

The 527 Bill Puts 501(c) Groups at Risk

The 527 legislation (HR 513) passed by the House on April 5, 2006 not only would extinguish many Section 527 groups in a breathtaking assault on free speech, but would also have far-reaching detrimental consequences on the operations of 501(c) groups by forcing them to rely more on their federal PACs or to pay tax on their political spending. At risk are non-profit lobbying and advocacy groups, business associations and labor unions.

Because federal tax law explicitly allows for some overlap between 501(c) and 527 activity, regulation of the latter will threaten the former. Much activity described by Section 527 is routinely and permissibly conducted by 501(c) groups. Indeed, the same advertisement could be deemed either a lobbying expense or a political one, depending on the view or bias of the regulator. If this bill becomes law, millions of dollars will begin to flow into 501(c) groups, inevitably leading to charges that many such groups are “evading” the new law’s restrictions.

In turn, the FEC and the IRS will be challenged in inevitable complaints filed by political adversaries of Section 501(c) groups to review their activities. Those groups must take such complaints seriously, and legal costs can quickly skyrocket. And, if the FEC or the IRS determines that the group should have operated as a political committee or even a non-federal 527 group, its treasury and viability could be threatened. If this legislation passes, the FEC in particular can be expected to become emboldened to target 501(c) groups that it believes should be subject to regulation.

The FEC could gain unprecedented explicit jurisdiction over 501(c) group operations, which could threaten the activities of such groups. Early versions of the House bill could have exposed 501(c) groups to comprehensive regulation of their political activities by giving the FEC explicit discretion to investigate their activities and determine that they should be regulated and restricted as 527s. This language could easily emerge as HR 513 proceeds to the Senate or conference committee. And even a slight modification as to what constitutes “any applicable 527 organization” that may be regulated by the FEC as a “political committee” could easily cover many 501(c) groups. But even if that language does not re-emerge, the inevitable next step for emboldened campaign finance “reform” advocates and their opinion-maker advocates will be to target 501(c) groups very directly through new legislation and novel legal tactics before activist judges.

Newspapers and so-called “campaign watchdog” groups are already calling for 527 regulations to be extended to 501(c) groups. *The Washington Post’s* editorial supporting the 527 bill noted hopefully that it could be expanded to cover other groups in the future. *The Philadelphia Inquirer* recently wrote that “The public would be better served by expanding the campaign spending regulations to include all the groups” instead of just 527s. And Public Citizen, which is part of the coalition of “reform” groups that engage in a daily drumbeat for enactment of 527 restrictions, published a report in 2004 on so-called “stealth PACs,” its name for “numerous non-profit groups with 501(c) tax status [that] exploit loose regulations and lax oversight to spend millions of dollars influencing elections while keeping secret the identities of their donors.” The report cited ordinary legislative and public advocacy as election-influencing activity that merited the same regulation as contributions to candidates and explicit electoral advocacy. Clearly, enactment of the 527 Bill will make 501(c) groups the next target of “reform.”

Many 501(c) groups will face huge new tax bills if HR 513 becomes law. For many years the IRS has encouraged 501(c) groups to form separate segregated funds with 527 status to conduct activities that might be considered election-influencing activities but don't require federal PAC status because they deal with state or local elections or the federal electoral impact is indirect or uncertain. Funding such activities through a 527 fund minimizes the potential tax consequences of paying for certain public communications and other activities, especially in an election year. But under the 527 bill, many 501(c) groups will find they are faced with two unattractive choices: either (a) make all such expenditures through a federal PAC or (b) pay a 35% tax on investment and royalty income, up to the amount of the possibly election-influencing expenditures, where no such tax exists today.

501(c) groups with state and local PACs will have to navigate new and complex rules. The new "allocation" rules in the 527 bill would make it illegal for a 501(c) group's state or local PAC to reference a federal candidate or a political party unless at least half the expenditure was paid by the group's federal PAC. This will make it much more difficult and expensive for a 501(c) group to undertake its ordinary activities and spend appropriately for its various programs.

The history of campaign finance regulation demonstrates that 501(c) groups will be the next targets for legislative restriction. When the McCain-Feingold law was enacted, it was widely and accurately predicted that it would lead to a flood of money into 527s, as they could lawfully receive and spend any sum from any source because they didn't contribute to federal candidates and couldn't coordinate their activities with them. Just as predictably, if 527s are deprived of funding, money will move into 501(c) groups that operate under similar constraints, and that will inevitably lead to equally draconian legislative proposals to shut off resources to them and curtail their core public policy activities.

Enforcement is biased against conservatives. As reformers and bureaucrats seek to use the Courts and the FEC enforcement process to expand the interpretation of this potential new law, conservatives are the likely target for test cases. As former FEC Chairman Brad Smith has written, "It doesn't take a long memory to recall that somehow the 1996 Democratic fundraising scandals became GOP scandals in the press. The Christian Coalition's decline was marked by an FEC investigation that sapped the group's finances and energy for years, despite its eventual exoneration. An FEC investigation also destroyed The Coalition, a major pro-GOP business effort in the late 1990s." The FEC investigation against The Coalition also generated enormous legal bills for many 501(c) groups that were members or supporters of the group.

This is because FEC enforcement is driven almost completely by outside complaints, and there is a whole left-wing complaint business, including, as Smith notes, "Common Cause, Democracy 21, the Center for Responsive Politics, the Center for Responsibility and Ethics in Washington (CREW), and the Campaign Legal Center." Their complaints are overwhelmingly filed against conservative groups and Republicans.

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