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# Campaign Finance Disclosure and Section 527 of the Code: A Look at the District Court's Opinion in *National Federation of Republican Assemblies*<sup>1</sup>

by Donald B. Tobin

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## I. Introduction

Recent amendments to section 527 of the code require tax-exempt political organizations to disclose contributions to and expenditures of the organization.<sup>2</sup> If organizations fail to make such disclosures, they lose the benefit of their tax-exempt status. This article looks at the recent district court decision involving section 527 and examines the ramifications of the decision for exempt organizations and for campaign finance reform advocates.

During the 2000 presidential primaries, Republicans for Clean Air ran a series of advertisements attacking Senator John McCain's record on the environment and praising then-Governor George W. Bush's. Republicans for Clean Air claimed that its advertisements were only "issue advertising" and did not expressly advocate the election or defeat of a candidate for federal office, and were not subject to federal election law. Republicans for Clean Air claimed it was not therefore required to disclose its contributors or its expenditures in any manner.

The advertisements sponsored by Republicans for Clean Air were simply one example of what was seen as abuses by



*Donald B. Tobin*

<sup>1</sup>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* (S.D. Ala. 2001) (No. 00-759-RV-C). A more thorough analysis of section 527, and the constitutionality of campaign finance disclosure provisions in the code will appear in the forthcoming winter issue of the *GEORGIA LAW REVIEW*. See Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 *GA. L. REV.* (Winter 2003).

<sup>2</sup>A political organization is defined as a "party, committee, association, fund, or other organization . . . organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function." IRC section 527(e)(1). Exempt function "means the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual" to a public office. IRC section 527(e)(2).

tax-exempt entities seeking to influence federal elections. The proliferation of independent expenditures during political campaigns and the difficulty in identifying the source of those expenditures increased the pressure for reform of campaign regulations that apply to advocacy by political organizations. After the primary campaign, Senator McCain joined with Senators Joe Lieberman (then a vice-presidential candidate) and Russ Feingold to craft legislation requiring the disclosure of the names of contributors to, and expenditures

of, what they termed “stealth PACs.”<sup>3</sup> Because the Supreme Court had previously struck down campaign disclosure provisions in the Federal Election Campaign Act (FECA) associated with issue advocacy,<sup>4</sup> Senators McCain, Lieberman, and Feingold took another approach. 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, the section that deals with the tax status of political organizations. The reformers amended section 527 and created campaign finance disclosure provisions in the tax code by conditioning tax benefits on compliance with the disclosure provisions. After the proposed changes were enacted into law, opponents almost immediately filed suit attacking the constitutionality of the provisions and alleging that the disclosure provisions violated plaintiffs’ First, Fifth, and Tenth Amendment rights.<sup>5</sup>

## II. How Section 527 Operates

There are at least three possible ways to interpret section 527’s disclosure provisions. The government’s interpretation views section 527 as an elective provision with two main attributes. Under this interpretation, section 527(i) provides organizations with a choice of 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.<sup>6</sup> If an organization fails to file an election to be a political organization under section 527, the organization is taxed on its otherwise exempt function income (defined as amounts received as a contribution of money or other property, membership dues, or proceeds from a political fundraiser).<sup>7</sup> Second, once an entity registers as a section 527 organization, to be exempt from tax the entity is required to file quarterly reports,<sup>8</sup> and disclose its expenditures and con-

tributors.<sup>9</sup> Specifically, subsection (j)(3)(A) provides that entities electing to be tax-exempt political organizations must disclose the amount of each expenditure of \$500 or more and the name and address of the person to whom the payment was made.<sup>10</sup> And subsection (j)(3)(B) requires the disclosure of the name and address of each contributor who contributed in the aggregate \$200 or more to the organization during the calendar year.<sup>11</sup>

If an entity has elected to be a section 527 political organization by filing a notice under subsection (i) and it fails to disclose under subsection (j), the entity is penalized (or taxed) on the amount “to which the failure relates.”<sup>12</sup> Under the government’s interpretation of the statute, an entity can elect to be a section 527 organization and disclose either some, all, or none of its contributors and expenditures. Under subsection (j), the entity would be taxed on those contributions or expenditures that it failed to disclose.

Plaintiffs, however, argue that all entities, even those that choose to opt-out under 527(i), are subject to the disclosure provision in subsection (j). They contend that the disclosure provisions are therefore mandatory on all entities meeting the definition of a political organization.<sup>13</sup>

A third option, not advocated by either party, is that an entity has a choice whether to opt-in to 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 (i), but not to other organizations who chose to opt-out and pay the tax due under (i)(4). Under this interpretation, (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 opt-out, pay tax on their income, and not disclose their contributors or expendi-

<sup>3</sup>146 Cong. Rec. 55995 (daily ed. June 28, 2000) (statement of Sen. Lieberman); see also S. 2582, S. 2583, 106th Cong. (2000).

<sup>4</sup>*Buckley v. Valeo*, 424 U.S. 1, 43 (1976).

<sup>5</sup>See *National Federation of Republican Assemblies v. U.S.*, \_\_\_ F.Supp.2d \_\_\_, 2002 WL 2008245 (S.D. Ala. ) (Aug. 27, 2002) [hereinafter *NFRA*]. 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. *Id.* at \*1, note 1.

<sup>6</sup>IRC section 527(i) (2002). An organization meets this requirement by filing Form 8871, *Political Organization Notice of Section 527 Status* with the IRS. Rev. Rul. 2000-49, 2000-44 IRB 430.

<sup>7</sup>IRC section 527(c)(3), (i)(4) (2002). Under subsection (b) an organization’s income is taxed at the highest corporate tax rate.

<sup>8</sup>If a regularly scheduled election is to be held during a specific calendar year the political organization must file a quarterly report, a pre-election report, and a post-general election report. IRC sections 527(j)(2)(A)(i)(I), (II), (III) (2002). If a regular election is not scheduled for a particular year, an organization must file semi-annual reports. IRC section 527(j)(2)(A)(ii) (2002).

<sup>9</sup>IRC section 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 IRB 430. The IRS was also required to make the reports available on the Internet. IRC section 6104(a)(3)(2002). See <http://efirms.irs.gov> (IRS Web site listing disclosure reports for political organizations).

<sup>10</sup>Expenditure is defined as “a payment, distribution, loan, advance, or deposit, of money, or anything of value. . . .” IRC section 527(e)(4) (2002), referencing IRC section 271(b)(3) (2002). If applied literally, this definition would require the disclosure of amounts spent to purchase office equipment.

<sup>11</sup>IRC section 527(j)(3) (2002). Contribution is defined as “a gift, subscription, loan, advance, or deposit, of money, or anything of value. . . .” IRC section 527(e)(3)(2002), referencing IRC section 271(b)(2) (2002). 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. section 434(a) (2002).

<sup>12</sup>IRC section 527(j)(1) (2002).

<sup>13</sup>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 under IRC section 7203.

tures. Organizations may not choose to opt-in and then disclose only some contributions or expenditures.

### III. District Court Decision

The district court took an interesting and sometimes confusing approach to analyzing the statute. Instead of analyzing section 527 as one aggregate tax provision, it divided the provision into two parts and considered the provisions in subsections (i) and (j) independently. In a previous decision,<sup>14</sup> it determined that subsection (i), which provides an organization must opt-in to the regulatory scheme or be subject to tax on its income, was a tax provision and that plaintiffs could not enjoin the collection of a tax under the Anti-Injunction Act. The court further determined that subsection (j), which requires exempt organizations to pay the top corporate rate on any undisclosed contribution or expenditure, was a penalty, and that plaintiffs could properly contest the constitutionality of subsection (j).<sup>15</sup> Therefore, the suit proceeded as an attack only on the constitutionality of subsection (j).

In its recent decision, the district court concluded that the disclosure provisions in subsection (j) are constitutional as they apply to contributions to political organizations involved in influencing federal elections, but unconstitutional as they apply to organizations involved in only local or state elections. Moreover, the district court held that the expenditure disclosure provisions are unconstitutional.

#### A. First Amendment Analysis

The court first recognized that subsection (j) applies only to organizations that elect to be treated as section 527 organizations under subsection (i). Organizations that opt-out under subsection (i) are taxable under (i)(4) on all of their income including exempt function income, which includes contributions to the organization. The court noted that an organization does not have a right to a tax deduction or tax-exempt status and that Congress can condition a tax subsidy on an entity's willingness to comply with regulatory requirements.<sup>16</sup> It thus concluded that if Congress was conditioning a tax subsidy on an entity's willingness to comply with the disclosure requirements, the traditional First Amendment campaign finance analysis under *Buckley v. Valeo* did not apply.<sup>17</sup> The court then examined subsection (j) to determine whether Congress permissibly conditioned an entity's tax-exempt status on its willingness to comply with campaign finance disclosure requirements.

#### 1. Contributions to Political Organizations

With regard to contributions to political organizations, the court found that Congress permissibly conditioned a tax-

exemption on an organization's willingness to disclose campaign contributions. First, it concluded that campaign contributions could be treated as income for tax purposes, and second, it found that by denying those benefits to organizations that failed to disclose contributions, Congress merely removed its tax subsidy for those specific disclosures. It therefore found the campaign contribution disclosure provisions in subsection (j)(3)(B) constitutional.<sup>18</sup>

#### 2. Expenditures of Political Organizations

The court took a very different approach with regard to the expenditure disclosure provisions. 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. Specifically, an organization that failed to disclose both its contributions and expenditures would be subject to a penalty of 57 percent.<sup>19</sup> 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. 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.<sup>20</sup>

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. The *Buckley* line of cases indicate when individuals and organizations must comply with the disclosure provisions in FECA. These cases have established the traditional "issue advocacy" v. "express advocacy" distinction. Express advocacy is defined as communication containing express words of advocacy such as "vote for," "elect," and "vote against."<sup>21</sup> Under the traditional *Buckley* approach, it is express advocacy that can clearly be subjected to campaign finance regulation.

Plaintiffs argued that because the communication here was not express advocacy, under *Buckley* the disclosure provisions violated the First Amendment. The court rejected plaintiffs' reading of *Buckley* but ultimately held that the expenditure disclosure provisions violated the First Amendment.

The court first rejected plaintiffs' assertion that only express advocacy could be regulated consistent with the First Amendment. It claimed that the issue/express advocacy dichotomy presented by plaintiffs was in fact incorrect, and

<sup>14</sup>*National Federation of Republican Assemblies v. United States*, 148 F.Supp.2d 1273 (S.D. Ala. 2001).

<sup>15</sup>*Id.* at 1280.

<sup>16</sup>*NFRA*, 2002 WL 2008245, \*11; *Leathers v. Medlock*, 499 U.S. 439, 451 (1991); *Regan v. Taxation with Representation*, 461 U.S. 540, 547 (1983); *Cammarano v. United States*, 358 U.S. 498 (1959).

<sup>17</sup>*Buckley v. Valeo*, 424 U.S. 1, 43 (1976); *NFRA*, 2002 WL 2008245, \*11.

<sup>18</sup>*NFRA*, 2002 WL 2008245, \*12.

<sup>19</sup>For example, if an organization fails to disclose both contributions and expenditures, the first \$100 it receives will be taxed at 35 percent, 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.

<sup>20</sup>*Regan v. Taxation with Representation*, 461 U.S. 540, 547 (1983) ("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.")

<sup>21</sup>*Buckley*, 424 U.S. at 44 n. 52 (sometimes referred to as magic words "vote for," "elect," "support," "cast your ballot for," "Smith for Congress," "vote against," "defeat," "reject.").



that communication that was not express advocacy still might not be considered issue advocacy.<sup>22</sup> In other words, the absence of express advocacy did not necessarily constitute issue advocacy. Instead, the court believed *Buckley* classified speech into “issue discussion” and “advocacy of a political result.”<sup>23</sup> Advocacy of a political result, however, extends further than the current definition of express advocacy. It was this latter speech, speech advocating a political result, that the district court believed could be regulated consistent with the First Amendment.<sup>24</sup>

The district court recognized that in the context of provisions dealing with caps on independent expenditures, which apply to expenditures “advocating the election or defeat of [a] candidate,” the Supreme Court found the language unconstitutionally vague because “the distinction between discussion of issues and candidates and advocacy of election or defeat of candidates may often dissolve in practical application.”<sup>25</sup> The Supreme Court, therefore, created a bright line test to ensure that individuals engaged in purely issue discussion would not find themselves inadvertently engaging in speech that made them subject to the act. The issue/express advocacy distinction presented just such a line.

The district court recognized, however, that the issue/express advocacy distinction was not universal. At most, it only applies to organizations whose major purpose is not the nomination or election of candidates for public office.<sup>26</sup> Political committees, defined as organizations whose “major purpose is the nomination or election of a candidate” may be regulated even if they are not engaged in express advocacy because their speech is “by definition, campaign related.”<sup>27</sup> The court noted that political organizations are similar to political committees because by definition section 527 organizations are created to influence the election of an individual to public office, and that Congress may constitutionally require disclosure of political organizations even if they are not engaged in express advocacy.<sup>28</sup>

But after the court concluded that political organizations’ speech could be regulated, it held that the expenditure disclosure provisions in subsection (j) were constitutionally deficient. The court concluded that under *Buckley* the regulation must still “bear[] a sufficient relationship to a substantial government interest” and that the expenditure disclosure provisions failed to satisfy such an interest. Specifically, the court rejected the assertion that either the “informational interest” or the “corruption rationale” that justified the regulation in *Buckley* was present here.

With regard to the informational interest, the court believed that the expenditure disclosure provisions did not satisfy an informational interest because they in no way tied the contribution to a candidate. The court concluded that absent such a tie the provision could not promote the informational interest of “increas[ing] the fund of information concerning those who support candidates.”<sup>29</sup>

The court reached a similar conclusion with regard to the corruption rationale. The court acknowledged that *Buckley* recognized that “disclosure requirements deter actual corruption,” but found that in this case the corruption rationale did not apply because the expenditure disclosure requirements do not require the disclosure of the candidate that benefits from the expenditures.<sup>30</sup> The district court therefore concluded that due to the attenuated risk of corruption when independent expenditures are involved, there must be affirmative evidence in support of the government’s claimed interest.<sup>31</sup> The court concluded that the “sufficiency of the government’s corruption interest is supported only in certain applications, with vast portions of its reach unsupported by the articulated interest.” Accordingly, it concluded that “section 527(j) is not narrowly tailored to serve the government’s interest in combating actual or perceived corruption.”<sup>32</sup>

## B. Fifth Amendment

In addition to arguing that section 527 violated the First Amendment, plaintiffs also argued that the disclosure provisions violated the equal protection clause of the Fifth Amendment because the disclosure provisions do not apply to other exempt organizations that may receive contributions or make expenditures for the purpose of influencing elections.<sup>33</sup> The court concluded that statutory classifications are generally valid if they bear a rational relation to a legitimate government purpose, but that statutes that infringe on fundamental rights are subject to a higher level of scrutiny. The court concluded that the contribution disclosure limitations were subject to rational basis scrutiny because the provision did not implicate plaintiffs’ First Amendment rights, but the expenditure limitations were subject to strict scrutiny because they did implicate plaintiffs’ First Amendment rights.

The court then upheld the contribution disclosure provisions under rational basis scrutiny, but rejected the expenditure provisions under a strict scrutiny analysis. In applying strict scrutiny, the court determined that under *Regan* Congress could have required all tax-exempt organizations to disclose their expenditures, and that its failure to do so raises Fifth Amendment concerns. The court further found that because the government failed to establish that political organizations are sufficiently different from other exempt organizations in ways that justify treating them differently,

<sup>22</sup>*NFRA*, 2002 WL 2008245, \*15.

<sup>23</sup>*Id.* at \*15-16, citing *Buckley*, 424 U.S. at 79.

<sup>24</sup>*Id.*

<sup>25</sup>*Id.* at \*16 citing *Buckley*, 424 U.S. at 42.

<sup>26</sup>*Id.*

<sup>27</sup>*Id.* at \*19-20, *Buckley*, 424 U.S. at 79.

<sup>28</sup>Specifically, section 527 provides that a political organization is an entity organized or operated for the purpose of influencing or attempting to influence the selection, nomination, election, or appointment of an individual to public office. IRC section 527 (e).

<sup>29</sup>*NFRA*, 2002 WL 2008245, \*24, citing *Buckley* at 81.

<sup>30</sup>*Id.* at \*25.

<sup>31</sup>*Id.*

<sup>32</sup>*Id.* at \*26.

<sup>33</sup>*Id.* at \*26-27. Labor unions, social welfare organizations, and other section 501 organizations are not subject to the disclosure provisions.

527(j)'s expenditure disclosure provisions violate the equal protection clause.<sup>34</sup>

### C. Tenth Amendment

Section 527's disclosure provisions specifically apply to local and state electoral advocacy.<sup>35</sup> Plaintiffs contended that Congress does not have the power to regulate state elections and that the provisions in section 527, as they pertain to organizations involved in state and local elections, violate the Tenth Amendment because Congress did not exercise its taxing power when it enacted section 527(j). The district court agreed with plaintiffs and concluded that Congress in passing section 527(j) was not exercising its taxing power but was instead attempting to regulate state and local elections.<sup>36</sup> The court noted that section 527(j) was not designed to raise revenue or aid in tax collection, but instead was an attempt by the government to regulate elections. Finally, the court noted that a political organization's tax liability is not impacted by the content of its disclosures or by the failure to make disclosures (because it believes subsection (j) is a penalty), and section 527(j), therefore, does not "assist in determining the fact or amount of tax liability."<sup>37</sup>

The court concluded that "while the taxing power authorizes Congress to legislate in an area otherwise reserved to the states," the statute at issue was not enacted pursuant to that power. It stated, "[b]ecause section 527(j) is not a revenue measure and does not serve any revenue purpose, the court concludes that on its face section 527(j) reflects Congress's purpose to regulate state and local electoral advocacy."<sup>38</sup>

## IV. Commentary on Decision

The district court decision raises complex and important tax, election, and constitutional law issues. Although the court struck down the expenditure-related disclosure provisions in subsection (j), the decision is a resounding win for the government and for election law reform advocates.

### A. Subsidy Rationale

First, this case accepted the government's argument that *Regan v. Taxpayers with Representation* was the appropriate authority for initially examining the constitutionality of the provision, and recognized that contributions to an exempt organization could be taxable to that organization as income. By concentrating on the subsidy rationale in *Regan*, the district court was able to uphold the contribution disclosure provisions without resorting to an analysis under *Buckley*. By accepting that *Regan* and not *Buckley* controls the case,

<sup>34</sup>*Id.* at 32-33. This conclusion, however, appears to be somewhat weakened by the court's determination that section 527's expenditure disclosure provisions are unconstitutional. The court concluded that "[w]hile the enforcement method chosen by Congress could not constitutionally have been imposed on other tax-exempt organizations without modification, the disclosure requirement itself could constitutionally have been imposed on such organizations." *Id.*

<sup>35</sup>IRC sections 527(e)(1), (2).

<sup>36</sup>*Id.* at 39.

<sup>37</sup>*Id.*

<sup>38</sup>*Id.*

the district court acknowledged that significant campaign finance reform provisions for exempt organizations will be considered constitutional as long as the provisions are conditions on an organization's exempt status.

In fact, even the court's determination that expenditure disclosure provisions are unconstitutional can easily be modified to address the court's concerns. The court concluded that due to the fact that contributions and expenditures could be taxed (or penalized) under subsection (j), the amount paid under subsection (j) could exceed the amount of the tax subsidy. It found this fact dispositive as to why the subsidy rationale did not apply to the expenditure disclosure provisions.

This concern, however, can be dealt with in three different ways. First, subsection (j) could be amended to state that the penalty imposed under subsection (j) may never exceed that amount that would have been due under (i)(4). This ensures that (j) only operates to eliminate that tax subsidy and does not produce a penalty in excess of that subsidy. If Congress so amended the statute, both the contribution and expenditure disclosure provisions would be constitutional under the court's opinion.

Second, that the amount paid under (j) should never exceed the amount owed under (i)(4) can reasonably be implied by the current statutory scheme. Although the district court recognized and then disregarded the fact that an organization should not end up paying more under (j) than it would have paid under (i)(4), common sense tells us that this will almost always be the case. An organization not wishing to disclose contributions or expenditures will simply choose not to file with the Secretary under (i) and will be taxed on its income, including contributions, under (i)(4). It is only those organizations that plan on disclosing contributions and expenditures, but then choose not to do so in specific instances, that are subject to subsection (j). Thus, an organization should never be subject to a greater "penalty" (or tax) under subsection (j) than it would have had to pay under (i)(4). For if the "penalty" under (j) would be greater than (i)(4), the organization would simply choose not to disclose any contributions or expenditures and pay tax under (i)(4). Because it is reasonable to assume that Congress did not intend organizations that partially comply with the statute to pay more than those that do not, the IRS could issue regulations stating that the payment required to be paid under subsection (j) shall not exceed what would have been paid under (i)(4). Such a reasonable interpretation of the statute would likely be upheld, and would ensure that section 527 as written would come within the *Regan* subsidy rationale.

Finally, the court accepted that the relevant legal question is whether the statute eliminates a subsidy or creates a penalty. But in answering that question, the court looked at subsection (j) by itself. It did not consider section 527 as a whole. If we consider subsection (j)'s import as part of section 527, we see that the statute as a whole falls within the subsidy rationale in *Regan*.

Although the government has argued that subsection (j) provides a choice to exempt organizations whether to disclose

or not, it can also be seen as an enforcement mechanism applicable to organizations that choose to opt-in to the regulatory structure. The statute as written provides that an organization may opt-in to the statutory framework by filing with the Secretary or it may opt-out and pay tax on its income.<sup>39</sup> If it opts-in, it is then subject to the disclosure requirements. 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 that disclosure and requires that organizations that fail to disclose pay the amount established in subsection (j).<sup>40</sup> 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 do so must pay a tax under (i)(4). Organizations that are willing to do so are exempt. 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 (i) and then not disclose under (j).

## B. Buckley Approach

In addition to concluding that the *Regan* analysis is the initial framework for considering the decision, the court also supported the position of campaign finance reformers by recognizing that the issue/express advocacy standard promoted by plaintiffs was not the proper standard under *Buckley*. The district court believed that speech advocating a political result could be regulated under *Buckley* even if it was not express advocacy, and specifically rejected the idea that the absence of express advocacy was issue advocacy. This decision opens the door for scholars and litigants arguing for a middle ground between express and issue advocacy.<sup>41</sup>

Campaign finance reform advocates may be less thrilled with the court's analysis of the government's interest in regulating campaign activity. The court recognized that the speech at issue here could be regulated consistent with *Buckley* if it satisfied an important government interest. It rejected, however, that the interests presented in *Buckley*, namely the information interest and the corruption rationale, were present

here. In this regard, the court failed to recognize that both the information interest and the corruption rationale were present here and were sufficient to establish important government interests.<sup>42</sup>

First, the court appears to conclude that the information interest was not served here because the statute was not strong enough. The court concluded that because the disclosure does not tie a specific expenditure to any candidate it does not satisfy the informational interest present in *Buckley*. This, however, ignores that although the expenditure disclosure provision may not in and of itself disclose who the expenditure supports, the disclosure along with knowledge of the expenditure does. For example, knowing that the Fund for a Great America spent \$50,000 on advertisements does not necessarily promote the informational interest in *Buckley*, but knowing that the Fund spent \$50,000 on advertisements attacking a specific candidate does. Absent the disclosure provision in section 527, it might be impossible to tie the advertisement to the Fund for a Great America. It is the combination of the disclosed information with public information that is already available that promotes the government's informational interest.<sup>43</sup>

Next, the court concluded that the expenditure disclosure provision does not satisfy the government interest in preventing corruption. In this regard, the court required convincing evidence that the disclosure provisions were necessary to prevent corruption. Even if this standard is correct, a point that I think is highly debatable, there is clearly convincing evidence that undisclosed expenditures by political organizations can have a corrupting influence on the electoral system. In fact, the advertisements by Republicans for Clean Air that shot life into the current reform effort highlight the corruption potential. Absent disclosure provisions it would have been impossible to compel Republicans for Clean Air to disclose the source of its funds.<sup>44</sup> The source turned out

<sup>39</sup>An organization that wishes to opt-out is not required to notify the IRS of that choice. All organizations that file to opt-in are subject to tax.

<sup>40</sup>If Congress did not require some type of penalty on undisclosed expenditures under (j), section 527 organizations could obfuscate the purposes of the act by disclosing all contributions and no expenditures. It is often unhelpful to know who funds an organization if one does not know who the organization supports. This problem is partially rectified by Federal Communication Commission rules that require political television advertisements to carry the name of the sponsor of the advertisement. See 47 U.S.C. 317 (2002); 47 C.F.R. 73.1212.

<sup>41</sup>Professor Edward Foley has recently suggested that an advertisement that compares two political candidates should be considered an election advertisement for FECA purposes. See Edward B. Foley, "Smith for Congress" and Its Equivalents: The Importance of Chamber of Commerce v. Moore, forthcoming in the ELECTION LAW JOURNAL.

<sup>42</sup>See *Landell v. Vermont Public Interest Research Group*, 300 F.3d 129 (2002) (finding strong enough corruption and information interests for far stricter campaign finance restrictions than those present here).

<sup>43</sup>Recent scholarship indicates that disclosure provisions, even as they apply to organizations not officially affiliated with a candidate, satisfy important informational interests because they provide voters with clues as to which organizations or individuals support various candidates. These clues help voters establish candidates' positions and empower voters. See Elizabeth Garrett, *The Future of Campaign Finance Reform Laws in the Courts and in Congress*, Chicago Public Law and Legal Theory Working Paper No. 19, at 11-13 (forthcoming 27 Ok. CTRY. U. L. REV. \_\_ (2002)) ("Voting cues must provide accurate information to voters in order to empower them: that is, the limited information that citizens obtain must allow them to draw correct conclusions . . .").

<sup>44</sup>After some pressure, Sam and Charles Wyly disclosed that they were the sponsors of the advertisements. The Wyly brothers spent \$2.5 million on the advertisements praising then-Governor Bush and attacking Senator McCain. Charles Wyly was also one of President Bush's "pioneer" fund-raisers and raised at least \$100,000 for the president's campaign. He and his brother also each contributed \$100,000 to the Bush-Cheney Inaugural Committee. Michael Petrocelli, "Bush Names Wife of Campaign Supporter to Kennedy Center," *Houston Chronicle*, Apr. 11, 2002 at A5.



to be a long-time friend of President Bush. Moreover, the wife of one of the sponsors of the commercial was recently appointed to the Kennedy Center Board by President Bush.<sup>45</sup> It is just this type of appearance of corruption that disclosure provisions are intended to address.<sup>46</sup>

### C. Tenth Amendment Analysis

With regard to the court's Tenth Amendment analysis, the court's conclusion that Congress was not exercising its taxing authority is puzzling. Under *Regan*, Congress may choose not to subsidize through a tax exemption political organizations that fail to disclose contributors and expenditures. There is no reason why Congress should be required to subsidize such organizations if they fail to comply with disclosure provisions simply because the organizations are engaged in state and local advocacy. Such an interpretation would in effect force Congress to provide a tax exemption to state and local political organizations. These organizations have no more right to such an exemption than organizations involved in advocacy at the federal level.

Moreover, the court's Tenth Amendment analysis shares the same error that the court made in striking down the expenditure limits. The court examines subsection (j) independently to determine that it is not a tax provision. Subsection (j) must be examined as part of section 527. If the entire section is considered, the provision is clearly an attempt by Congress to eliminate tax subsidies for organizations that fail to comply with the disclosure provisions. It does not matter that significant revenue is not raised by the particular statute. The provision helps create fairness and equity in the code by preventing taxpayers from subsidizing organizations engaged in secret political speech.<sup>47</sup>

<sup>45</sup>Charles Wyly's wife, Caroline Wyly, was appointed by President Bush to serve on the John F. Kennedy Center Advisory Committee on the Arts. 38 Weekly Comp. Pres. Doc. 615 (Apr. 15, 2002).

<sup>46</sup>The legislative history surrounding the amendments to section 527 also indicates that Congress was concerned with the potential for corruption posed by undisclosed campaign expenditures. See 146 *Cong. Rec.* S5995 (daily ed. June 28, 2000) (statement of Sen. Lieberman) ("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."). Moreover, according to Public Citizen, political organizations are now being used and controlled by candidates to promote their candidacies. To the extent that these organizations are not involved in express advocacy, they contend that they are not subject to FECA. Public Citizen identified 61 members of Congress who have political organizations and the top 25 political organizations collected approximately \$30 million in a two-year election cycle. See "Congressional Leaders' Soft Money Accounts Show Need for Campaign Finance Reform Bills," *Public Citizen*, at 1, Feb. 26, 2002.

<sup>47</sup>The court's Fifth Amendment analysis has no impact on the decision. The court concluded that if the disclosure provision violates the First Amendment it also violates the Fifth Amendment, and if it can withstand First Amendment scrutiny it also survives Fifth Amendment scrutiny.

### V. Conclusion

In all, campaign reform advocates should be pleased with the district court's decision in *National Federation of Republican Assemblies*. The court accepted the government's position that a tax-exempt organization's tax status can be conditioned upon the entity's willingness to comply with campaign finance disclosure provisions. In fact, the court indicated that the reasons for upholding the statute in this instance may be extended to regulating other tax-exempt organizations. Thus, the tax subsidy rationale from *Regan* will continue to provide a framework for campaign finance reform as more and more tax-exempt entities engage in political advocacy.<sup>48</sup>

Moreover, the court, in interpreting *Buckley*, used a more flexible test and rejected the issue/express advocacy dichotomy that so many courts are currently using. By recognizing that speech other than express advocacy can be regulated under *Buckley* the decision increases the chances that disclosure provisions will be upheld even outside of the exempt organization tax subsidy framework.

To the extent the court struck down the disclosure provisions, the alleged infirmities can easily be fixed. Congress can amend section 527 and clarify that the penalty under subsection (j) can never exceed that amount that an organization would have had to pay had it not chosen to be an exempt organization. Alternatively, Congress can clearly set out the government's informational and corruption interests that justify campaign finance disclosure provisions.

The most immediate impact of this decision, however, is to give credence to the IRS's current push to require political organizations to comply with section 527.<sup>49</sup> The district court's decision clearly requires that organizations involved in political advocacy at the federal level wishing to be tax-exempt comply with the notice provisions in section 527(i) and the contribution disclosure provisions in subsection (j). Section 527 organizations would therefore be wise to comply with the IRS's current regulations until a final decision is reached in this case.

<sup>48</sup>To the extent organizations are now trying to conduct political advocacy through other exempt organizations, such as (c)(4) organizations, the district court opinion should give them pause. If the perceived abuse by section 527 organizations is transferred to 501(c)(4) organizations, Congress can, under the district court's logic, expand the disclosure provisions to cover other exempt organizations.

<sup>49</sup>IRS News Release IR-2002-84 (July 1, 2002) (warning political organizations that they have only 15 days to submit past-due or corrected items); IRS Notice 2002-34, 2002-21 IRB 990 (IRS announcement of voluntary compliance program to promote disclosure by political organizations).



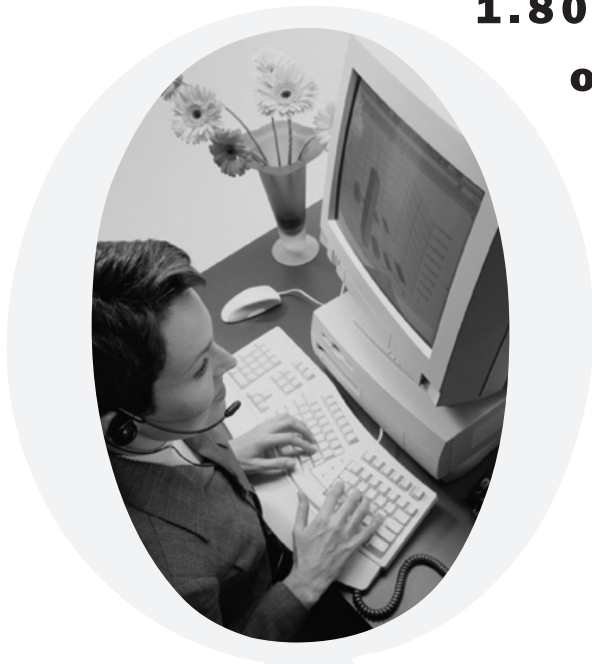
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