rev. Rul. 74-21, 1974-1 C.B. 14.

income,¹⁷⁸ that the IRS believes that contributions to political organizations are gifts and therefore not income.¹⁷⁹ This would be consistent with the IRS's position that, absent a specific provision in the Code to the contrary, the contributor to the organization must pay gift tax.¹⁸⁰ The premise behind the requirement that a payor pay gift tax is that the donor is not receiving compensation or adequate consideration in money or money's worth for the contribution.¹⁸¹

But in determining whether a payment should be included in income or whether it is a gift for income tax purposes, the test is whether the payment was given with detached and disinterested generosity.¹⁸² Thus, a donor might be subject to gift tax on a payment since it was not given for money or money's worth—the test for estate and gift tax purposes—but the payment still might not be considered a gift for income tax purposes. To the extent that the payors are receiving something for their payments, (*i.e.*, the ability to influence policy or the ability to magnify their voices by joining together), the gift theory also may fail since the payment would not have been given with detached and disinterested generosity.

The notion that the payor to a political organization receives a benefit in exchange for a payment, thus leading to a finding that the payment is income for income tax purposes, is supported by cases rejecting the IRS's position that payments to political organizations are gifts subject to the gift tax.¹⁸³ In *Stern v. United States*,¹⁸⁴ Mrs.

¹⁷⁸ *Id.*

¹⁷⁹ See Tax Treatment of Contributions of Appreciated Property to Committees of Political Parties, 37 Fed. Reg. 22,427, 22,427 (Oct. 19, 1972) (Notice of Opportunity to Submit Written Comments to Request for Public Hearing) (indicating that it is matter of history that IRS has never required political committees to file income tax returns because it believed that virtually all of receipts were from gifts); I.R.S. Announcement, 1973-2 C.B. 6-461, 461 (reversing previous position and requiring political parties to file returns, and indicating that gross income will include interest and dividends but not contributions). *But see supra* note 43 (indicating IRS based its decision on conduit theory and not gift theory).

¹⁸⁰ See Rev. Rul. 72-583, 1972-2 C.B. 534, 534-35 (indicating that, except in Fifth Circuit where *Stern v. United States*, 436 F.2d 1327 (5th Cir. 1971), was binding precedent, IRS would consider transfers to political campaigns to be gifts for tax purposes); *see also supra* note 43 (discussing evolving classification of contributions).

¹⁸¹ I.R.C. § 2512(b) (2000).

¹⁸² *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960).

¹⁸³ *Stern v. United States*, 436 F.2d 1327, 329-30 (5th Cir. 1971); *see also Carson v.*

Stern, a wealthy investor, was upset that business leaders consistently ranked Louisiana as a poor place to locate their businesses.¹⁸⁵ She believed that this ranking was due to political corruption in Louisiana.¹⁸⁶ Mrs. Stern made large political expenditures and pooled her money with that of other like-minded individuals.¹⁸⁷ Mrs. Stern argued that these payments were not subject to gift tax because they were made to protect her property and her personal interest by promoting efficiency in Government.¹⁸⁸ The court found that the political expenditures were made in the ordinary course of business, for the purpose of protecting her property, and were free of donative intent.¹⁸⁹ Specifically, the court found that:

The contributions were motivated by [Stern's] desire to promote a slate of candidates that would protect and advance her personal and property interests. . . . In a very real sense, then, Mrs. Stern was making an economic investment that she believed would have a direct and favorable effect upon her property holdings and business interests¹⁹⁰

While this holding relieved Mrs. Stern of gift tax liability, it may have subjected the receiving organization to income tax. If the payment was made in the ordinary course of business without donative intent, then the payment should be considered income to the association since it was not made with detached and disinterested generosity.

Under *Stern*, payments to political organizations in the ordinary course of business or for financial reasons would not be considered

Comm'r, 641 F.2d 864, 865-66 (10th Cir. 1981) (finding payment was for donor's own economic advantage and campaign contributions are not gifts within meaning of gift tax law); Jeffrey Schoenblum, *The Changing Meaning of "Gift": An Analysis of the Tax Court's Decision in Carson v. Commissioner*, 32 VAND. L. REV. 641, 657-58 (1979) (stating *Stern* rejected gift tax treatment on narrow grounds).

¹⁸⁴ 436 F.2d 1327 (5th Cir. 1971).

¹⁸⁵ *Id.* at 1328.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 1328-29.

¹⁸⁹ *Id.* at 1329.

¹⁹⁰ *Id.* at 1330.

gifts and would be income to the political organization. The problem with applying the *Stern* logic to payments to political organizations is that the question whether a payment is a gift or not for income tax purposes is a factual analysis based on whether the payment was made with detached and disinterested generosity.¹⁹¹ It is impractical to make such a determination about each contribution made to a political organization. The difficulty in making this determination for each donor makes enforcement extremely burdensome. It does, however, provide a basis upon which Congress could make the determination that all payments to political organizations are income for income tax purposes. Congress could determine that in the political organization context payments are rarely made with detached and disinterested generosity. Recognizing that collection efforts would be difficult under the present test, Congress could decide to eliminate the fact-based test and legislate that payments to political organizations are not gifts for income tax purposes. Such an action by Congress would change the status-quo baseline and would clarify that payments to political organizations are not excludable from income as gifts.

4. *Ordinary and Necessary Business Deduction.* If a political organization's contributions are income to the organization, the political organization still might not have taxable income since the expenditures might offset its receipts. Under such a circumstance, the exempt organization would not be receiving a significant tax benefit due to its exempt status because it would have little taxable income absent the exemption.

While in theory this might be the result, under the status-quo baseline, political organizations could not deduct such expenditures.¹⁹² As early as 1915, a U.S. Treasury Department regulation prohibited businesses from deducting lobbying expenses as ordinary and necessary business expenses.¹⁹³ This regulation

¹⁹¹ *Comm'r v. Duberstein*, 363 U.S. 278, 289-91 (1960).

¹⁹² The result might be different if a tax theory baseline were used. Since in theory the political organization is in the business of influencing elections, its advertising expenses would be ordinary and necessary business expenses. Thus, if measured against the tax theory baseline, the exempt organization receives little tax benefit since very little of its income would have been subject to tax absent exempt status.

¹⁹³ T.D. 2137, 17 *Treas. Dec. Int. Rev.* 48, 57-58 (1915).

was upheld, albeit in a different form, by the Supreme Court in *Textile Mills Securities Corp. v. Commissioner*,¹⁹⁴ on the grounds that contracts "to spread such insidious influences through legislative halls have long been condemned," and that it was within agency rule-making authority to draw a line between legitimate business expenses and "those arising from that family of contracts to which the law has given no sanction."¹⁹⁵

In 1962, Congress amended section 162(e) and allowed businesses to deduct expenses related to legislation "of direct interest" to the taxpayer.¹⁹⁶ In 1993, however, Congress once again amended section 162(e), which now prohibits any deduction for most expenses incurred to influence legislation or political campaigns.¹⁹⁷ Section 162(e)(5)(A) allows an organization in the business of influencing legislation to deduct payments made directly on behalf of another person, but subsection (e)(5)(A) only applies to direct lobbying on behalf of a specific client.¹⁹⁸ Section 162(e)(5)(A) is not relevant in the political organization context where the political organization is acting to promote its own agenda and the agenda of its members.¹⁹⁹

¹⁹⁴ 314 U.S. 326 (1941).

¹⁹⁵ *Id.* at 338-39.

¹⁹⁶ Revenue Act of 1962, Pub. L. No. 87-834, § 3(a), 76 Stat. 960, 973 (1962). Section 276 also prohibits the deduction of amounts spent on political advertisements if the advertisements inure to the benefit of a political party or candidate. I.R.C. § 276(a)(1) (2000).

¹⁹⁷ I.R.C. § 162(e); *see also* Geary v. Comm'r, 235 F.3d 1207, 1210-11 (9th Cir. 2000) (holding that San Francisco police officer could not deduct as ordinary and necessary business expenses amounts he paid to promote ballot initiative that would have allowed him to continue to patrol with puppet that he claimed he used to promote community relations).

¹⁹⁸ I.R.C. § 162(e)(5)(A).

¹⁹⁹ The logic of section 162(e)(5)(A) is that the third party was prohibited from deducting the payments when they were made to the political organization and that disallowance would produce double taxation. H.R. REP. NO. 103-213 pt. 4, at 610 (1993), *reprinted in* 1993 U.S.C.A.N. 1088, 1299; *see also* Simmons, *supra* note 71, at 100-01 (suggesting another justification for denying ordinary and necessary business expense deduction, namely that payments at issue are capital expenditures because they create future benefits). Although advertising usually is deductible despite its long-term benefits, such a policy contradicts the basic tax theory that items that produce long-term benefits should be capitalized. Treas. Reg. § 1.162-20(a)(2) ("Expenditures for institutional or 'good will' advertising which keeps the taxpayer's name before the public are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the patronage the taxpayer might reasonably expect in the future."). *See also* Simmons, *supra* note 71, at 99-100. Simmons argues that the general rule on advertising should not apply in the political context because it is designed to produce long-term benefits. Simmons, *supra* note 71, at 101. Simmons's approach would create significant accounting problems. What happens if a candidate loses the race? The advertising would then have no long-term benefit and would be immediately

Since under the status-quo baseline a nonexempt political organization would not be allowed to deduct its expenditures on political advertising as an ordinary and necessary business expense, a nonexempt political organization would have significant taxable income. It would have to include all contributions in income and would not be able to deduct most of its expenses.²⁰⁰ Providing tax-exempt status to political organizations, therefore, is a significant tax subsidy to the organization.

C. CONGRESS MAY REQUIRE THAT GIFT TAX BE PAID ON PAYMENTS MADE TO A POLITICAL ORGANIZATION

Even if a political organization is not required to include payments in income, it still receives a significant benefit in that contributions to the organization are not subject to the gift tax. As discussed previously, the IRS subjects contributions to exempt organizations to the gift tax.²⁰¹ Donors to section 527 political organizations are specifically exempted from gift tax treatment under section 2501(a)(5).²⁰² Individuals making payments to exempt organizations other than section 501(c)(3) and section 527 organizations that exceed the annual gift tax exclusion amount are subject to gift tax on the amount that exceeds the exclusion amount.²⁰³ In circumstances such as the Wily situation discussed in the beginning

deductible. What about an attempt to influence a U.S. House race versus a Senate race? Would one be amortizable over two years while the other over six? What Simmons's argument does point out, however, is that, if Congress chose to do so, it could require that a political organization's campaign expenditures be capitalized over a specific period of time.

²⁰⁰ The IRS issued guidance regarding the tax treatment of an exempt organization when its exempt status had been revoked. Gen. Couns. Mem. 39,813 (Mar. 19, 1990). The Service concluded that contributions to the organization are income, and that the organization was entitled to deductions for its expenditures. *Id.* The Service specifically indicated, however, that expenditures of the organization are not deductible if they are disallowed by the Code. *Id.* Applying this treatment to political organizations would have them include contributions in income, but they would not be able to deduct expenses for political advertising.

²⁰¹ See *supra* notes 43-60 and accompanying text.

²⁰² I.R.C. § 2501(a)(5) (2000).

²⁰³ In 2002, a gift of up to \$11,000 to any individual in a particular year was exempt from gift tax. I.R.C. § 2503(b). This amount was adjusted for inflation. I.R.C. § 2503(b)(2). If an individual makes a gift of over \$11,000 to any individual or entity, the amount over \$11,000 is subject to gift tax. Under section 2505 of the Code, an individual is allowed a credit against gift tax owed up to \$1,000,000. I.R.C. §§ 2010, 2505. Thus, if a person chooses, she can avoid paying gift tax and reduce her credit by the amount of the gift tax.

of this Article,²⁰⁴ the exemption from the gift tax provides a significant financial benefit to individuals contributing to section 527 organizations. Since the ability to make large contributions to an organization is one of the major benefits of using an entity not subject to FECA, the gift tax exclusion provides a significant tax benefit. Under existing law, payments to section 501(c)(4) organizations are subject to gift tax and that lessens their attractiveness as a nonregulated campaign entity.²⁰⁵

It is far from clear that this benefit is sufficient to implicate the subsidy rationale used by Congress to support the disclosure requirements in section 527.²⁰⁶ Because the gift tax is paid by the payor, there is no direct tax benefit bestowed on the exempt organization by Congress. The lack of a direct connection between the tax benefit received and the political organization may defeat any attempt to use the gift tax as a rationale for the subsidy argument.

Economically, however, the political organization is the obvious beneficiary of the gift-tax exemption. Because a payor is exempt from gift tax, she may be willing to make a larger contribution to a political organization. The political organization then becomes the

²⁰⁴ See *supra* notes 14-21 and accompanying text (discussing advertisement purchased by supporters of then-Governor George W. Bush).

²⁰⁵ See Hill, *supra* note 9, at 389-90 (indicating that § 501(c)(4) organization sought private letter ruling confirming that it had created valid § 527 organization, and private letter ruling was motivated by fact that substantial contributor to 501(c)(4) organization would have been subject to gift tax on her contribution); see also Priv. Ltr. Rul. 96-52-026 (Oct. 1, 1996) (ruling that gifts made to 527 organization created by 501(c)(4) organization were exempt from gift tax); Joseph Mikrut, *Disclosure of Political Activities of Tax Exempt Organizations: Hearings Before the House Subcomm. on Oversight of the Comm. on Ways and Means*, 106th Cong. 40-41 (testimony of Joseph Mikrut, Tax Legislative Counsel, U.S. Dep't of the Treasury) (discussing tax treatment under current law for 501(c) nonprofits and 527 organizations); Kip Dellinger, *Gift Tax on Political Contributions? A Lousy Idea!*, 78 TAX NOTES 621, 621-22 (1998) (arguing that political contributions should not be taxed as gifts); Jonathan Barry Forman, *Taxing Soft Money*, 78 TAX NOTES 357, 357 (1998) (arguing that soft money contributions should be subject to gift tax); Gregory Colvin, *Hypothetical Comparison: Major Donor Support of Advocacy Programs*, 18 EXEMPT ORG. TAX REV. 39, 82 (1997) (discussing 501(c)(4) organization seeking private letter ruling that it properly created 527 organization so major donor could avoid gift tax).

²⁰⁶ See H.R. REP. NO. 106-702, at 14 (2000) ("In addition, the Committee believes that given the tax benefits conferred under present law [including] the benefit of the gift tax exemption for contributions to section 527 organizations, the public interest is served by greater public disclosure of information relating to the political activities of such organizations.").

direct beneficiary of the tax subsidy. The argument that the political organization receives a tax subsidy even though the direct benefit is bestowed on the payor is strengthened by the Court's discussion in *Regan*. In *Regan*, the Court explained that there are two types of tax subsidies received by section 501(c)(3) organizations: one whereby donations to it are deductible and the other whereby its income is not subject to tax.²⁰⁷ If donations to a section 501(c)(3) organization are considered a subsidy to the organization because the donor can deduct the payment, then the fact that a donor is relieved of gift tax when she contributes to a section 527 organization provides an almost identical subsidy to the exempt organization. Thus, the Court previously has found that a tax subsidy exists to a tax-exempt organization even though the organization is not the direct beneficiary of the deduction.²⁰⁸ It is therefore likely that the benefit/subsidy rationale would apply here and that exempt organizations would be considered to have received a tax subsidy since payments to such organizations are exempt from the gift tax.

D. CONGRESS CAN CONDITION THE BENEFIT RECEIVED ON AN EXEMPT ORGANIZATION'S COMPLIANCE WITH CAMPAIGN FINANCE DISCLOSURE PROVISIONS

Once it is established that a tax subsidy exists, the next factor to examine is whether the statute properly conditions the benefit received on compliance with specific regulatory provisions. A central factor here is conditioning the grant of the subsidy to be narrowly tailored to the benefit received, and the statute must not eliminate the organization's ability to engage in unsubsidized speech. Congress can properly design a statute that meets these requirements, and the Supreme Court has upheld disclosure requirements that were required as a condition of receiving a Government subsidy.

For example, as early as 1912, the Supreme Court was confronted with the issue whether providing a discounted postal rate could be

²⁰⁷ *Regan v. Taxation With Representation*, 461 U.S. 540, 544 (1983).

²⁰⁸ *Id.*

conditioned on a requirement that the recipient make certain public disclosures. In *Lewis Publishing Co. v. Morgan*,²⁰⁹ the Court upheld provisions in the Post Office Appropriation Act of 1912²¹⁰ that required second class mailers to disclose the names and addresses of the editor, managing editor, publisher, business managers, owners (including stockholders), bondholders, and other security holders.²¹¹ The Act also required that all advertisements in the publications be plainly marked as advertisements.²¹²

Although *Lewis Publishing* is not a tax case, it provides tremendous insight into the application of the subsidy rationale in the tax context. A postal rate can be seen as a Government fee, similar to a tax, on people using the postal system. The reduction in the fee creates a subsidy to publishers in a similar manner to that of a tax deduction or credit.

The Court rejected the publishers' First Amendment challenge, holding that in creating a reduced rate (*i.e.*, second class mail) for publishers, Congress had bestowed a privilege on publishers that discriminated in their favor.²¹³ The Court determined that the provision merely affixed conditions upon publishers to receive the benefits of second class mail status, and that those conditions aided in determining whether the publications were entitled to the beneficial status.²¹⁴ The Court's main justification for upholding the regulation was that Congress has the right to classify postage rates, and that the Act's disclosure requirements were within Congress's authority.²¹⁵ The Court also recognized, however, that the publishers were receiving a benefit from the Government—partially to increase the "dissemination of current intelligence"—and that the public had a right to know to whom the Government was providing the benefit.²¹⁶ In fact, the legislative history indicated that one

²⁰⁹ 229 U.S. 288 (1913).

²¹⁰ 37 Stat. 539 (1912).

²¹¹ *Lewis Publ'g*, 229 U.S. at 296-97. Disclosure was not required of persons owning less than 1% of the total amount of stocks, bonds, or mortgages. *Id.*

²¹² *Id.* at 297.

²¹³ *Id.* at 303-04. The Court noted that second class mail was eighty times cheaper than first class mail. *Id.* at 304.

²¹⁴ *Id.* at 314-16.

²¹⁵ *Id.* at 312-13.

²¹⁶ *Id.*

reason Congress required the disclosure was so that the public would know the people who own and control the entities receiving the subsidy.²¹⁷

Very similar justifications can be given for requiring disclosure in the section 527 context. Just as publishers received a significant benefit in the form of subsidized mailing, section 527 organizations receive significant benefits in the form of tax subsidies. To the extent those subsidies are provided, it is reasonable that the public know the people who contribute to and benefit from the subsidies.

The Court has applied a similar subsidy rationale when Congress has chosen not to subsidize through the tax code behavior that arguably is protected by the First Amendment.²¹⁸ For example, in *Cammarano v. United States*,²¹⁹ which was discussed in the previous section for the proposition that the granting of a tax deduction is a subsidy from the Government,²²⁰ the Court rejected a First Amendment challenge to a tax statute that prohibited the deduction of amounts spent by businesses for lobbying for the promotion or defeat of legislation.²²¹ Two taxable entities involved in beer distribution sought to deduct, as ordinary and necessary business expenses, amounts paid to organizations whose purpose was to urge

²¹⁷ *Id.* at 312; see also S. REP. NO. 62-955, at 24 (1912):

We believe that, since the general public bears a large portion of the expense of distribution of second-class matter and since these publications wield a large influence because of their special concessions in the mails, it is not only equitable but highly desirable that the public should know the individuals who own or control them.

Id.

²¹⁸ See *Leathers v. Medlock*, 499 U.S. 439, 450-53 (1991) (upholding general tax that applied to cable companies even though other media organizations were exempt from tax). The Court has taken a different approach when the tax provision is specifically aimed at the press; *Regan v. Taxation With Representation*, 461 U.S. 540, 545-46 (1983) (upholding statute prohibiting § 501(c)(3) organizations from lobbying); *Cammarano v. United States*, 358 U.S. 498, 512-13 (1959) (upholding regulation denying ordinary and necessary business expense for amounts spent to defeat legislation). See *Minneapolis Star & Tribune Co. v. Minn. Comm'r of Revenue*, 460 U.S. 575, 591-92 (1998) (holding that tax on cost of paper and ink over \$100,000 consumed in production of publications violated First Amendment); *Grosjean v. Am. Press Co.*, 297 U.S. 233, 250-51 (1936) (finding tax on publications with weekly circulations above 20,000 unconstitutional).

²¹⁹ 358 U.S. 498 (1959).

²²⁰ See *supra* notes 139-49 and accompanying text.

²²¹ 358 U.S. at 498.

the defeat of initiatives that would have restricted liquor sales.²²² Taxpayers argued that the denial of the deduction violated their First Amendment rights because the denial was based on the content of their speech.²²³ The Court rejected this argument and found that the taxpayers were “not being denied a tax deduction because they [were] engag[ing] in constitutionally protected activities, but [were] simply being required to pay for those activities entirely out of their own pockets.”²²⁴ The Court recognized that the denial of a tax deduction for amounts expended to promote or defeat legislation was plainly not “aimed at the suppression of dangerous ideas.”²²⁵

The Court revisited *Cammarano* in the exempt organization context in *Regan v. Taxation With Representation*.²²⁶ Taxation With Representation (TWR) was a nonprofit organization that sought tax-exempt status under section 501(c)(3) of the Code.²²⁷ TWR acknowledged that a major component of its activities would consist of attempting to influence legislation.²²⁸ It sought section 501(c)(3) status despite the fact that 501(c)(3) specifically prohibits organizations from attempting to influence legislation.²²⁹ TWR claimed that the prohibition against substantial lobbying was unconstitutional under the First and Fifth Amendments.²³⁰

The Court recognized that TWR was not just seeking the right to lobby, but was explicitly seeking a subsidy in the form of a tax benefit for its lobbying activities.²³¹ The Court stressed that both tax exemptions and tax deductibility are a form of subsidy that are administered through the tax code.²³² The Court concluded that

²²² *Id.* at 500-02.

²²³ *Id.* at 512-13.

²²⁴ *Id.* at 513.

²²⁵ *Id.* (quoting *Speiser v. Randall*, 357 U.S. 513, 519 (1958)).

²²⁶ *Regan v. Taxation With Representation*, 461 U.S. 540 (1983).

²²⁷ *Id.* at 541-42. The exemption under § 501(c)(3) is far more advantageous than an exemption under §§ 501(c)(4) or 527 because donations to a § 501(c)(3) organization are deductible by the donor under § 170. I.R.C. § 170 (2000). Contributions to § 501(c)(4) or § 527 organizations are not deductible by the donor, but the contributions are not taxable as income to the exempt organization. I.R.C. §§ 170, 501(c)(3), 501(c)(4).

²²⁸ *Regan*, 461 U.S. at 541-42.

²²⁹ *Id.* at 542-43.

²³⁰ *Id.* at 542.

²³¹ *Id.* at 543-44.

²³² *Id.* at 544.

Congress did not deny TWR the right to receive deductible contributions for other purposes, nor did it deny TWR any independent benefit on account of its intention to lobby.²³³ Instead, Congress “merely refused to pay for the lobbying out of public monies.”²³⁴ The Court rejected TWR’s assertion that it had a right to section 501(c)(3) status and concluded that “[w]e again reject the ‘notion that First Amendment rights are somehow not fully realized unless they are subsidized by the State.’”²³⁵

In reaching this conclusion, the Court recognized that the situation would be different if Congress discriminated invidiously in the subsidies in such a way as to “aim at the suppression of dangerous ideas.”²³⁶ But the Court concluded that the action here regulated entities “regardless of the content of any speech they may use.”²³⁷ The Court noted that there was “no indication that the statute was intended to suppress any ideas or any demonstration that it has had that effect.”²³⁸ Furthermore, the Court explicitly rejected the notion that strict scrutiny applies whenever “Congress subsidizes some speech, but not all speech.”²³⁹

In *Cammarano* and *Regan*, the Court upheld conditions that Congress placed on tax subsidies.²⁴⁰ These conditions, however, were not content based, and they denied a benefit that was closely associated with the subsidy. In *Cammarano*, plaintiffs were not allowed to deduct business expenses that were spent on political advocacy,²⁴¹ and in *Regan*, tax-exempt entities were prohibited from lobbying.²⁴² The *Cammarano* plaintiffs did not lose their right to take all business deductions due to their political activities; they

²³³ *Id.*

²³⁴ *Id.* at 545.

²³⁵ *Id.* at 546 (quoting *Cammarano v. United States*, 358 U.S. 498, 515 (1959) (Douglas, J., concurring)).

²³⁶ *Id.* at 548 (citing *Cammarano v. United States*, 358 U.S. 498, 513 (1959), and quoting *Speiser v. Randall*, 357 U.S. 513, 519 (1985)).

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ *Id.* at 548-49.

²⁴⁰ *Id.* at 551; *Cammarano*, 358 U.S. at 513.

²⁴¹ 358 U.S. at 513.

²⁴² 461 U.S. at 545.

just lost the right to deduct the specific payments that were spent on political advocacy.²⁴³

Regan does not fit cleanly within the *Cammarano* rationale. Under the provision at issue in *Regan*, an entity could lose its 501(c)(3) status completely if it engaged in lobbying.²⁴⁴ An entity would not, as in *Cammarano*, merely lose its tax exemption for the specific funds it expended on lobbying.²⁴⁵ The penalty in *Regan* was broad and appears not to be narrowly tailored to remove only the subsidy at issue.

The Court nevertheless found the restriction on lobbying constitutional.²⁴⁶ In reaching this conclusion, the Court implicitly recognized that TWR had another outlet to exercise its First Amendment rights.²⁴⁷ Specifically, the Court noted that TWR's original structure of two separate organizations—a section 501(c)(3) organization that was mainly involved in educational activities and a section 501(c)(4) organization that was involved in influencing elections—allowed TWR to lobby.²⁴⁸ Under this structure, the section 501(c)(3) organization would receive tax deductible donations, and the section 501(c)(4) organization would not.²⁴⁹

²⁴³ *Cammarano*, 358 U.S. at 513. One could envision a statute that denied all ordinary and necessary business expense deductions to any business involved in political advocacy. I contend such a statute would be considered a "penalty" since the denial of the subsidy is overly broad and is not narrowly tailored to the specific behavior that the Government wishes not to subsidize.

²⁴⁴ *Regan* upheld the provision in section 501(c)(3) that prohibits 501(c)(3) organizations from having as a substantial part of their activities attempting to influence legislation. *Regan*, 401 U.S. at 541. Since that prohibition was upheld, an organization that attempts to influence legislation may lose its tax-exempt status. If an organization loses its tax-exempt status, its income would be subject to tax.

²⁴⁵ In *Cammarano*, the Court upheld regulations prohibiting the deduction of lobbying expenses under section 162 of the Code. The consequence of running afoul of this prohibition would be the expenses in question would not be deductible. 358 U.S. at 504-06.

²⁴⁶ *Regan*, 461 U.S. 550-51.

²⁴⁷ *Id.* at 544-45.

²⁴⁸ *Id.* at 543.

²⁴⁹ *Id.* The concurring opinion stressed that the escape valve of allowing a § 501(c)(3) organization to lobby through a § 501(c)(4) organization was essential in upholding the statutory scheme. *Id.* at 551-54 (Blackmun, J., concurring). But, the concurrence appears to ignore the fact that the § 501(c)(4) organization, like the § 527 organization, receives some subsidies from the Government in the form of a tax exemption, and that Congress also would have had the power to prohibit § 501(c)(4) organizations from lobbying.

In other words, TWR could organize its activities to avoid a broad sanction for lobbying. By separating into two organizations, TWR could ensure that it did not lose its entire tax exemption for engaging in lobbying. Under the scheme suggested by the Court, it could use donations that were not tax deductible to lobby through a section 501(c)(4) organization and use tax deductible donations for its education activities.²⁵⁰

A statutory scheme that involved an “opt-out” provision similar to the one in section 527 was examined by the D.C. Circuit in *American Society of Association Executives v. United States*.²⁵¹ Prior to 1993, lobbying expenses could be deducted as ordinary and necessary business expenses under section 162(e) of the Code.²⁵² In 1993, Congress amended section 162(e) to prohibit organizations from deducting lobbying expenses.²⁵³ However, Congress realized that exempt organizations—mainly political organizations under sections 501(c)(4) and 527—could be used as pass-through entities for lobbying expenses, thereby allowing lobbying expenses to be deductible.²⁵⁴ For example, the corporation could provide money to the exempt organization in the form of “membership fees.” These fees arguably would be deductible under section 162 as ordinary and necessary business expenses. The exempt organization could then use the funds to lobby Congress. Since the nonexempt organization could deduct its “membership fees” and the exempt organization could lobby, absent another change in the law, exempt organizations could become a conduit for providing a business deduction for lobbying expenses. Because this is exactly what Congress was trying to avoid, Congress also provided that the portion of dues paid to an organization that are attributable to the organization’s

²⁵⁰ *Id.* at 544.

²⁵¹ 195 F.3d 47 (D.C. Cir. 1999).

²⁵² Starting in approximately 1915, businesses were denied deductions for ordinary and necessary business expenses pursuant to Treasury Regulations. T.D. 2137, 17 Treas. Dec. Int. Rev. 48, 57-58 (1915). In 1962, Congress passed legislation allowing a deduction under § 162 for direct lobbying. Revenue Act of 1962, Pub. L. No. 87-834, § 3(a), 76 Stat. 960, 973 (1962).

²⁵³ Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13222, 107 Stat. 312, 477 (1993) (“OBRA of 1993”).

²⁵⁴ H.R. CONF. REP. NO. 103-213, reprinted in 1993 U.S.C.A.N. 1088, 1286; see also *Am. Soc’y of Ass’n Executives v. U.S.*, 23 F. Supp. 2d 64, 66-68 (D.D.C. 1998) (discussing deductibility of lobbying expenses).

lobbying expenses would not be deductible by the payor organization.²⁵⁵ Under the statutory scheme, the exempt organization is responsible for notifying the taxpayer about the amount of the membership dues that are not deductible pursuant to section 162(e)(3).²⁵⁶

Congress, perhaps recognizing the burden that these notice provisions placed on exempt organizations, also provided an alternative means by which an exempt organization could meet its obligations.²⁵⁷ Instead of notifying members of the portion of dues that are not deductible due to lobbying expenses, the organization could instead pay a "proxy tax"²⁵⁸ of thirty-five percent on the amount of such lobbying expenses. Presumably the proxy tax is equal to the benefit the payor organization receives when it is able to deduct the expense.²⁵⁹ If the exempt organization pays the proxy tax, the payor organization is entitled to deduct the entire amount of its membership dues.

The American Society of Association Executives (ASAE) did not notify members of the amount of membership dues that were spent on lobbying activities, and instead paid the proxy tax on the amount of lobbying expenses it incurred.²⁶⁰ ASAE then sued for a refund arguing that the statute violated the First Amendment.²⁶¹ The court rejected ASAE's First Amendment challenge, holding that in this case there was no burden on the First Amendment.²⁶² The court determined that ASAE could split its organization into two organizations: one that would engage in lobbying and one that would

²⁵⁵ I.R.C. § 162(e)(3) (2000); OBRA of 1993, 107 Stat. at 477.

²⁵⁶ I.R.C. § 6033(e)(1)(A)(ii).

²⁵⁷ See Lee A. Sheppard, *The New Etiquette of Lobbying*, 60 TAX NOTES 1176, 1179 (1993) (indicating that representatives of trade associations sought proxy tax because of their concern that notification provision would be very costly).

²⁵⁸ I.R.C. § 6033(e)(2)(A). This provision is referred to as the "proxy tax" because the exempt organization is incurring the tax liability as a proxy for its members' ability to deduct their membership dues.

²⁵⁹ This obviously is not a zero sum game in all instances. The corporate tax rate now ranges from 15% to 35% depending on the income of the corporation. I.R.C. § 11(b). The payor therefore receives a deduction at its marginal rate, and the exempt organization has to pay tax on that same amount at 35%.

²⁶⁰ *Am. Soc'y of Ass'n Executives v. United States*, 195 F.3d 47, 48 (D.C. Cir. 1999).

²⁶¹ *Id.*

²⁶² *Id.* at 52.

not.²⁶³ This would allow the organization that did not lobby the opportunity to receive deductible contributions, while denying that right to the other organization.²⁶⁴

It is unclear whether the possibility that ASAE could split into two organizations was necessary for the Government to prevail on the First Amendment issue, or whether the "proxy tax" provision was sufficient to create any necessary opt-out option. As far as the exempt organization is concerned, the proxy tax is an easier, less intrusive way of reaching the same result as splitting the organization into two. If the exempt organization notifies its members regarding the portion of dues that are not attributable to lobbying, the member may deduct that portion of the dues. Therefore, disallowing a deduction on the amount the corporation contributes has the same effect as it would have if ASAE split into two organizations.

Regan and *ASAE* indicate that the ability to opt-out of the regulatory structure without suffering a greater penalty than the denial of the subsidy is an important component of upholding a provision that uses the subsidy rationale in *Regan*. Having an opt-out provision and narrowly tailoring denial of the subsidy to the specific behavior the subsidy encourages are strong indicators that Congress is merely removing a subsidy and not instituting a penalty. A provision without such characteristics will have a greater chance of being characterized as a penalty.

For example, in *Speiser v. Randall*,²⁶⁵ the Court struck down a California law that conditioned a special property tax credit for veterans on the veteran's willingness to sign a declaration that he did "not advocate the overthrow of the Government of the United States or of the State of California by force or violence or other unlawful means."²⁶⁶ The Supreme Court of California construed this language as denying the tax exemptions only to taxpayers who engaged in speech that could be criminally punished consistent with the First Amendment, and for purposes of the case, the Court

²⁶³ *Id.* at 50.

²⁶⁴ *Id.*

²⁶⁵ 357 U.S. 513 (1958).

²⁶⁶ *Id.* at 515.

assumed that the California Supreme Court was correct.²⁶⁷ The Court, however, overturned the California constitutional provision holding that the procedures set forth were insufficient to protect a taxpayer's speech.²⁶⁸ According to the Court, the California constitutional amendment did not adequately protect a taxpayer's rights in that it placed the burden on the taxpayer to prove he had not engaged in improper speech.²⁶⁹ The Court reasoned that when "the right to speak is sought to be deterred by a State's general taxing program due process demands that the speech be unencumbered until the State comes forward with sufficient proof to justify its inhibition."²⁷⁰

While the *Speiser* decision appears to rest on very limited grounds—that there were not sufficient due process protections to justify the state policy—the decision was clearly intended to be much broader. In reaching its conclusion, the Court claimed that to deny a tax exemption to an otherwise eligible taxpayer solely because of his speech is in effect penalizing him for the speech.²⁷¹ While in *Speiser* such a penalty may have been warranted because the speech itself may have been unlawful, the Court nonetheless found that the state was using the denial of a tax deduction as a means of punishment.²⁷² The Court also noted that the denial of a tax exemption for engaging in certain speech "will have the effect of coercing the claimants to refrain from the proscribed speech."²⁷³ The Court then claimed that such a denial was aimed at "dangerous ideas."²⁷⁴

²⁶⁷ *Id.* at 519-20.

²⁶⁸ *Id.* at 528-29.

²⁶⁹ *Id.*

²⁷⁰ *Id.*

²⁷¹ *Id.* at 518.

²⁷² *Id.* at 519.

²⁷³ *Id.*

²⁷⁴ *Id.* In a series of cases, the Court also has rejected discriminatory taxes on newspapers, finding that these taxes burden rights protected under the First Amendment. See *Ark. Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 227 (1987) (holding Arkansas's tax on receipts from sales of tangible personal property violated First Amendment by exempting some, but not all, magazines). The Court believed the tax was particularly repugnant because the "magazine's tax status depend[ed] entirely on its content." *Id.* at 229; *Minneapolis Star & Tribune Co. v. Minn. Comm'r of Revenue*, 460 U.S. 575, 576 (1983) (finding that specific tax imposed only on cost of paper and ink used by newspapers violated First Amendment); *Grosjean v. Am. Press Co.*, 297 U.S. 233, 249 (1936) (stating tax on newspaper's gross receipts

The reasoning underlying the opinion in *Speiser* poses a significant problem for advocates of the subsidy approach to campaign finance. Since under *Speiser* the denial of a tax benefit can be a form of punishment,²⁷⁵ the denial of tax-exempt status can be seen as a punishment for engaging in political communication. But as we will see, *Speiser* was a general punishment for engaging in speech and was not merely the denial of a specific subsidy tied to a specific activity.²⁷⁶

The Court in *Regan* and *Cammarano* implicitly relied on the greater powers argument and distinguished *Speiser*, claiming that "petitioners are not denied a tax deduction because they engage in protected activities, but instead, are simply required to pay for the activities out of their own pockets."²⁷⁷ But this distinction is completely unsatisfying to anyone struggling with these cases.²⁷⁸ Clearly the denial of a subsidy that is conditioned upon the denial of a right still penalizes the person for engaging in that right.²⁷⁹ Besides pointing out that the "unconstitutional conditions" doctrine may be suspect²⁸⁰ or that the doctrine itself is inconsistently applied,²⁸¹ the fact that a provision is narrowly tied to the specific subsidy or provides a way to opt-out of the statutory scheme

from advertising, if newspaper's circulation exceeded 20,000, violated First Amendment); *But cf. Leathers v. Medlock*, 499 U.S. 439, 445 (1991) (holding Arkansas sales tax on receipts that exempted newspapers but not cable companies was constitutional).

²⁷⁵ *Speiser*, 357 U.S. at 519.

²⁷⁶ See *infra* notes 302-10 and accompanying text.

²⁷⁷ *Cammarano v. United States*, 358 U.S. 498, 513 (1959).

²⁷⁸ See George Cooper, *The Tax Treatment of Business Grassroots Lobbying: Defining and Attaining the Public Policy Objectives*, 68 COLUM. L. REV. 801, 837 (1968) (arguing subsidy rationale in *Cammarano* is unsatisfying because both denial of deduction and imposition of tax restrict free speech and act as penalty for that speech); Epstein, *supra* note 135, at 76-80 (explaining that provisions in *Regan* do not create distortion in political process and that statute covers full range of activities without subject matter or viewpoint discrimination); Robert C. Post, *Subsidized Speech*, 106 YALE L.J. 151, 174-75 (1996) ("The doctrines have become formalistic labels for conclusions, rather than useful tools for understanding.")

²⁷⁹ *But see* Epstein, *supra* note 135, at 4-8 (asking why there should be any limitation on scheme that rests on consent of individual whose rights are infringed).

²⁸⁰ See TRIBE, *supra* note 135, at 681 (indicating unconstitutional conditions doctrine has been somewhat eroded); Cass R. Sunstein, *Why the Unconstitutional Conditions Doctrine is an Anachronism*, 70 B.U. L. REV. 593, 620 (1990) (indicating unconstitutional conditions doctrine has been somewhat eroded).

²⁸¹ See Post, *supra* note 278, at 152 (stating doctrines have become formalistic labels for conclusions).

furnishes another rationale for distinguishing *Speiser*, where there was a penalty, from *Regan* and *Cammarano*, where there was not.

In a series of cases since *Speiser*, the Supreme Court appears to be relying on whether an individual or organization has an alternative means of engaging in nonsubsidized speech. For example, in *Rust v. Sullivan*,²⁸² the Court indicated that the Government may limit speech, even in a content-specific way, as long as the Government provides a benefit to the recipient and the recipient has an alternative means of receiving the information.²⁸³

Rust involved a statute that prohibited organizations that received Government family planning funds from discussing abortion as an option.²⁸⁴ The Court noted that the failure to grant a subsidy for speech was not a penalty; it was merely a decision by the Government not to subsidize specific speech.²⁸⁵ But central to the Court's decision that the statute was a subsidy and not a penalty was that the health organization could still provide counseling about abortion through a separate entity that did not receive federal funds.²⁸⁶ This opt-out would allow the Government to guarantee that its funds were not being used for an unintended purpose, while still ensuring that abortion as a family planning viewpoint was not restricted. The Court relied on this distinction despite the fact that requiring that a separate entity be formed to provide the additional viewpoint is quite an onerous undertaking.²⁸⁷

²⁸² 500 U.S. 173 (1991).

²⁸³ *Id.* at 196; see also *Posadas de P.R. Assocs. v. Tourism Co.*, 478 U.S. 328, 347-48 (1986) (validating law conditioning permission of casino to operate on its acceptance of advertizing restrictions); David Cole, *Beyond Unconstitutional Conditions: Charting Spheres of Neutrality in Government-Funded Speech*, 67 N.Y.U.L. REV. 675, 685 (1992) (explaining *Rust* analysis in unconstitutional conditions framework); Christina E. Wells, *Abortion Counseling as Vice Activity: The Free Speech Implications of Rust v. Sullivan and Planned Parenthood v. Casey*, 95 COLUM. L. REV. 1724, 1726 (1995) (explaining *Rust* by looking at counseling as activity rather than speech).

²⁸⁴ *Rust*, 500 U.S. at 193.

²⁸⁵ *Id.*

²⁸⁶ *Id.* at 196.

²⁸⁷ The right to condition benefits appears to be even stronger in the tax context where Congress is granted great leeway in designing a taxation scheme. See U.S. CONST. amend. XVI ("The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.") (emphasis added); see also *Leathers v. Medlock*, 499 U.S. 439, 451 (1991) ("Inherent in the power to tax is the power to discriminate in taxation."); *Regan v. Taxation With Representation*, 461 U.S. 540, 547 (1983) ("Legislatures have especially broad

Since there was still an outlet to engage in unsubsidized communication regarding abortion, the organization was not penalized for engaging in such speech.²⁸⁸

The Court took a different approach when the subsidy component could not be severed from the nonsubsidy component. For example, in *Legal Services Corp. v. Velazquez* ("LSC"),²⁸⁹ the Court struck down a funding provision limiting a Legal Services Corporation lawyer from challenging existing welfare laws.²⁹⁰ Under the Legal Services Corporation Act, a Legal Services attorney could represent poor individuals in suits challenging the denial of welfare benefits, but the attorney could not challenge the validity of existing laws.²⁹¹ The Court struck down the provision, holding that Congress "may not design a subsidy to effect this serious and fundamental restriction on advocacy of attorneys and the functioning of the judiciary."²⁹²

Although the Court distinguished *Rust* from *LSC* based on a public/private speech distinction (in *Rust* the organization was speaking for the Government while in *LSC* the lawyer was representing a client),²⁹³ that distinction is unsatisfying in this context. The Legal Services lawyer satisfies the Government's interest in providing legal representation to the poor, just as the medical provider in *Rust* satisfies the Government's interest in providing family planning options to the poor. In neither case was the recipient actually speaking for the Government.²⁹⁴

latitude in creating classifications and distinctions in tax statutes."); *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 430 (1955) (recognizing "the intention of Congress to tax all gains except those specifically exempted").

²⁸⁸ Similar analysis was used by the Court in *Regan*. 461 U.S. at 544 (reasoning that § 501(c)(3) organization could still lobby through § 501(c)(4) organization).

²⁸⁹ 531 U.S. 533 (2001).

²⁹⁰ *Id.* at 538; see also *FCC v. League of Women Voters*, 468 U.S. 364, 400-01 (1984) (finding that broadcasting station could not segregate its activities with respect to source of their funding and therefore finding challenged provision unconstitutional).

²⁹¹ *LSC*, 531 U.S. at 536-37.

²⁹² *Id.* at 544.

²⁹³ *Id.* at 541-43.

²⁹⁴ See *id.* at 554 (Scalia, J. dissenting) ("If the private doctors' confidential advice to their patients at issue in *Rust* constituted 'government speech,' it is hard to imagine what subsidized speech would *not* be government speech. Moreover, the majority's contention that the subsidized speech in these cases is not government speech because the lawyers have a professional obligation to represent the interests of their clients founders on the reality that the doctors in *Rust* had a professional obligation to serve the interests of their patients.").

To the extent that *Rust* can be distinguished from *LSC*, the more important distinction is that between the advisor's ability to provide abortion counseling absent the subsidy in *Rust*, and the inability of the lawyer to do so in *LSC*. The client in *Rust* could still receive significant information from the clinic, she just could not receive all the information she might need or want. She could, however, according to the Court, find that information elsewhere.²⁹⁵ As the Court noted in *LSC*, "[T]he patient in *Rust* was not required to forfeit the Government-funded advice when she also received abortion counseling through alternative channels."²⁹⁶ While it is debatable whether alternative channels really existed, since women visiting family planning clinics may not have been in a position either economically or emotionally to obtain additional information, the Government's subsidy of only some of the necessary information did not prevent alternative channels of information.

By contrast, in *LSC*, the restrictions at issue prevented the attorney from providing fair representation to the client. The client could not bifurcate her representation by having one attorney represent her nonconstitutional claim and another represent her constitutional claim. The restriction at issue completely eliminated the client's ability to receive adequate representation.²⁹⁷

It is this opt-out, or the ability to receive both the subsidized and nonsubsidized information, that saves section 527's disclosure provisions from constitutional challenge and distinguishes the subsidy in *Regan* from the penalty in *Speiser*.²⁹⁸ In *Regan* as in *Rust*, the section 501(c)(3) organization was not completely prohibited from speaking, but instead could create a non-501(c)(3) entity as an outlet for its speech.²⁹⁹ It could opt-out of the regulatory scheme and ensure that the Government benefit only went to speech that did not involve lobbying.³⁰⁰ *Speiser*, on the other hand, could

²⁹⁵ *Rust v. Sullivan*, 500 U.S. 173, 196 (1991).

²⁹⁶ *LSC*, 531 U.S. at 547.

²⁹⁷ *Id.* at 546-47 ("Thus, with respect to the litigation services Congress has funded, there is no alternative channel for expression of the advocacy Congress seeks to restrict.").

²⁹⁸ See Fudenberg, *supra* note 132, at 399-402 (distinguishing *Regan* from *Speiser* based on fact that *Regan* deals with exclusion of benefit while *Speiser* deals with waiver of right).

²⁹⁹ *Rust v. Sullivan*, 500 U.S. 173, 177-98 (1991); *Regan v. Taxation With Representation*, 461 U.S. 540, 544 (1983).

³⁰⁰ *Rust*, 173 U.S. at 197-98; *Regan*, 461 U.S. at 544.

not opt-out of the regulatory scheme.³⁰¹ He could not accept the tax deduction based on his veteran's status and create a separate entity with which to express his views against the Government. Speiser could not bifurcate his speech, nor seek a deduction based on the ratio of unoffending to offending speech. The ability to opt-out of the regulatory structure and still engage in nonsubsidized speech is, therefore, one factor that indicates a provision is a subsidy and not a penalty.

E. CONGRESS CANNOT ATTEMPT TO USE THE SUBSIDY RATIONALE IN REGANTO REGULATE THE SPECIFIC CONTENT OF THE SPEECH

Another factor for considering whether a subsidy or penalty exists is whether the statute attempts to regulate the specific content of the speech. The statutory scheme at issue in *Speiser* was designed to limit a particular type of speech, specifically speech that advocated the overthrow of the Government.³⁰² On its most simple terms, the statute at issue in *Speiser* was aimed at the content of the speech. It was in no way content neutral, and it was aimed at the suppression of "dangerous ideas."³⁰³ In the section 527 context, the Government is not attempting to regulate the content of the speech of the exempt entity. Instead, it is trying to ensure that only well-regulated political organizations receive tax benefits. When Congress originally passed the provision providing for tax-exempt status for political organizations, Congress did so because it believed that political organizations were essential to the political process

³⁰¹ *Speiser v. Randall*, 357 U.S. 513, 514-15 (1958).

³⁰² *Id.* at 514-17.

³⁰³ *Id.* at 519. Compare *Rosenberger v. Rector & Visitors*, 515 U.S. 819, 834 (1995) (determining that University of Virginia's decision not to fund student organizations that engage in religious speech was viewpoint discrimination that violated First Amendment), with *Regan v. Taxation With Representation*, 461 U.S. 540, 548 (1983) (denying that subsidy for lobbying is aimed at suppressing dangerous ideas). *Rosenberger* distinguished *Regan* based on the fact that denying a tax benefit for lobbying is not viewpoint discrimination. *Rosenberger*, 515 U.S. at 834. See generally Jeffrey VanHooreweghe, *Legal Services Corporation v. Velazquez: The Supreme Court's Missed Opportunity to Clarify the Viewpoint Discrimination Doctrine's Role in Subsidized Speech Cases*, 50 CATH. U. L. REV. 539 (2001) (discussing Supreme Court's viewpoint discrimination adjudication in subsidized speech cases).

and deserved a tax exemption.³⁰⁴ Congress was not required to provide the tax exemption to political organizations. Just as Congress had the authority to provide a benefit to political organizations, it also has the authority to determine that it will provide that benefit only when those organizations are regulated, make public disclosures, and are accountable to the citizenry.³⁰⁵ There is no evidence that one particular party or organization receives a disproportionate benefit under section 527. Elimination or regulation of exempt entities therefore may have been aimed at undisclosed, politically motivated speech but it was not aimed at a particular idea.

This distinction undoubtedly will be unsatisfactory to some since the First Amendment covers not only content-based regulation, but also governs the prohibition of public discussion of an entire topic.³⁰⁶ It could be argued that the changes in section 527 are intended to limit public discussion during political campaigns. But the Court seems to be moving away from such a strict interpretation of viewpoint/topic regulation.³⁰⁷ Unlike the newspaper cases cited above,³⁰⁸ section 527 does not penalize speech on a particular topic and is not designed to suppress particular ideas. Any exempt political organization engaging in speech to influence an election must disclose its contributors and expenditures, or pay tax on the undisclosed amounts.³⁰⁹ There is no attempt to penalize entities based on either the viewpoint of the organization or the topic it seeks to discuss. The organization simply loses the benefit of its exempt status on contributions and expenditures it chooses not to disclose.³¹⁰

³⁰⁴ S. REP. NO. 93-1357, at 25-27 (1974), *reprinted in* 1975 U.S.C.C.A.N. 7478, 7502.

³⁰⁵ *Lewis Publ'g Co. v. Morgan*, 229 U.S. 288, 312-16 (1913).

³⁰⁶ *FCC v. League of Women Voters*, 468 U.S. 364, 384 (1984).

³⁰⁷ *See Leathers v. Medlock*, 499 U.S. 439, 453 (1991) ("[D]ifferential taxation of speakers, even members of the press, does not implicate the First Amendment unless the tax is directed at, or presents the danger of suppressing, particular ideas."); *Regan*, 461 U.S. at 548 (differential tax treatment of lobbying by charities and veterans' groups was constitutional since there was no showing that statute was intended to suppress dangerous ideas).

³⁰⁸ *See supra* note 274 (citing newspaper cases).

³⁰⁹ I.R.C. § 527(b), (c), (j) (2000).

³¹⁰ I.R.C. § 527(j).

Similarly, general tax statutes that impact the delivery of speech do not violate the First Amendment as long as they are not designed to suppress specific ideas or content. In *Leathers v. Medlock*³¹¹ the Court considered, once again, the conflict between taxation statutes and the First Amendment. *Medlock* involved a slightly different legal question than the one at issue in *Cammarano*, *Regan*, and *ASAE*. In *Medlock*, the question was whether the denial of an exemption to cable operators from an Arkansas sales tax violated the First Amendment.³¹² The cable companies argued that their expressive activities were protected by the First Amendment and that Arkansas's sales taxation of cable services violated the First and Fourteenth Amendments because newspapers, magazines, and satellite broadcast services are exempt from sales taxation.³¹³

While recognizing that cable broadcasts were speech under the First Amendment, the Court noted that a tax that discriminates among speakers is constitutionally suspect only in certain circumstances.³¹⁴ Specifically, the Court noted that in several cases it found taxes specifically directed at the press to be in violation of the First Amendment,³¹⁵ but that this particular tax neither singled out the press for special treatment nor applied exclusively to the press.³¹⁶ The Court stressed that differential taxation of First Amendment speakers is suspect when it attempts to suppress the "expression of particular ideas or viewpoints" or the "content of taxpayer speech."³¹⁷ The Court concluded that "differential taxation of speakers, even members of the press, does not implicate the First Amendment unless the tax is directed at, or presents the danger of suppressing, particular ideas."³¹⁸

³¹¹ 499 U.S. 439 (1991).

³¹² *Id.* at 441-42.

³¹³ *Id.* at 442-43.

³¹⁴ *Id.* at 444.

³¹⁵ See *Minneapolis Star & Tribune Co. v. Minn. Comm'r of Revenue*, 460 U.S. 575, 592-93 (1983) (holding that tax on cost of paper and ink over \$100,000 consumed in production of publications violated First Amendment); *Grosjean v. Am. Press Co.*, 297 U.S. 233, 250-51 (1936) (finding tax on publications with weekly circulations above 20,000 unconstitutional).

³¹⁶ *Medlock*, 499 U.S. at 444-47.

³¹⁷ *Id.* at 447.

³¹⁸ *Id.* at 453.

The lesson from *Cammarano*, *Regan*, *Medlock*, and *Speiser* is that the conferral of tax-exempt status is not a right, but a privilege that the Government may condition upon meeting certain requirements. This ability to condition a benefit is not absolute, but as long as the Government does not attempt to suppress “dangerous ideas” and an individual or entity still has an ability to “speak” in some forum, the taxation scheme will survive First Amendment scrutiny.

Under this line of reasoning, the Government could condition an organization’s tax-exempt status on the organization’s acceptance of a regulatory scheme requiring disclosure of contributors and expenditures. Any provision relying on the tax benefit doctrine to regulate exempt entities should have the following attributes:

- 1) A concrete tax benefit must be available to organizations that file, and are granted, section 527 status and agree to be bound by the disclosure provisions in section 527;
- 2) The denial of the subsidy at issue must be narrowly tailored to the benefit received or the provisions must provide a clear opt-out option for entities that choose not to accept the subsidy; and
- 3) The statute must not attempt to regulate the specific content of the speech.³¹⁹

Since Congress could draft a statute that meets the above requirements, Congress has the power to use the subsidy rationale in *Regan* to regulate political organizations.³²⁰

³¹⁹ Although some may question whether the tax benefit may be denied solely based on the content of the speech, it appears from *Rust* that as long as an unsubsidized forum is available, the Government can condition a benefit based on content. *Rust v. Sullivan*, 500 U.S. 173, 192-200 (1991). In *LSC*, the Court implies that *Rust* can be distinguished because in that case the speaker was acting on behalf of the Government. *Legal Servs. Corp. v. Velazquez*, 531 U.S. 533, 540-49 (2001). For an alternative explanation, see Post, *supra* note 278, at 174-75, which argues that the decision in *Rust* can be seen as regulation of speech within managerial domains. However, Post rejects the regulation as lacking justification even under the lower standard he argues applies to speech within managerial domains. Post, *supra* note 278, at 174-75.

³²⁰ See *supra* note 127 and accompanying text (discussing *Regan* subsidy rationale).

F. POLITICAL ORGANIZATION'S EXEMPT STATUS MAY BE CONDITIONED ON AN ENTITY'S WILLINGNESS TO COMPLY WITH A REGULATORY SCHEME

Since section 527 political organizations do in fact receive a tax subsidy based on their exempt status, the disclosure provisions in section 527 should be upheld under the subsidy rationale in *Regan* as long as the statutory framework operates constitutionally to condition the subsidy based on an entity's willingness to comply with regulatory requirements.

1. *Current 527 Framework.* The disclosure provisions contained in section 527 are designed to comply with the subsidy rationale in *Regan*. It is unclear, however, whether section 527 as amended provides a sufficient opt-out procedure, if it provides one at all, to survive constitutional challenge.³²¹ According to the Government, under section 527(i),³²² an organization is not treated as a political organization unless it files a notice with the Secretary of Treasury.³²³ This notice provision creates two types of organizations, those that notify the Secretary (opt-in) and those that do not (opt-out). An organization that opts out presumably is not a political organization and is not subject to the disclosure provisions; instead its contributions and expenditures are subject to tax under subsection (i)(4).³²⁴

³²¹ In *NFRA*, the district court concluded that there was a sufficient opt-out procedure for the contribution disclosure provisions to be upheld under the *Regan* analysis. *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300, 1319-20 (2002). The court took a very different approach with regard to the expenditure disclosure provisions. *Id.* at 1320. The court recognized that under subsection (j), an exempt organization that failed to disclose its contributions and expenditures could incur a penalty (or a tax) greater than its income. *Id.* Specifically, an organization that failed to disclose both its contributions and expenditures would be subject to a penalty of 57%. The court believed that subsection (j) as it applied to expenditures went beyond merely withdrawing a tax subsidy, since the amount the exempt organization was required to pay exceeded the amount of the subsidy. *Id.* at 1320-21. The court therefore concluded that the First Amendment analysis in *Buckley v. Valeo*, and not the subsidy analysis in *Regan v. Taxpayers With Representation*, applied. *Id.* at 1322.

³²² I.R.C. § 527(i) (2000).

³²³ Brief of the United States of America in Support of Its Motion to Dismiss at 4-6, *Nat'l Fed'n of Republican Assemblies v. United States*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C).

³²⁴ I.R.C. § 527(i)(4) (2000). Under subsection (i)(4), if an organization fails to notify the Secretary that it is a political organization, the taxable income of such an organization includes its exempt function income as well as any deductions directly associated with the

If an organization opts in, it has a further choice of disclosing all contributions and expenditures or only disclosing specific ones.³²⁵ Those that choose to disclose all contributions and expenditures are not taxed on their exempt function income (*i.e.*, the contributions and expenditures are not included in income).³²⁶ Those that choose to opt-in but not to disclose all contributions or expenditures are subject to tax, also referred to as a penalty, on those contributions and expenditures that the political organization chooses not to disclose.³²⁷

The Government's reading of the statute generally fits within the subsidy rationale in *Regan*. Under the Government's interpretation, entities have two different ways by which they can opt-out of the regulatory scheme, and the consequence of doing so is merely the denial of a tax exemption, either in whole or in part.³²⁸ Its interpretation that political organizations have a choice whether to comply with the disclosure provisions is weakened by the fact that subsection (j)(1) is described as a "penalty for failure" to comply and does not, on its face, appear to be merely an opt-out provision.³²⁹

production of such income. *Id.* In addition, payments to such an organization presumably would not be exempt from gift tax under § 2501(a)(5) because such an organization would not be a political organization within the meaning of § 527(e)(1). See I.R.C. § 2501(a)(5) (stating that gift tax does not apply to transfer of money to political organization). *But see* Simmons, *supra* note 71, at 98 (arguing that these payments may not be gifts, but instead are purchases of services with value equal to contributions).

³²⁵ Brief of the United States of America in Support of Its Motion to Dismiss at 4-5, Nat'l Fed'n of Republican Assemblies v. United States, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C).

³²⁶ *Id.*

³²⁷ The Code provides that if an organization fails to make a disclosure required by subsection (j)(1), the organization shall pay an amount equal to the highest corporate tax rate multiplied by the amount to which the failure relates. I.R.C. § 527(j)(1). The highest corporate rate is currently 35%. I.R.C. § 11(b).

³²⁸ Brief of the United States of America in Support of Its Motion to Dismiss at 4-5, Nat'l Fed'n of Republican Assemblies v. United States, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C).

³²⁹ I.R.C. § 527(j)(1). Regardless of the section heading, subsection (j)(1) operates in a similar manner as the "proxy tax" discussed above in *American Society of Association Executives v. United States*, see *supra* notes 251-60 and accompanying text, and operates as a mechanism for allowing exempt organizations to receive contributions even though those contributions are not disclosed. Moreover, even if subsection (j) is a penalty provision, the penalty applies only to organizations that opt into the regulatory scheme in § 527. The organization still has an opt-out option since it can decline to file with the Secretary and pay a tax based on subsection (i)(4).

The language in subsection (j)(1)(A) also implies that the disclosures are required and not merely a choice.³³⁰ If these disclosures are required, then opt-in organizations may be subject to criminal penalties for failure to provide information required by the Internal Revenue laws.³³¹

The Government's argument is also somewhat weakened by the fact that opt-in organizations must pay tax on both undisclosed contributions *and* expenditures.³³² On first blush, the taxation of expenditures appears contrary to merely requiring contributions to be included in income and appears to be more of a penalty than the denial of a subsidy. Although taxing both contributions and expenditures can create a very high tax rate,³³³ it is very unlikely that an organization would be subject to tax on both its contributions and expenditures.

In the first instance, organizations that choose under subsection (i) not to identify themselves as political organizations are taxed on their exempt function income.³³⁴ Exempt function income includes

³³⁰ See I.R.C. § 527(j)(1)(A); see also *Nat'l Fed'n of Republican Assemblies v. United States*, 148 F. Supp. 2d 1273, 1281 (S.D. Ala. 2001) (finding that requirements in § 527(j) are not optional). Except for organizations exempted by the statute, all political organizations are required to file the notice with the Secretary. Rev. Rul. 2000-49, 2000-2 C.B. 430 (Oct. 12, 2000). But recent statements by the IRS indicate that the disclosure provisions are optional. See I.R.S. Notice 2002-34, 2002-21 I.R.B. 990 ("To be tax-exempt, a political organization . . . must file Form 8871."); I.R.S. Fact Sheet FS 2002-11 (May 2002) ("The filing requirements . . . apply to those political organizations that . . . wish to be exempt from federal income tax provisions.").

³³¹ If an organization is required to make a disclosure and fails to do so, the Government may seek criminal penalties under § 7203. See I.R.C. § 7203 (noting that willful failure to file return, supply information, or pay tax may result in criminal penalties); see also *Nat'l Fed'n of Republican Assemblies*, 148 F. Supp. 2d at 1279 (finding that subsection (j) operates as penalty, not tax). The district court in *NFRA* recognized, however, that the Government claimed that "section 7203 does not apply to Section 527(j) [and that] Section 527(j) effectively establishes that it will not be used to sanction nondisclosing political organizations." *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300, 1322 (S.D. Ala. 2002).

³³² I.R.C. § 527(j) (2000).

³³³ Plaintiffs in *NFRA* contend that this creates a 70% tax (*i.e.*, 35% on contributions and 35% on expenditures). Plaintiff's Opposition to Defendant's Motion to Dismiss at 7, *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300 (S.D. Ala. 2002) (No. 00-0759-RV-C). The statute actually creates an effective tax rate of 57.75%. For example, if an organization fails to disclose both contributions and expenditures, the first \$100 it receives will be taxed at 35% causing the organization to pay a tax of \$35. Once the remaining \$65 is spent, the organization must once again pay tax on that amount, causing a tax of \$22.75. The total tax on the \$100 will be \$57.75, not \$70.

³³⁴ I.R.C. § 527(i)(4) (2000).

contributions to the organization but it does not include expenditures.³³⁵ Thus, an organization that wishes to be completely anonymous can do so, and it will not be subject to tax on its expenditures. Under subsection (i)(4) it will only be taxed on its income.³³⁶ This provides a mechanism by which an organization can avoid disclosure and simply lose the benefit of its exempt status.³³⁷

If an organization chooses to disclose some contributions and expenditures but not others, the organization is subject to tax treatment under subsection (j).³³⁸ It is subsection (j) that provides a tax at the highest corporate rate for any undisclosed contributions or expenditures.³³⁹ But this provision applies in the context of an organization that is seeking the benefit of exempt status but chooses not to disclose specific contributions or expenditures. If expenditures were not subject to tax, an organization could use this partial disclosure method to obfuscate the provision's purpose.

If expenditures were not subject to tax, an organization could file with the Secretary as a section 527 political organization. It could then disclose all of its contributions under subsection (j), but none of its expenditures. Absent section 527(j)(1), the organization would succeed in being exempt from tax because its contributions were disclosed and would not be subject to tax. The organization could remain anonymous because its expenditures were not disclosed, and it would be difficult, if not impossible, to determine what political advocacy the organization funded. The tax on expenditures ensures that if an organization chooses to comply with section 527, it cannot avoid the disclosure provisions by disclosing all contributions and no expenditures.³⁴⁰

³³⁵ I.R.C. § 527(c)(3).

³³⁶ I.R.C. § 527(i)(4).

³³⁷ The district court in *NFRA* rejected this logic, stating, "Even indulging the generous assumption that political organizations will routinely and repeatedly weigh the risk of a penalty exceeding their tax exemption if they do give notice against the risk of unnecessarily forfeiting a tax exemption if they do not, mistakes will certainly be made in these predictions." *NFRA*, 218 F. Supp. 2d at 1321. The fact that some exempt organizations will not choose correctly does not vitiate the fact that they had a choice.

³³⁸ I.R.C. § 527(j)(1) (2000).

³³⁹ *Id.*

³⁴⁰ To the extent that the expenditures are from funds that were tax exempt (*i.e.*, the organization disclosed some contributions, but did not disclose its expenditures), taxing expenditures might be justified on the same grounds as denying an ordinary and necessary

Finally, under the alternative theory that views section 527(i) as the opt-out provision and subsection (j) as an enforcement provision of subsection (i), many of the concerns discussed above do not apply. Although the Government has argued that subsection (j) provides exempt organizations with a choice whether to disclose or not,³⁴¹ it also can be seen as an enforcement mechanism applicable to organizations that choose to opt into the regulatory structure. The statute as written provides that an organization may opt into the statutory framework by filing with the Secretary, or it may opt-out and pay tax on its income.³⁴² If it opts in, it is then subject to the disclosure requirements. Under this theory, subsection (j) is not an attempt to provide more options, but instead can be seen as a provision to enforce the original decision to opt-in or not. Once an organization chooses the benefit of tax-exempt status, it must disclose. Subsection (j) merely enforces disclosure and requires that organizations that fail to disclose must pay the amount established in subsection (j).³⁴³ If this analysis is correct, section 527 meets the subsidy rationale because the subsidy is being conditioned upon an organization's willingness to comply with the regulatory structure. Organizations that are not willing to comply must pay a tax under subsection (i)(4). Organizations that are willing to do so are exempt.

business deduction for political expenses. Expenditures of the exempt organization are similar to the ordinary and necessary business expenses incurred by other corporations, and other corporations are not allowed to deduct these payments. If expenditures are derived from income that was not subject to tax, absent taxing expenditures, the exempt organization could pay for its political work with tax-exempt undisclosed funds. This is exactly what the disallowance of the deduction of ordinary and necessary business expenses prohibits other businesses from doing. The taxation of expenditures can therefore be seen as necessary to obtain symmetry with the Code provisions that prohibit deductions as ordinary and necessary business expenses. If businesses cannot obtain deductions for these expenditures, exempt organizations should not get the same benefit when they fail to disclose the expenditures.

³⁴¹ Brief of the United States of America in Support of Its Motion to Dismiss at 4-5, *Nat'l Fed'n of Republican Assemblies v. United States*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C).

³⁴² I.R.C. § 527(i) (2000). An organization that wishes to opt-out is not required to notify the IRS of that choice. *Id.* All organizations that file to opt-in are subject to tax. *Id.*

³⁴³ If Congress did not require some type of penalty on undisclosed expenditures under subsection (j), § 527 organizations could obfuscate the purposes of the Act by disclosing all contributions and no expenditures. It often is unhelpful to know who funds an organization if one does not know who the organization supports. This problem is partially rectified by FCC rules that require political television advertisements to carry the name of the sponsor of the advertisement. 47 U.S.C. § 317 (2000); 47 C.F.R. § 73.1212 (2001).

Subsection (j) merely deals with organizations that agree to comply with the statute, but then do not do so. In that instance, the penalty may exceed the amount of the subsidy. If it did not, all organizations would choose to be exempt under subsection (i)(4) and then not disclose under subsection (j).

2. *Where There Is a Will There Is a Way.* In its attempt to avoid the First Amendment problems associated with *Buckley* and require disclosure of what it saw as abusive attempts to obfuscate campaign finance regulations, Congress created a new, complex campaign regulatory scheme within the tax code. Sponsors of the amendment believed that by placing these provisions in the Code, they could avoid constitutional problems.³⁴⁴ In doing so, they created other problems. They rested the validity of the statute on the subsidy rationale in *Regan*, but failed to clearly justify the existence of a subsidy. They neither established that entities involved were originally properly subject to tax, nor that the statute really operated as a decision to withhold a subsidy. Opponents of the provision have, therefore, been able to argue that the provision does not fit within the *Regan* subsidy framework.³⁴⁵

But the overarching question is not whether this particular statute does what it is supposed to do, but whether a statute could be written to achieve the reformers' goals.³⁴⁶ Although I believe section 527, if properly interpreted, could withstand constitutional attacks, Congress could design a statute that more clearly achieves the reformers' objectives. In considering a new taxation scheme, Congress should clarify (1) the tax benefits received by tax-exempt political organizations, (2) that an option exists to opt-out of the taxation scheme, and (3) that criminal penalties do not apply.

³⁴⁴ 146 CONG. REC. S5996 (daily ed. June 29, 2000) (statement of Sen. Lieberman); 146 CONG. REC. S6000 (daily ed. June 29, 2000) (statement of Sen. Feingold); 146 CONG. REC. S996 (daily ed. June 29, 2000) (statement of Sen. McCain); 146 CONG. REC. H5289 (daily ed. June 27, 2000) (statement of Rep. Haughton).

³⁴⁵ *Nat'l Fed'n of Republican Assemblies*, 218 F. Supp. 2d 1300, 1312-15 (S.D. Ala. 2002).

³⁴⁶ For a discussion of conditional federal spending and federal powers, see Albert J. Rosenthal, *Conditional Federal Spending and the Constitution*, 39 STAN. L. REV. 1103, 1123-27 (1987).

To reach this goal, Congress should take the following steps:

- 1) The Code should be amended to clarify that gross income under section 61 includes payments received by an organization in furtherance of the organization's causes.³⁴⁷ Section 102 also could be amended to clarify that these payments are not gifts. Amending sections 61 and 102 will clarify the tax baseline and eliminate any question whether the exempt status of the political organization provides a subsidy to the organization.³⁴⁸
- 2) Congress should create a second type of political entity deemed a political corporation. This entity would be taxable as a corporation, but would be prohibited from having shareholders or paying dividends. It would be a hybrid between the exempt political organization and a classic subchapter C corporation.³⁴⁹ The entity would be the organizational form for all organizations involved in political advocacy, broadly defined, that choose either not to file as a section 527 organization or do not come within the definition of a political organization under section 527. These organizations would be taxed on payments to the organization as income and would not be able to deduct payments on political advertise-

³⁴⁷ This provision would not apply to exempt organizations because they are exempt from tax under § 501 of the Code. I.R.C. § 501 (2000).

³⁴⁸ The payments still might not be classified as income if they were determined to be capital contributions, but this language at least creates a baseline that contributions to a political organization are income. Congress made a similar determination with regard to gifts from employers. I.R.C. § 102(c). Instead of applying a factual analysis to determine whether gifts from an employer are made with detached and disinterested generosity, Congress statutorily determined that all transfers from an employer to an employee, except certain de minimis ones, constitute income to the employee. *Id.*

³⁴⁹ Subchapter C corporations are those corporations organized under subchapter C of the Internal Revenue Code. See I.R.C. §§ 301-386. These provisions govern the rules of taxation for most corporations. S corporations, governed by subchapter S of the Code, are small business corporations that meet, among other things, specific organizational requirements regarding the number of shareholders and classes of stock. See I.R.C. §§ 1361-1377. Section 1361(a)(2) of the Code defines a subchapter C corporation as a corporation which is not an S corporation. I.R.C. § 1361(a)(2).

ments unless those expenditures would otherwise be deductible under section 162. This entity would provide a clear "opt-out" choice for political organizations seeking to refrain from making the necessary disclosures under section 527.

- 3) To clarify that an opt-out option exists and that criminal penalties do not apply to organizations exercising the opt-out option, section 527 should be amended to clarify that an organization's filing as a section 527 exempt organization is optional. If the entity prefers to avoid disclosure completely, it may file as a political corporation. Subsection (i) could be amended to clarify that an entity that meets the definition of a political organization, but chooses not to file with the Secretary, will be deemed a political corporation.³⁵⁰ Obviously, if the political corporation engages in advocacy covered by FECA, it would be subject to FECA's disclosure requirements despite its decision to opt-out of section 527's disclosure provisions.
- 4) Section 527(j) should be reworked to clarify that if an organization "opts out" either wholly or in part, it does not suffer a penalty and is not subject to criminal penalty. Congress could modify subsection (j) to recognize the three types of organizations the Government claims can exist under section 527. The first type of entity, an organization that chooses not to disclose, will no longer be subject to section 527, but instead will be subject to the provisions underlying the new political corporation. The two remaining entities—organizations that file with the Secretary as political organizations and choose to disclose their contributions and expenditures, and those organiza-

³⁵⁰ While headings are not part of the statute, the heading for subsection (i) states that "[o]rganizations must notify Secretary that they are section 527 organizations." I.R.C. § 527(i). This heading can be read as requiring organizations that seek exempt status to notify the Secretary, but for clarification reasons, Congress may also wish to modify the heading for subsection (i).

tions that seek to avoid disclosure with respect to specific contributions and expenditures—will be subject to tax on the undisclosed amounts. Subsection (j) should therefore be further clarified to indicate that organizations may withhold disclosure on some contributions or expenditures without suffering a penalty. In this regard, subsection (j) should provide a method by which a political organization may file with the Secretary the amounts of contributions or expenditures that it chooses not to disclose, and the organization may pay a tax at the highest corporate rate for those amounts.³⁵¹

- 5) Since section 2501 currently exempts payments to political organizations from the gift tax,³⁵² section 2501 needs to be modified to clarify that this exception does not apply to undisclosed payments to a political organization.
- 6) Because the potential for criminal penalties may be seen as a significant infringement on free speech and could potentially shift the statutory scheme from a subsidy scheme to a penalty scheme, section 527 should include language that clarifies that the failure to make a disclosure under section 527 will not result in criminal liability.

These changes would clarify that Congress was seeking to deny a tax benefit to political organizations that choose not to disclose political contributions. While there is still a subsidy/penalty problem—the lack of a subsidy may operate as a penalty—the statutory scheme I recommend fits within the current subsidy

³⁵¹ As previously discussed in the context of the “proxy tax,” taxing the contributions at the highest corporate rate makes sense because that is the rate at which the organization would likely have to pay tax on the payments had it not been exempt from tax. See *supra* notes 256-60 and accompanying text. Since the exempt organization is opting out only with respect to specific payments, it is difficult to determine what the exempt organization’s tax rate would have been. Using the highest corporate rate ensures that the exempt organization will not get a tax benefit in the form of a rate reduction by choosing the opt-out option instead of the political corporation option.

³⁵² I.R.C. § 2501(a)(5) (2000).

framework in *Regan*. It clarifies that the exempt status of political organizations provides them with significant tax benefits and provides them with two methods of opting out. A political entity may organize as a political corporation and pay tax on its contributions, or it may organize as a political organization and pay tax on those contributions the organization seeks not to disclose. Finally, these changes clarify that criminal penalties do not exist for the failure of an organization to meet the disclosure requirements.³⁵³

III. AN ALTERNATIVE APPROACH TO MANDATING DISCLOSURE OF CONTRIBUTORS AND EXPENDITURES

Although a thorough discussion of *Buckley* and its impact on campaign finance disclosure provisions is outside the scope of this Article, one approach that may have allowed reformers to avoid the tax subsidy approach used in section 527 is worth discussing, even if in abbreviated form.³⁵⁴ In *Buckley*, the Court upheld disclosure provisions, without limiting the definition of contributions or

³⁵³ Congress could further increase the likelihood that the statute will be upheld by raising the minimum dollar amount of a contribution and expenditure that must be disclosed. Clearly, contributions of \$200 and expenditures of \$500 do not cause the type of concern regarding political corruption that is normally presented in the campaign context; amounts of \$1,000 and \$5,000 seem far more reasonable.

³⁵⁴ For a more thorough discussion of *Buckley*, see Lillian R. BeVier, *Money and Politics: A Perspective on the First Amendment and Campaign Finance Reform*, 73 CAL. L. REV. 1045, 1053-55 (1985) (arguing *Buckley* was properly decided); Hasen, *supra* note 97, at 276-83 (arguing that Congress has power to require disclosure of contributions and expenditures with regard to issue advertising); Bradley A. Smith, *Faulty Assumptions and Undemocratic Consequences of Campaign Finance Reform*, 105 YALE L.J. 1049, 1057-84 (1996) (arguing against reform and contending that corruption rationale is faulty and that campaign finance reform offends notions of equality). See generally BUCKLEY STOPS HERE: LOOSENING THE JUDICIAL STRANGLEHOLD ON CAMPAIGN FINANCE REFORM (E. Joshua Rosenkrantz ed., 1998) (arguing that campaign finance regulation is not counter to First Amendment); IF BUCKLEY FELL: A FIRST AMENDMENT BLUEPRINT FOR REGULATING MONEY IN POLITICS (E. Joshua Rosenkrantz ed., 1999) (reporting on Twentieth Century Fund Working Group on Campaign Finance Litigation's belief that Supreme Court should overrule or limit parts of *Buckley*); THE CONSTITUTION AND CAMPAIGN FINANCE REFORM (Frederick G. Slabach ed., 1998) (providing anthology of articles on campaign finance reform); Richard Kornylak, Note, *Disclosing the Election-Related Activities of Interest Groups Through § 527 of the Tax Code*, 87 CORNELL L. REV. 230 (2002) (calling for objective criteria to determine if advertisement is election related); David D. Storey, Note, *The Amendment of Section 527: Eliminating Stealth PACs and Providing a Model for Future Campaign Finance Reform*, 77 IND. L.J. 167 (2002) (arguing that section 527 is less than comprehensive campaign finance reform).

expenditures to express advocacy, to the extent that the contributions and expenditures were paid to, or expended by, a political committee.³⁵⁵ In the political committee context, it is the entity, not whether the entity engages in express or issue advocacy, that subjects the organization to campaign finance disclosure. To the extent political organizations are similar to political committees, Congress did not need to amend the Code to subject section 527 organizations to the disclosure provisions in FECA. Under *Buckley*, Congress can mandate that political organizations comply with the disclosure provisions in FECA and disclose contributors and expenditures.³⁵⁶

A. *BUCKLEY V. VALEO*: THE TRADITIONAL APPROACH TO THE CONSTITUTIONALITY OF CAMPAIGN FINANCE DISCLOSURE PROVISIONS

In the context of campaign finance reform, reformers advocate the disclosure of contributors to and expenditures of entities involved in influencing elections. In *Buckley v. Valeo*, the Court set out the traditional structure for analyzing Congress's ability to require the disclosure of campaign contributions and expenditures.³⁵⁷ The *Buckley* line of cases indicates when individuals and organizations must comply with the disclosure provisions in FECA.³⁵⁸ These cases have established the traditional "issue advocacy" v. "express advocacy" distinction.³⁵⁹ Express advocacy is often defined as communication containing express words of advocacy such as "vote for," "elect," and "vote against."³⁶⁰ Under this

³⁵⁵ *Buckley v. Valeo*, 424 U.S. 1, 67-70 (1976). For a definition of political committee, see *infra* notes 388-407 and accompanying text.

³⁵⁶ *Buckley*, 424 U.S. at 67-70.

³⁵⁷ *Id.* at 60-85.

³⁵⁸ *Missouri v. Shrink Mo. Gov't PAC*, 528 U.S. 377, 414-15 (2000) (Kennedy, J., dissenting) (indicating that "so called" issue advertising is not subject to FECA); *Fed. Election Comm'n v. Mass. Citizens for Life (MCFL)*, 479 U.S. 238, 249 (1986) (finding that MCFL was not political committee and its advertisements, which were not express advocacy, were not subject to FECA). See also *supra* note 70 (interpreting *Buckley* with regard to express/issue advertising).

³⁵⁹ See *supra* note 70 (addressing issue).

³⁶⁰ *Buckley*, 424 U.S. at 44 n.52 (providing examples of words of advocacy that include "vote for," "elect," "support," "cast your ballot for," "Smith for Congress," "vote against," "defeat," "reject"). These words of advocacy are sometimes referred to as magic words. As discussed

approach, only express advocacy is regulated under FECA and subject to disclosure requirements.

1. *Buckley v. Valeo: Treatment of Expenditures and Contributions*. In 1974, as part of a major post-Watergate campaign reform effort, Congress passed the Federal Election Campaign Act Amendments.³⁶¹ The Act was designed to reduce the corrupting influence of money in the political process and contained significant restrictions on political contributions and expenditures on almost every entity involved in the political process.³⁶² As is relevant for this discussion, the Act restricted the amount that individuals and groups could contribute to and spend relative to a clearly identified candidate, and it required disclosure of contributions or expenditures by almost anyone engaged in speech designed to influence an election.³⁶³

In discussing provisions in FECA regarding contribution and expenditure limitations, the Court differentiated between expenditures, which it believed were entitled to significant protection, and contributions, which it believed were entitled to less protection.³⁶⁴ The Court upheld contribution limitations with regard to contributions to a clearly identified candidate or political committee.³⁶⁵ The Court found that such a restriction had only a marginal restriction upon the contributors' ability to engage in free communication.³⁶⁶ The Court also believed that the contribution limitation was justified by the Government's interest of preventing corruption in the campaign context.³⁶⁷

supra in note 70, what constitutes express advocacy is still an open question.

³⁶¹ Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974) (codified as amended at 2 U.S.C. §§ 431-456 (2000)).

³⁶² *Id.* See also 120 Cong. Rec. 8183-8185 (1974) (statement of Sen. Pell, Chair of the Subcommittee on Privileges and Elections). For a discussion of political contributions and their influence on elections, see generally ANTHONY GIERZYNSKI, MONEY RULES: FINANCING ELECTIONS IN AMERICA (2000).

³⁶³ Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 1263 (1974) (codified as amended at 2 U.S.C. §§ 431-456 (2000)).

³⁶⁴ *Buckley*, 424 U.S. at 20-21.

³⁶⁵ *Id.* at 35.

³⁶⁶ *Id.* at 21; see also *Nixon v. Shrink Mo. Gov't PAC*, 528 U.S. 377, 386-87 (2000) (determining that limiting contributions left communication significantly unimpaired).

³⁶⁷ *Buckley*, 424 U.S. at 26-27 ("To the extent that large contributions are given to secure a political *quid pro quo* from current and potential office holders, the integrity of our system of representative democracy is undermined."); see also *Fed. Election Comm'n v. Nat'l*

The Court took a different approach with regard to expenditure limitations.³⁶⁸ The Court noted that this provision would subject an individual to a criminal penalty for placing a one-quarter page advertisement "relative to" a candidate in a major metropolitan newspaper.³⁶⁹ The Court was particularly concerned that the Act contained criminal penalties, and that the vague language in the Act could provide a "trap for the innocent" by not providing fair warning that an advertiser might be subject to the Act's requirements.³⁷⁰ The Court found that the phrase "relative to" was indefinite because it "fail[ed] to clearly mark the boundary between permissible and impermissible speech."³⁷¹ In order to resolve the risk posed by the statute's ambiguity, the Court limited section 608(e) to communications that "in express terms advocate the election or defeat of a clearly identified candidate for Federal office."³⁷² Even so limited, the Court found that the Government interest in preventing corruption and the appearance of corruption was inadequate to justify the restrictions on independent expenditures.³⁷³

The Court took another approach with regard to the disclosure provisions that apply to political candidates and political commit-

Conservative Political Action Comm., 470 U.S. 480, 497 (1984) ("Corruption is a subversion of the political process. Elected officials are influenced to act contrary to their obligations of office by the prospect of financial gain to themselves or infusions of money into their campaigns."); Fed. Election Comm'n v. Nat'l Right to Work Comm., 459 U.S. 197, 208 (1982) (preventing corruption or appearance of corruption implicates integrity of democratic process); First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 788 n.26 (1978) (determining that government interest in preventing corruption has never been doubted).

³⁶⁸ Section 101(a) of FECA amends 18 U.S.C. § 608 and provides that "no person" may make expenditures "relative to a clearly identified candidate" that exceed an aggregate amount of \$1,000 in any year. Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, § 101(a), 88 Stat. 1263, 1265 (1974) (codified as amended at 18 U.S.C. § 608 (2000)).

³⁶⁹ *Buckley*, 424 U.S. at 40.

³⁷⁰ *Id.* at 41 & n.48.

³⁷¹ *Id.* at 41-42.

³⁷² *Id.* at 44.

³⁷³ *Id.* But see Buchsbaum, *supra* note 17, at 675 (noting that because of size and way in which independent expenditures are made candidates may feel indebted to entity making contribution, and listing examples when such influence may have been wielded); David Schultz, *Revisiting Buckley v. Valeo: Eviscerating the Line Between Candidate Contributions and Independent Expenditures*, 14 J.L. & POL. 33, 86-88 (1998) (arguing that Court should revisit underpinnings of its decision in light of changes in political landscape). See generally David A. Strauss, *Corruption, Equality, and Campaign Finance Reform*, 94 COLUM. L. REV. 1369 (1994) (discussing corruption rationale in context of equality and direct democracy).

tees. Section 434 of FECA requires political candidates and committees to disclose their contributions and expenditures in any calendar year.³⁷⁴ Contributions and expenditures are defined as amounts "for the purpose of . . . influencing" the nomination or election of a candidate for federal office.³⁷⁵ Although the Court recognized that compelled disclosure can seriously infringe upon the First Amendment, it found the Government's interests outweighed that infringement.³⁷⁶ Specifically, the Court recognized that (1) disclosure provides the public with information that may be helpful to voters in evaluating those who seek office, and that sources of a candidate's financial support also alert voters to the interests to which candidates are most likely to be responsive; (2) disclosure requirements deter actual corruption and the appearance of corruption by exposing large contributions and expenditures to publicity; and (3) disclosure provides an essential means for gathering information necessary to police violations of expenditure and contribution limits.³⁷⁷

2. *Disclosure Provisions for Independent Expenditures over \$100.* Section 434(e) of FECA required that "[e]very person . . . who makes contributions or expenditures" over \$100 in a calendar year other than to a political committee or candidate for the purpose of influencing elections must file a statement with the FEC.³⁷⁸ Individuals who failed to make such a disclosure were subject to civil and criminal penalties.³⁷⁹ The Court determined that the provision was vague and overbroad because it could be interpreted to include individuals or organizations who were merely engaged in

³⁷⁴ Section 434(b)(3)(A) of FECA requires a political committee to disclose all contributions in excess of \$200. 2 U.S.C. § 434(b)(3)(A) (2000). Section 434(b)(4) of FECA requires the disclosure of expenses. 2 U.S.C. § 434(b)(4).

³⁷⁵ 2 U.S.C. § 431(8)(A)(i), (9)(A)(i).

³⁷⁶ *Buckley*, 424 U.S. at 64-66.

³⁷⁷ *Id.* at 67-68. The Court noted, however, that minor parties must be allowed to show that they will suffer impermissibly by disclosure. *Id.* at 73-74; see also *Brown v. Socialist Workers '74 Campaign Comm.*, 459 U.S. 87, 101-02 (1982) (holding that disclosure did not apply to minor political party that had historically been object of harassment); *NAACP v. Alabama*, 357 U.S. 449, 466-67 (1958) (holding that NAACP did not need to disclose membership lists).

³⁷⁸ 2 U.S.C. § 434(e) (2000).

³⁷⁹ 2 U.S.C. § 437(g)(6)(A), (g)(11).

issue discussion.³⁸⁰ Section 434(e) applied to everyone and covered an extremely broad range of issue-related speech, and it is no wonder the Supreme Court found that this provision raised serious constitutional concerns.

In order to avoid the vagueness problem, the Court construed section 434(e) as imposing reporting requirements only on individuals and groups when they make contributions earmarked for a candidate or political committee, or when they make expenditures that expressly advocate the election or defeat of a candidate for public office.³⁸¹ In such instances, there would be no trap for the innocent and no chance that issue discussion would be hampered. The Court made clear that this express advocacy limitation did not apply to political candidates or committees.³⁸²

Since the Court construed section 434(e) as applying only to express advocacy, political organizations have argued that their issue advocacy speech cannot be subject to disclosure requirements.³⁸³ Although the Court limited section 434(e) to express advocacy, there is nothing in *Buckley* that indicates that speech other than express advocacy can never be subject to disclosure requirements.³⁸⁴

³⁸⁰ *Buckley*, 424 U.S. at 76-77.

³⁸¹ *Id.* at 79-80.

³⁸² *Id.* at 80.

³⁸³ Brief of the United States of America in Support of Its Motion to Dismiss at 25-26, *Nat'l Fed'n of Republican Assemblies v. United States*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C).

³⁸⁴ See, e.g., Elizabeth Garrett, *Money, Agenda Setting, and Direct Democracy*, 77 TEX. L. REV. 1845, 1873 (1999) (arguing that, despite decision in *Buckley*, several kinds of disclosure provisions may still be constitutional); Trevor Potter, *Buckley v. Valeo, Political Disclosure and the First Amendment*, 33 AKRON L. REV. 71, 71 (1999) (stating that Court did not address disclosure requirements in communication not expressly advocating election or defeat of candidate, but that without facts that disclosure poses severe restriction on litigant and scales tip toward disclosure); Trevor Potter & Kirk L. Jowers, *The Frequently Mischaracterized Impact of the Courts on the FEC and Campaign Finance Law*, 51 CATH. U. L. REV. 839, 848-49 (2002) (demonstrating courts' varying interpretations of *Buckley* express advocacy, some of which recognized speech outside explicit terms provided in *Buckley* as subject to disclosure requirements). But see Lillian R. BeVier, *Mandatory Disclosure, "Sham Issue Advocacy," and Buckley v. Valeo: A Response to Professor Hasen*, 48 UCLA L. REV. 285, 289-90 (2000) (arguing that Court in *Buckley* narrowed construction of disclosure requirements to apply only to express advocacy). The district court recognized this point in *NFRA* and concluded that political advocacy can be regulated even if it is not express advocacy. *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300, 1323-25 (S.D. Ala. 2002). It also concluded that the absence of express advocacy is not necessarily issue advocacy. *Id.*

B. REFORMERS MAY NOT HAVE HAD TO USE THE TAX CODE AS A MECHANISM FOR CAMPAIGN FINANCE DISCLOSURE SINCE POLITICAL ORGANIZATIONS MAY BE REGULATED UNDER *BUCKLEY*

Under the traditional *Buckley* approach, communication becomes subject to FECA's disclosure requirements based on the content of the speech, regardless whether it is express or issue advocacy. An alternative "entity" approach, which requires disclosure not based on the content of the speech, but on the entity engaged in the speech, is also constitutional under FECA. Under the entity approach, there are at least two possible justifications for upholding the constitutionality of the disclosure provisions in section 527 even under *Buckley*. First, political organizations are similar to political committees, and they arguably fall within the statutory definition of political committees.³⁸⁵ Secondly, even if political organizations are not political committees and cannot be treated as such, the reasons for upholding disclosure requirements for political committees also apply to political organizations. Since political organizations are expressly chartered to influence elections, the vagueness concerns outlined in *Buckley* simply do not apply.³⁸⁶ In the section 527 context, there are no traps for the innocent, and there is no fear that individuals or groups will be criminally prosecuted based on ambiguous language.³⁸⁷

1. *Political Organizations Fit Within the Definition of Political Committee.* FECA defines political committees as "any committee, club, association, or other group of persons which receives contributions aggregating in excess of \$1,000 during a calendar year or

³⁸⁵ See *Disclosure of Political Activities of Tax Exempt Organizations: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 106th Cong. 60 (2000) (testimony of Glenn J. Moramarco) (arguing that § 527 organizations are political committees).

³⁸⁶ See Brief of the United States of America in Support of Its Motion to Dismiss at 25, *Nat'l Fed'n of Republican Assemblies v. United States*, 148 F. Supp. 2d 1273 (S.D. Ala. 2001) (No. 00-0759-RV-C); Kornylak, *supra* note 354, at 254 (arguing that spending by § 527 organizations is by definition campaign related and that concerns regarding vagueness in *Buckley* are not present in *NFRA*).

³⁸⁷ See generally Kathleen M. Sullivan, *Political Money and Freedom of Speech*, 30 U.C. DAVIS L. REV. 663 (1997) (arguing that contribution limits should be replaced with vigorous disclosure requirements, and contending that arguments against disclosure requirements are weaker in context of candidate elections).

makes expenditures aggregating in excess of \$1,000 during a calendar year.”³⁸⁸ Contributions and expenditures are defined as anything of value for the purpose of influencing the nomination or election of a candidate for federal office.³⁸⁹ Under this definition, political organizations would generally fall under the definition of political committee since, by definition, they are formed to influence the selection, nomination, election, or appointment of an individual to federal office.³⁹⁰

The Court further limited the definition of political committee in its discussion regarding the expenditure disclosure provisions.³⁹¹ The Court found that the definition of political committee might reach groups engaged in purely issue discussion, and it limited the definition of political committee to “encompass organizations that are under the control of a candidate or the *major purpose* of which is the nomination or election of a candidate.”³⁹²

The Court, however, did not limit the definition of political committee as it applied to the disclosure of contributions.³⁹³ In fact, prior to *Buckley*, the Court in *Burroughs v. United States*³⁹⁴ upheld disclosure provisions with regard to political committees, which were defined as organizations that receive contributions or make expenditures “for the purpose of influencing or attempting to influence” the presidential and vice presidential elections.³⁹⁵ The Court held that Congress had the authority to pass legislation that safeguarded elections “from the improper use of money to influence the result.”³⁹⁶

³⁸⁸ Federal Election Campaign Act, 2 U.S.C. § 431(4) (2000).

³⁸⁹ *Id.* § 431(8)(a).

³⁹⁰ I.R.C. § 527(e)(2) (2000) (defining exempt function). This provision would not apply to § 527 organizations that are formed to influence state or local elections. The district court in *NFRA* held the disclosure provisions violated the Tenth Amendment in that Congress, through § 527, sought to regulate state and local election campaigns. *Nat'l Fed'n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300, 1352-53 (S.D. Ala. 2002).

³⁹¹ *Buckley v. Valeo*, 424 U.S. 1, 79 (1976).

³⁹² *Id.* (emphasis added).

³⁹³ *See Hasen, supra* note 97, at 270 (discussing *Buckley* and contribution disclosure provisions).

³⁹⁴ 290 U.S. 534 (1934).

³⁹⁵ *Id.* at 541. Federal Corrupt Practices Act of 1925 (Title III of the Act of Feb. 28, 1925), 43 Stat. 1070, cited in *Buckley v. Valeo*, 424 U.S. 1, 61 (1976).

³⁹⁶ *Burroughs*, 290 U.S. at 545.

But even if the more limited definition of political committee used in the expenditure context applies in the contribution context, many section 527 organizations still fit the definition of a political committee. Section 527 organizations are, by definition, created to influence the election of an individual to federal office.³⁹⁷ If that is the purpose of the organization, then it clearly satisfies the requirement that its *major* purpose be the nomination of a federal candidate.³⁹⁸

It is unclear, however, whether political organizations could be subject to the full panoply of regulations that apply to political committees. In dicta in *Federal Election Commission v. Massachusetts Citizens for Life* ("MCFL"),³⁹⁹ the Court indicated that subjecting a political organization like MCFL⁴⁰⁰ to the full range of regulatory requirements that apply to political committees would likely be so burdensome as to foreclose speech.⁴⁰¹ But the Court specifically noted that, if MCFL's independent spending became so significant that its major purpose was to influence elections, then the organization would be properly classified as a political committee.⁴⁰²

Thus, while it is unclear whether section 527 organizations can be subject to all of the restrictions that apply to political committees, it is clear that political organizations fit the general definition of political committee. The justifications for upholding disclosure

³⁹⁷ This would not apply to § 527 organizations engaged in purely state or local campaigns.

³⁹⁸ Once again, it is clear that this discussion does not apply to § 527 organizations organized to influence state and local elections. State and local disclosure provisions may apply in that instance. See generally PETER C. CHRISTIANSON ET AL., LOBBYING, PACS, AND CAMPAIGN FINANCE, 50 STATE HANDBOOK (2002) (discussing campaign finance laws in each state); MICHAEL J. MALBIN & THOMAS L. GAIS, THE DAY AFTER REFORM: SOBERING CAMPAIGN FINANCE LESSONS FROM THE AMERICAN STATES (1998) (examining state campaign finance laws).

³⁹⁹ 479 U.S. 238 (1986).

⁴⁰⁰ MCFL was a corporation that engaged in both issue and express advocacy. See *id.* at 241-44, 249-51 (detailing MCFL's activities and finding express advocacy).

⁴⁰¹ *Id.* at 254-55. The Court recognized that if MCFL engaged in express advocacy, it could still be subject to the disclosure provisions regarding its contributors and expenditures. *Id.* at 262 (finding MCFL will be required to disclose contributions and expenditures meant to influence elections); see also *id.* at 266 (O'Connor, J., concurring) ("In my view, the significant burden on MCFL in this case comes not from the disclosure requirements that it must satisfy, but from the additional organizational restraints imposed upon it by the Act.").

⁴⁰² *Id.* at 262.

provisions for political committees—both the information and corruption justifications—also apply to political organizations that are almost indistinguishable from political committees.⁴⁰³ Congress may not be able to subject political organizations to the same level of regulation as political committees, but the less onerous disclosure provisions clearly can be justified by the fact that political organizations meet the definition of a political committee.⁴⁰⁴

Since political organizations are admittedly organized to influence elections, they fall squarely within the definition of political committees and may be regulated under *Buckley* using either the broader definition of political committee that applies to contributions or the more restrictive definition that applies to expenditures.⁴⁰⁵ Under either standard, the disclosure provisions in section 527 should be upheld for similar reasons as those relied on in *Buckley*.⁴⁰⁶ As the Court noted in *Buckley*, disclosure provisions generally are “the least restrictive means of curbing the evils of campaign ignorance and corruption that Congress found to exist.”⁴⁰⁷

2. *The Vagueness Concerns in Buckley Do Not Apply to Section 527 Organizations.* Even if section 527 organizations are not

⁴⁰³ In fact, according to Public Citizen, political organizations are now being used and controlled by candidates to promote their candidacy. See PUBLIC CITIZEN CONGRESS WATCH, CONGRESSIONAL LEADERS’ SOFT MONEY ACCOUNTS SHOW NEED FOR CAMPAIGN FINANCE REFORM BILLS 1 (Feb. 26, 2002), available at <http://www.citizen.org/publications> (last visited Feb. 14, 2002). To the extent that these organizations are not involved in express advocacy, they contend that they are not subject to FECA. *Id.* at 5-6. Public Citizen identified sixty-one members of Congress who have political organizations, and the top twenty-five political organizations collected approximately \$30 million in a two-year election cycle. *Id.* at 6-8.

⁴⁰⁴ In addition, to the extent that § 527 is considered a tax subsidy, even the greater regulation that applies to political committees may be permissible. See *MCFL*, 479 U.S. at 256 n.9 (explaining that, if nonprofit corporations do not set up lobbying arms, they are not eligible for tax deductible contributions).

⁴⁰⁵ As previously discussed, many § 527 organizations deliberately avoid “express advocacy” to escape FECA, claiming that they are not involved in influencing elections, but describing their activities as election activities when seeking tax exempt status. See *supra* notes 46-62 and accompanying text. Treating all § 527 organizations as political committees would ensure that political organizations could not escape the disclosure provisions while still obtaining tax-exempt status.

⁴⁰⁶ The district court in *NFRA* recognized that political organizations could be required to disclose expenditures under *Buckley*, although it found that the disclosure provisions at issue were unconstitutional because there was not a sufficient relationship between the disclosure provisions and a substantial Government interest. *Nat’l Fed’n of Republican Assemblies v. United States*, 218 F. Supp. 2d 1300, 1335 (S.D. Ala. 2002).

⁴⁰⁷ *Buckley v. Valeo*, 424 U.S. 1, 68 (1976).

considered political organizations, the narrowly drawn disclosure provisions contained in section 527 are constitutional for many of the same reasons that disclosure provisions are constitutional with regard to political committees. The *Buckley* Court limited the definition of contributions and expenditures because it was concerned that, absent such limitations, individuals and groups engaged in purely issue discussion would unknowingly find themselves subject to the disclosure provisions in the Act.⁴⁰⁸ Thus, an individual engaged in what she believed was purely issue discussion might find herself subject to civil and criminal penalties when she had no intention of engaging in campaign-related speech. This concern does not exist when political organizations are at issue. These are organizations formed for the purpose of influencing elections. By definition, they are not purely engaged in a discussion of relevant issues. Entities that apply for tax-exempt status under section 527 assert that they are entitled to that status because they are engaged in communication for the purpose of influencing elections.⁴⁰⁹ Any line-drawing problems regarding whether their communication is designed to influence elections disappear. There is no trap for the innocent because these entities have announced their intention to be involved in campaign-related speech.⁴¹⁰ The concerns that motivated the Supreme Court to limit the definitions of "contribution" and "expenditure" simply do not apply in the context of political organizations under section 527.⁴¹¹

⁴⁰⁸ *Id.* at 74-77.

⁴⁰⁹ See I.R.C. § 527(e) (2000).

⁴¹⁰ For examples of § 527 organizations admitting their intent to influence elections, see Priv. Ltr. Rul. 99-25-051 (June 25, 1999); Priv. Ltr. Rul. 98-08-037 (Feb. 20, 1998); Priv. Ltr. Rul. 972-5-036 (June 20, 1997).

⁴¹¹ Opponents of disclosure provisions have argued that disclosure provisions are unconstitutional because there is a constitutional right to anonymous free speech. *McIntyre v. Ohio Elections Comm'n*, 514 U.S. 334, 342 (1995). *McIntyre* involved an Ohio statute that prohibited the distribution of anonymous handbills attempting to influence an election or ballot initiative. *Id.* at 336. The Supreme Court struck down the Ohio statute, holding that an author's decision to remain anonymous is an aspect of the freedom of speech protected by the First Amendment. *Id.* at 341-42. It then concluded that, in this instance, Ohio's interest in preventing fraudulent and libelous statements and its interest in providing the electorate with relevant information was an insufficient state interest to overcome the infringement on the First Amendment. *Id.* at 348-51. Although it is unclear the extent to which *McIntyre* applies outside of the one-on-one communication context presented in the case, it is clear that *McIntyre* does not apply to the disclosure provisions in FECA as applied to political

C. AN ALTERNATIVE APPROACH

The approach taken by the reformers in amending section 527 of the Code was a clever and permissible act of Congress, which was desperate for campaign finance reform. Since it appeared that amending FECA and requiring the disclosure of contributions to, and expenditures of, groups involved in all types of political advocacy might raise constitutional problems, reformists sought an alternative path—amending the Internal Revenue Code.

The approach taken by the reformers, or one similar to it, will likely pass constitutional muster, although the approach is an inadequate and complicated method of encouraging campaign finance disclosure. To the extent the provision survives under the subsidy approach in *Regan*, an opt-out provision is essential. If the opt-out provision is real, then at least some organizations will choose to opt-out of the disclosure scheme. If a sufficient number of organizations opt-out, or if organizations opt-out only with regard to controversial contributions or expenditures, the effectiveness of the disclosure provisions will be seriously impacted.

A more effective and substantially simpler approach would be to amend FECA and clarify that political organizations are political committees under FECA.⁴¹² Alternatively, Congress could create a

committees. Those provisions were upheld by the Supreme Court in *Buckley*. *Buckley*, 424 U.S. at 74, 79-80; see also *Buckley v. Am. Constitutional Law Found.*, 525 U.S. 182, 196, 199-200 (1999) (rejecting name tag requirement for circulators of ballot initiative, but upholding requirement that circulators sign affidavit when submitting petitions that included their name and address); *United States v. Harriss*, 347 U.S. 612, 626 (1954) (upholding disclosure provisions requiring disclosure of payments to and expenditures of lobbyists); *Griset v. Fair Political Practices Comm'n*, 884 P.2d 116, 126 (Cal. 1994) (holding candidate did not have First Amendment right to distribute anonymous pamphlets opposing ballot measure); Hasen, *supra* note 97, at 273-74 (distinguishing *McIntyre* from *Buckley*, reasoning in part that possibility of corruption is significantly less with regard to ballot initiatives because ballot measure cannot be corrupted as candidates can); Kornylak, *supra* note 354, at 254-57 (highlighting three Governmental interests in disclosure provisions of § 527: preventing corruption, informing electorate, and electoral accountability); Thomas H. Dupree, Jr., Comment, *Exposing the Stealth Candidate: Disclosure Statutes After McIntyre v. Ohio Elections Commission*, 63 U. CHI. L. REV. 1211, 1214 (1996) (arguing that televised speech by political candidates is not protected by *McIntyre*). But see David W. Ogden & Joel A. Nichols, *The Right to Anonymity Under the First Amendment*, 49 FED. LAW. 44, 44 (2002) (arguing that laws that ban anonymous speech are by their very nature disproportionate and content-based and should be subject to strict scrutiny).

⁴¹² If political organizations are political committees under FECA, they would be subject

new FECA category for political organizations, and provide that such organizations must disclose their contributors and expenditures. Under this approach, which is an entity approach, the entity's status under FECA would be determined by its status under the Internal Revenue Code. If the organization was a political organization under the Code, it would also be subject to regulation under FECA. Entities therefore could not seek the benefit of exempt status while avoiding the disclosure provisions in FECA. Moreover, the disclosure provisions could be mandatory and no opt-out option would be required. This approach provides an alternative to the speech-specific issue/express advocacy distinction currently in place.⁴¹³ Political organizations would become subject to basic disclosure requirements similar to those now required of entities engaged in express advocacy.

IV. CONCLUSION

The influence of third-party expenditures in political campaigns has grown immensely since disclosure provisions were first considered in *Buckley v. Valeo*. In amending FECA, Congress took a very broad approach to the regulation of independent expenditures, and in limiting that approach the Supreme Court drastically curtailed the disclosure provision in FECA. Congress then sought an alternative way to encourage the disclosure of third-party expenditures and amended section 527 of the Code using the tax subsidies provided to political organizations as a mechanism for encouraging disclosure of campaign expenditures.

to disclosure even if they engaged only in issue advocacy. An alternative approach would be to restrict § 527 status organizations that are subject to FECA's disclosure provisions. See generally David S. Karp, Note, *Taxing Issues: Reexamining the Regulation of Issue Advocacy by Tax-Exempt Organizations Through the Internal Revenue Code*, 77 N.Y.U.L. REV. 1805 (2002) (arguing that section 527 status should be limited to organizations that engage in express advocacy).

⁴¹³ The recently passed McCain-Feingold campaign finance reform measure takes a different, categorical approach, attempting to define all speech that occurs at a specific time and references a candidate as electioneering communication subject to disclosure. See Bipartisan Campaign Reform Act of 2002, Pub. L. 107-155, § 201, 116 Stat. 81, 88-91 (2002) (to be codified at 2 U.S.C. §§ 431-456).

This approach, or one similar to it, can withstand constitutional attack. It follows the tax subsidy rationale upheld by the *Regan* Court by conditioning a tax benefit on the exempt organization's compliance with campaign finance disclosure provisions. Although encouraging disclosure through the tax code is constitutional, it is not the best approach for mandating campaign finance disclosure. Since the constitutionality of the disclosure provisions is based on a tax subsidy argument, some organizations might forgo tax-exempt status and thereby avoid the disclosure provisions. A better approach is to use the tax status of the organization as a triggering mechanism for subjecting the organization to regulation under FECA. Since political organizations are similar to political committees, which are already subject to disclosure provisions under FECA, Congress could mandate under FECA that all political organizations disclose their contributors and expenditures. Mandating disclosure through FECA will provide a broader and simpler method for requiring the disclosure of contributors to, and expenditures of, third-party organizations involved in political campaigns.

