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**H.R. 513, THE “527 REFORM ACT OF 2005”**

H.R. 513, the “527 Reform Act of 2005” (“527 Bill”), passed by the House of Representatives on April 5, 2006, would amend the Federal Election Campaign Act (“FECA”) to:

- **Sharply curtail the ability of individuals and groups to associate in the pursuit of political and policy goals, even though under current Section 527 law they must act completely independently of candidates and parties and fully disclose their receipts and spending**, by outlawing many non-federal Section 527 organizations.
- **Force tax-exempt Section 501(c) organizations--advocacy groups, unions, non-profit corporations and trade associations, all across the political spectrum--to finance substantially more of their communications about federal officeholders and their voter mobilization activities either through federal PACs or through taxable general treasury spending.**
- **Divert much political activity from transparent Section 527 groups to Section 501(c) groups whose finances are confidential--**which inevitably will lead to demands that those Section 501(c) groups’ general treasury fundraising and spending be targeted in order to extinguish all “soft” “election-influencing” activity.
- **Skew federal election law in favor of wealthy individuals and business corporations** over unions and other Section 501(c) non-profit groups, because the rich can pay for everything a Section 527 group will no longer be able to, and businesses will still be able to spend for political purposes in tax-neutral ways.
- **Unjustly shield federal officeholders from public criticism and accountability by outlawing groups that engage in public speech about their official conduct.**
- **Make federal election law even more complex and intimidating to individuals and groups than it already is.**

Four years ago Congress enacted the Bipartisan Campaign Reform Act (BCRA). It barred federal candidates and officeholders and national political parties from dealing in any way with “soft money” – that is, money other than strictly limited contributions from individuals and federal

PACs – and imposed soft money controls on even state and local parties. The rationale was to end the danger or even “appearance” of corruption when soft money goes to candidates, officeholders or the parties that are presumed to be channels to influence them. Meanwhile, BCRA doubled the amounts of hard money that federal candidates could receive from individuals and indexed them to inflation; the \$1,000 contribution limit of yesteryear is now \$2,100.

BCRA also imposed the first election-law limits ever on independent, non-electoral speech by unions, business corporations, and incorporated non-profit advocacy groups, trade associations and Section 527 groups – barring them from paying to broadcast anything within 60 days of an election that even “refers” to a federal candidate, no matter the content or context. The rationale was that the broadcast might “influence” the election, so BCRA labeled it an “electioneering communication,” and it was considered to be a very bad thing -- in legal terms, the “functional equivalent” of the “express advocacy” of the election or defeat of a federal candidate, until then the only speech that federal law prohibited unions and business and non-profit corporations from engaging in.

**The 527 Bill has nothing to do with limiting the flow of money to candidates or parties, or addressing any other circumstance judicially recognized as susceptible to corruption or its appearance. Instead, it substantially enlarges upon BCRA’s ban on certain union or corporate-funded broadcasts by targeting individuals and groups – no longer limited to unions and corporations – that band together in the 527 organizational form to influence politics and policy, or even just to register voters or get them to vote, while operating completely independently of candidates and parties, and publicly disclosing their receipts and spending.**

**The 527 Bill goes far beyond BCRA in preventing those associational activities from happening *anywhere, almost any time and by any means* by a 527 unless it’s carried out by the most stringently regulated creature of federal election law – the federal PAC. And, in doing so, the 527 Bill both restricts the political activities of Section 501(c) organizations in significant new ways and plainly lays the groundwork for the next stage of “reforming” how Section 501(c) groups may operate.**

The 527 bill also includes a provision, not directly related to Section 527 organizations, that would eliminate current limits on how much political parties can spend in coordination with their presidential, Senate and House candidates in general elections and enable unlimited coordination also in primary elections.

This analysis first summarizes the 527 Bill, and then assesses its likely impact on Section 527 political and associational activity independent of candidates and political parties, on Section 501(c) tax-exempt groups, and on the relative power of participants in the political system.

## **SUMMARY OF THE BILL**

### **I. Converting Most Non-Federal “527”s Into Federal PACs**

The 527 Bill compels most currently non-federal (“soft”) Section 527 organizations-- whether they are independent, unaffiliated groups or the “separate segregated funds” of Section 501(c) organizations--to operate instead as federal political committees, subjecting them to all of FECA’s federal (“hard”) money, registration and reporting requirements.

**The 527 Bill declares that every organization that registers with the Internal Revenue Service under Section 527 of the Internal Revenue Code is a federal PAC *unless* it satisfies one of the following exceptions:**

**A. Complete Exceptions**

1. Its annual receipts are less than \$25,000;
2. It is a state or local candidate or political party committee;
3. It exclusively pays expenses of an elective or political party office that would be deductible if paid by an individual; *or*
4. It exclusively pays expenses of a newsletter fund of a federal, state or local candidate or elective officeholder.

**B. Conditional Exceptions**

1. It consists solely of state or local candidates or officeholders, but *only* if:
  - i. It refers *only* to non-federal candidates or “state or local issues” (initiatives, referenda, constitutional amendments, bond issues or other ballot issues) in *all* its “*voter drive activities*” - - that is, voter registration, voter ID, GOTV or generic campaign (party-promotion) activity and related public communications in connection with an election where a federal candidate appears on the ballot - - *and*
  - ii. It *never* refers to federal candidates (*unless* either that candidate is also a non-federal candidate or the reference concerns only the federal candidate’s endorsement of a non-federal candidate or state or local ballot issue) or political parties (*unless* the reference either is to identify the speaker, does not reflect support for or opposition to a federal candidate, or is not a generic activity) in *any* of its voter drive activities; *or*
- 2(a). Its “election or nomination activities relate exclusively” to:
  - i. “Elections where no candidate for Federal office appears on the ballot”;
  - ii. Candidates for *non*-federal elected offices;
  - iii. The selection of individuals for *non-elected* offices; *or*

- iv. State or local ballot initiatives, referenda, constitutional amendments, bond issues or other ballot issues;
- (b). But *only* if it does *not* spend more than \$1,000 for either:
- i. **Public communications that “promote, support, attack or oppose” a clearly identified federal candidate** at *any* time during the year before a general federal election (*e.g.*, November 7, 2005 through November 7, 2006); *or*
  - ii. **Voter drive activities, unless:**
    - a) It operates only in one state;
    - b) It refers to non-federal candidates or state or local ballot issues in *all* of its voter drive activities;
    - c) It *never* refers to federal candidates or political parties;
    - d) Federal officeholders and candidates and national political parties don’t participate in its activities *except* to solicit contributions for them from hard-money sources (individuals and federal PACs) and amounts (\$5,000/yr.); *and*
    - e) It doesn’t contribute to federal candidates.

“Voter drive activity” does *not* include communications directed by unions to their members, by corporations to their shareholders, and by unions or corporations to their executive and administrative personnel, and their families.

NOTE: If the current Federal Election Commission (FEC) regulatory definition of “in connection with an election” applies, this includes voter registration, GOTV, voter ID and generic activity from a state’s earliest federal primary filing deadline until the general election (or, in states without primaries, from January 1 of the federal election year until the general election). But the 527 Bill’s intent may be to cover these activities for an even *longer* period of time.

**II. Requiring Either All-Federal Spending or Particular Allocated Spending Between Federal and “Qualified” Non-Federal Accounts of Political Committees and Section 501 (c) Organizations**

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**A. The 527 Bill requires independent (“non-connected”) FEC political committees, as well as FEC-registered “separate segregated funds” of unions, advocacy groups, business and non-profit corporations and trade associations (the “connected**

organizations” of those funds) either to pay (with hard money) for certain spending that does *not* involve federal “contributions” or “expenditures” regulated by FECA, or to “allocate” such spending with newly defined and restricted so-called “qualified” non-federal political accounts (see II(B), below). The FEC could increase any of the 50% hard-money minimum requirements below by regulation, except that it could either increase or decrease the 50% minimum for administrative expenses. (These allocation rules don’t apply to state or local party committees or groups of state or local candidates or officeholders.) Specifically:

<b>Source of payment</b>	<b>Administrative (overhead) expenses</b>	<b>Fundraising for both federal and non-federal accounts (but NOT for public communications)</b>
Federal Account	At least 50%	At least 50%
Qualified Non-federal Account	At most 50%	At most 50%
Connected Organization	Up to 100%	Up to 100%
	<b>Public communications or voter drive activities that refer to political party but no candidate, and don't relate exclusively to an election with no federal candidates</b>	<b>Public communications or voter drive activities that refer to federal candidates (but NOT non-federal candidates), whether or not they also refer to a political party</b>
Federal Account	At least 50%	100%
Qualified Non-federal Account	At most 50%	None
Connected Organization	Unclear	Unclear
	<b>Public communications or voter drive activities that refer to political party AND non-federal candidates (but NOT federal candidates) and don't relate exclusively to an election with no federal candidates</b>	<b>Public communications or voter drive activities that refer to federal AND non-federal candidates, whether or not they also refer to a political party</b>
Federal Account	At least 50%	At least 50%

Qualified Non-federal Account	At most 50%	At most 50%
Connected Organization	Unclear	Unclear
	<b>Public communications or voter drive activities that refer to non-federal candidates (and NOT to federal candidates or political parties)</b>	<b>Public communications and voter activities that refer to non-federal candidates, political parties or both and are related exclusively to an election with no federal candidates</b>
Federal Account	Any % (inferred from bill)	Any % (inferred from bill)
Non-Federal Account	Any % (inferred from bill)	Any % (inferred from bill)
Connected Organization	Any % (inferred from bill)	Any % (inferred from bill)

**B. The 527 Bill permits only “qualified” non-federal accounts to allocate spending with federal accounts.** As described in II(A), above, an independent (“non-connected”) FEC political committee or an FEC political committee that is the “separate segregated fund” of a “connected organization” – a union, business or non-profit corporation, advocacy group or trade association – may allocate spending only with a “qualified” non-federal account, meaning an account subject to the following new rules:

1. Funds for the non-federal account are “raised ...only from individuals” and the account “may not accept more than \$25,000...from any one individual in any calendar year”;
2. All qualified non-federal accounts of non-connected committees and separate segregated funds that are affiliated -- “directly or indirectly established, financed, maintained or controlled by the same person or persons” -- must be “treated as one account”;
3. National political parties and federal candidates and officeholders may not solicit, receive, direct, transfer or spend donations to the account;
4. The account must comply with all other applicable federal, state and local laws, including contribution limits; *and*
5. All of a qualified non-federal account’s receipts and disbursements must be reported to the FEC by its affiliated federal PAC, even if the account fully reports to the Internal Revenue Service (IRS) or a state or local government agency.

**C. These allocation requirements are even more hard-money oriented than the allocation regulations the FEC issued effective January 1, 2005:**

1. The bill permits allocation with only “qualified” non-federal accounts, that is, accounts composed of individual money capped at \$25,000/yr., while the regulations impose no new requirements on non-federal accounts that allocate with federal accounts;
2. The bill requires fundraising expenses to be paid at least 50% federal and allows *no* allocation for public communications that fundraise, while the regulations permit all fundraising expenses to be allocated according to the ratio of federal and non-federal funds received.
3. The bill requires public communications and voter drives that refer to both political parties and non-federal candidates to be paid at least 50% federal, while the regulations permit them to be paid 100% non-federal; *and*
4. The bill requires public communications and voter drives that refer to both federal and nonfederal candidates to be paid at least 50% federal, while the regulations require them to be allocated on a relative time/space basis.

See 11 C.F.R. § 106.6(b), (c) and (f); FEC, “Political Committee Status, Definition of Contribution, and Allocation for Separate Segregated Funds and Nonconnected Committees,” 69 Fed. Reg. 68056 (Nov. 23, 2004).

**III. Repealing Limits on Party Coordinated Expenditures with Candidates**

The 527 Bill repeals current limits on how much a national, state or local political party can spend in coordination with its presidential, Senate and House candidates to advance their campaigns.

Under current law, party committees together can make such coordinated expenditures according to various formula. Effective in 2005, parties are permitted to spend, in a general election, \$38,300 with a House candidate, and from \$76,600 to \$2,014,900 with a Senate candidate (depending on state population). In 2004 parties could spend \$74.6 million with a presidential nominee; the 2008 figure is not yet set. The 527 Bill eliminates all such restrictions, enabling unlimited coordinated spending by parties with their candidates in both primary and general elections.

**IMPACT ON “527” POLITICAL ASSOCIATIONAL ACTIVITY INDEPENDENT OF CANDIDATES AND PARTIES**

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**A. The 527 Bill will directly impair the ability of individuals and groups to associate for political, legislative and policy purposes.** The bill eliminates a substantial range of uses of the 527 organizational form with its new triggers for federal PAC status: dealing to *any* degree with federal candidates or elections, or spending just \$1,000.01 on “promote support, attack or oppose” (“PSAO”) communications or various “voter drive activity.” The Supreme Court has repeatedly upheld an individual’s First Amendment right to spend as much

as he or she wishes to convey any electoral message, including about federal elections, *independently* of candidates and parties.

**B. The bill targets substantial political, legislative and policy spending despite the fact that it occurs completely independently of candidates, officeholders and political parties.** The campaign to eliminate “soft money” is no longer aimed at redressing “corrupt” influences associated with the private giving of soft money to candidates and parties. The demonizing characterization of supposedly sinister “527s” and of virtually all political activities as “soft money influence” masks the fact that what’s being targeted are the pooled and fully publicly disclosed efforts of individuals, membership groups, unions and other associations to advance common political and social causes *independently* of candidates, officeholders and parties.

**C. The bill effectively imposes an “any purpose” test for federal PAC status--contrary to the “major purpose” requirement judicially imposed in *Buckley v. Valeo*, 424 U.S. 1, 79 (1976)--because it also federalizes *any* 527 that spends over \$1,000 either to “promote, support, attack or oppose” a federal candidate at *any* time within a year before a general election, or for most “voter drive activity”--even if totally non-partisan--during substantial periods of time before a federal election.**

**D. The bill fails to define what “promote, support, attack or oppose” (PSAO) means or even restrict it to speech that refers to candidacy or elections.** Communications that express opinions about incumbent federal officeholders’ official conduct, policy positions or legislative votes could convert the 527 speaker into a federal PAC. For example, if the bill were in effect during 2003-04, commentary about “the President’s” policies from November 2, 2003 to November 2, 2004, would have turned the Section 527 group into a federal PAC. Likewise, a voter guide that indicates its sponsor’s public policy views, and therefore inferentially suggests which candidate positions the guide’s sponsor prefers, could be prohibited speech for a non-federal Section 527 group.

**E. The bill leaves the financing of voter drive activity by supposedly corruptible state and local political parties less regulated than the financing of the same activity by independent groups that pose no danger of corruption.** That’s because (subject only to state law) the parties can solicit and use union, corporate and individual contributions up to \$10,000/yr. for “voter drive activity,” but if a Section 527 group spends even \$1,000.01 on the same activity, it must operate as a federal PAC, with union and corporate contributions prohibited, and individual contributions capped at \$5,000/yr.

## **IMPACT ON SECTION 501(c) ORGANIZATIONS AND THEIR HARD AND SOFT MONEY POLITICAL ACCOUNTS**

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**A. The 527 Bill proponents falsely contend that the bill has no impact on organizations that are tax-exempt under Section 501(c) of the Internal Revenue Code.** While the bill states that it doesn’t affect the determination of whether any Section 501(c) organization is itself a federal PAC, it will directly impair their ability to raise and spend money for political purposes by forcing them to either rely more on federal PACs or to pay tax on their political spending.

**B. The 527 Bill will curtail or eliminate the activity of Section 501(c) organizations to use separate segregated non-federal Section 527 accounts (“527 SSFs”)**

**funded by their regular treasury funds in order to make tax-exempt political disbursements.** Since the 1970's the IRS has encouraged this practice so that tax-free investment income doesn't finance political activity; these accounts are not "evasions" of federal election law. But the 527 Bill will mandate that non-profit groups conduct their operations otherwise, for any of three reasons:

1. *First*, the 527 SSF will be treated like any other Section 527 organization, forced to operate as a federal PAC unless it satisfies one of the new narrow exceptions (receipts less than \$25,000/yr., confined to non-federal elections, etc.).
2. *Second*, even if the 527 SSF *does* satisfy one of these exceptions, in order to allocate spending with a federal PAC as a "qualified" non-federal account, the 527 SSF's money must be "raised only from individuals" and it "may not accept more than \$25,000 from any one individual in any calendar year." This apparently means that even a Section 501(c) membership organization could *not* fund its non-federal Section 527 account with general treasury funds comprised of individual dues receipts.
3. *Third*, under the new "allocation" requirements for federal and "qualified" non-federal SSFs of Section 501(c) organizations, the federal PAC must finance a substantial share of the political activity anyway, ranging from 50% to 100%, depending solely on whether and when public communications or voter drive activity "refers" in any manner or context to federal candidates, political parties or non-federal candidates.

**C. But the 527 Bill might be read also to prevent Section 501(c) groups now from using their general treasury accounts for public communications or voter drive activities that "refer" to federal candidates or political parties.** That's because the bill's "allocation" provision states that the Section 501(c) "connected organization" of a federal PAC and a qualified non-federal account can pay for their administrative and fundraising expenses--but the bill does *not* likewise provide that the connected organization can pay for public communications or voter drive activity that "refers" to federal candidates or political parties, and instead authorizes only the separate political funds to spend for those purposes. If so interpreted, Section 501(c) groups will be barred immediately from pursuing their usual advocacy and voter engagement work – unless they do so through separately funded, highly regulated political accounts.

**D. Even if that reading is rejected, the 527 Bill will force Section 501(c) organizations to finance much more political and legislative activity than they do now either through (a) a federal PAC or (b) taxable general treasury spending.** That's because if the IRS considers a Section 501(c) group's general treasury spending to be election-influencing (so-called "exempt function" activity), the group must pay a 35% tax on that spending (or the general treasury account's investment (interest) income, whichever is less) under Section 527(f)(1). The Internal Revenue Code enables Section 501(c) groups to influence elections without paying that tax if they use a non-federal Section 527 account and publicly report its finances. But the 527 Bill upsets that system by sharply reducing the permissible uses of those non-federal Section 527 accounts, forcing the spending instead into Federal PACs or taxable general treasury spending, or--as will often likely happen--chilling the activity entirely.

**E. The 527 Bill invites further regulation of Section 501(c) groups if the bill causes associational activity that was conducted through transparent Section 527 organizations to be undertaken instead through them.** A September 2004 Public Citizen report pejoratively labeled Section 501(c) groups--including unions, trade associations and both liberal and conservative advocacy organizations--“the new stealth PACs” because some of their activities (cited examples include legislative advocacy and membership communications) can influence elections with little or no disclosure (except for unions, which must make detailed disclosures of their receipts and spending under the Labor-Management Reporting and Disclosure Act). In the “reform” worldview, this is intolerable and must be remedied through forced conversion to federal PAC status. The 527 Bill is another significant step down a classic slippery slope that leads inexorably to the general treasury funding and spending of Section 501(c) groups themselves.

**F. The 527 Bill could prohibit or at least chill donations by non-profit groups to organizations that engage in even non-partisan voter registration and GOTV activities.** With non-federal 527 accounts placed off-limits for much “voter drive activity,” donors in the non-profit community may have to use their federal PACs (if they have them and can afford this) or risk making taxable donations from their general treasuries to sustain these important civic efforts.

**G. The new “affiliation” rule for “qualified” non-federal accounts will destroy the autonomy of state and local branches of national non-profit Section 501(c) groups by imposing on their non-federal 527 accounts the same affiliation rules that currently apply to federal PACs.** Yet while most national organizations with state and local affiliates collectively maintain just one or a few federal accounts, they typically sponsor many non-federal accounts in various states and localities, subject to the different state laws. These state-based funds usually operate very autonomously from each other. But the new affiliation rule will compel an unpredictable and burdensome legal aggregation of these non-federal accounts if the Section 501(c) organization and its branches wish to avoid using 100% hard money and instead to “allocate” their political spending.

**H. Because of this new affiliation rule and the individual-only funding requirement for “qualified” non-federal accounts, Section 501(c) organizations will have to create and maintain both “qualified” and other (not “qualified”) non-federal accounts in order to preserve some ability to do political spending permissible under state and local law.** But this would be administratively complex and would still not avoid the significant, new dependence on hard money for non-electoral activities that the 527 Bill mandates.

**I. The allocation rule will prevent state and local PACs sponsored by branches of Section 501(c) organizations from making most “references” to political parties in a public communication or “voter drive activity” in a federal election year--even just saying “vote Democratic” or “vote Republican”--unless they are funded with individual money and secure at least 50% of the cost of the “reference” from the parent Section 501(c) organization’s federal PAC.**

### **IMPACT ON RELATIVE POWER OF PARTICIPANTS IN THE POLITICAL SYSTEM**

**A. The 527 Bill will enhance the power of wealthy individuals.** They will still be able to finance whatever political activity they wish – they’ll just hire others to carry it out. But the bill prohibits people who can’t afford to self-finance their political activities from pooling their resources together in order to do exactly the same thing that the rich can pay for themselves.

**B. The 527 Bill will insulate federal officeholders and candidates from much public criticism and electoral risk, as the bill's sponsors explicitly admit.** “[Sen.] McCain said that lawmakers should support the bill out of self-interest, because it would prevent a rich activist from trying to defeat an incumbent by diverting money into a political race through a 527 organization. ‘That should alarm every federally elected Member of Congress,’ he said.” *Washington Times* (Feb. 3, 2005). The bill will only further enhance the power and voices of elected officials at the expense of their constituents and those affected by their official actions.

**C. The 527 Bill will skew FECA in favor of business corporations over unions and other non-profit groups, upsetting the historic balance of federal election law.** The bill fosters imposition of the 35% “penalty tax” on Section 501(c) groups while leaving corporate tax rules on businesses unchanged. Unlike non-profit organizations, businesses have no need to create treasury-financed Section 527 accounts as a prerequisite to funding their political activities; rather, they may use their corporate general treasuries without incurring a tax in doing so. Although most business political expenditures are non-deductible, this is inconsequential for corporations that owe little or no tax through other accounting devices or that experience an overall loss for tax purposes; and, the corporate tax is graduated from 15% to 35% as a function of the amount of net income. For a business that is economically indifferent to whether its next spending is tax-deductible, a decision to spend on politics is tax-neutral under the Internal Revenue Code. By contrast, a Section 501(c) group compelled by the 527 Bill to use its general treasury account for political spending, which previously could have been effected through its Section 527 account *without* being taxed, will face a penalty tax at the highest 35% rate. And, as a tax on spending, this tax will apply irrespective of whether the group has any actual net income, and it will have no offsetting deductions. Even if the group’s investment (interest) income is less than its political spending, the group will pay the 35% tax on that lesser amount.

**D. The 527 Bill will make one political party’s hard money advantage over others even more potent by completely deregulating party coordinated spending with candidates.** By eliminating the coordinated spending limits and allowing coordinated spending in primaries, the 527 Bill will greatly advantage whichever political party succeeds in raising the most hard money.