



# 527 Groups and Campaign Activity: Analysis Under Campaign Finance and Tax Laws

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## Summary

During recent election cycles, there has been controversy regarding the increased campaign-related activity of 527 groups and to what extent they are regulated under federal law. The controversy stems from the intersection between the Federal Election Campaign Act (FECA), which regulates “political committees,” and Section 527 of the Internal Revenue Code (IRC), which provides tax-exempt status to “political organizations.” Some groups that qualify for beneficial tax treatment as “political organizations” seemingly intend to influence federal elections in ways that may place them outside the FECA definition of “political committee.” This report refers to this subset of Section 527 political organizations as 527 groups or 527s.

Considerable debate has been generated about the extent to which FECA currently regulates 527 groups as “political committees” and the constitutional parameters of such regulation. In the 110<sup>th</sup> Congress, the 527 Reform Act of 2007 (H.R. 420 and S. 463) would have amended FECA to generally treat all Section 527 political organizations active in federal elections as “political committees.” Similar legislation has not yet been introduced in the 111<sup>th</sup> Congress.

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## Background

Campaign-related activity by entities commonly referred to as 527 groups or 527s has increased over the past several election cycles. These groups are a subset of the political organizations that qualify for tax-exempt status under Section 527 of the Internal Revenue Code (IRC).<sup>1</sup> Beginning in earnest in the late 1990s, 527 groups have funded broadcast communications that discuss the position of federal candidates on public policy issues, but carefully avoid expressly advocating for or against a candidate. Although these “issue advocacy” communications are widely viewed as intending to influence elections, some argue that they are not regulated—and cannot be constitutionally regulated—by the Federal Election Campaign Act (FECA) due to an interpretation of the Supreme Court’s campaign finance law jurisprudence only permitting regulation of communications expressly advocating for the election or defeat of a clearly identified candidate. It was also in the late 1990s that the Internal Revenue Service (IRS) issued several private rulings indicating that some issue advocacy activities qualify as “exempt function” activities under IRC § 527,<sup>2</sup> thereby permitting these groups to qualify for § 527 status. As a result, 527 groups have been able to utilize this “regulatory gap” between the IRC and FECA: while their issue advocacy and campaign activities are sufficient to qualify for § 527 tax-exempt treatment, arguably, they are not sufficiently election-related to trigger regulation under FECA.<sup>3</sup>

By the 2000 election cycle, as the campaign activity of 527s continued to grow, they were often referred to as “stealth PACs” because they were not reporting to the Federal Election Commission (FEC), and only had contact with the IRS if they had to file a tax return. In response, Congress amended IRC § 527 in 2000 and 2002 to generally require that most § 527 political organizations report information to the IRS, the FEC, or a state.<sup>4</sup> Section 527 political organizations that are not FEC-regulated political committees are generally required to report to the IRS their existence within 24 hours of formation and periodically disclose information on contributors who have given at least \$200 during the year and expenditures made to persons who have received at least \$500 during the year, in addition to annual information and tax return requirements.<sup>5</sup> There are exceptions for small organizations, state and local candidate political committees, and state and local political party committees, among others.<sup>6</sup>

Following enactment of the Bipartisan Campaign Reform Act of 2002 (BCRA),<sup>7</sup> which amended FECA and eliminated the flow of unregulated money to political parties, the prominence of 527 groups continued to increase. As unregulated political party soft money was no longer available, there was greater reliance on 527 groups to help candidates compete in increasingly expensive election campaigns.

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<sup>1</sup> Examples of other § 527 political organizations include candidate committees, party committees, political action committees (PACs), and organizations involved in state and local elections or activities related to non-elective offices.

<sup>2</sup> See Priv. Ltr. Rul. 9652026 (Oct. 1, 1996); Priv. Ltr. Rul. 9725036 (March 24, 1997); Priv. Ltr. Rul. 9808037 (Nov. 21, 1997); Priv. Ltr. Rul. 199925051 (March 29, 1999).

<sup>3</sup> Richard Briffault, *Law and Democracy: A Symposium on the Law Governing Our Democratic Process: The 527 Problem ... and the Buckley Problem*, 73 *Geo. Wash. L. Rev.* 949, 958-959 (2005).

<sup>4</sup> P.L. 106-230 and P.L. 107-276.

<sup>5</sup> See I.R.C. § 527(i), (j), and (k), § 6104(a), (b) and (d), § 6033.

<sup>6</sup> For more information on the reporting requirements, see CRS Report RS21716, *Political Organizations Under Section 527 of the Internal Revenue Code*, by (name redacted).

<sup>7</sup> P.L. 107-155.

# Regulating 527 Campaign Activity

## Statutory Provisions

FECA regulates “political committees,” which it defines to include “any committee, club, association, or other group of persons which receives contributions aggregating in excess of \$1,000 during a calendar year or which makes expenditures aggregating in excess of \$1,000 during a calendar year.”<sup>8</sup> In addition, FECA defines both “contribution” and “expenditure” as monies or anything of value “for the purpose of influencing any election for Federal office.”<sup>9</sup> Under FECA, a registered political committee is required to raise and spend funds subject to FECA contribution limits, source restrictions, and disclosure requirements.

IRC § 527 provides beneficial tax treatment to qualifying “political organizations.”<sup>10</sup> These are any organization, including a party, committee, association, or fund, that is organized and operated primarily to directly or indirectly accept contributions and/or make expenditures for an “exempt function.” An “exempt function” is the “influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors....”<sup>11</sup>

It is immediately apparent that the IRC definition of “political organization” is broader than that of FECA’s definition of “political committee” because it includes organizations intending to influence state and local campaigns and non-elective offices. With respect to federal election activities, the two terms, based purely on their statutory definitions, nonetheless appear to encompass the same types of groups. However, there is a disconnect between them that stems from the Supreme Court’s campaign finance jurisprudence establishing the constitutional limitations on Congress’s ability to regulate election activity.

## Constitutional Parameters <sup>12</sup>

In order to preserve FECA’s regulation of contributions and expenditures against invalidation for constitutional vagueness, the Supreme Court in its 1976 landmark decision, *Buckley v. Valeo*, construed the terms “contribution” and “expenditure” to encompass only funds donated for or spent for express advocacy (that is, voter communications using explicit phrases and words such as “vote for,” “vote against,” “elect,” and “defeat”).<sup>13</sup> Likewise, the Court construed the term “political committee” to include only “organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate.”<sup>14</sup> In so doing, the

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<sup>8</sup> 2 U.S.C. § 431(4)(A).

<sup>9</sup> 2 U.S.C. § 431(8)(A), (9)(A).

<sup>10</sup> For a complete discussion of I.R.C. § 527, see CRS Report RS21716, *Political Organizations Under Section 527 of the Internal Revenue Code*, by (name redacted).

<sup>11</sup> I.R.C. § 527(c)(3). An “exempt function” also includes making certain office-related expenditures.

<sup>12</sup> For more information, see CRS Report RL30669, *The Constitutionality of Campaign Finance Regulation: Buckley v. Valeo and Its Supreme Court Progeny*, by (name redacted).

<sup>13</sup> *Buckley v. Valeo*, 424 U.S. 1, 44, n. 52 (1976).

<sup>14</sup> *Id.* at 79.

*Buckley* Court established the “major purpose test,” which determines whether or not an organization, if it raises more than \$1,000 in “contributions” or makes more than \$1,000 in “expenditures,” is subject to regulation under FECA as a “political committee.”<sup>15</sup>

Neither FECA nor the Supreme Court, however, has yet defined precisely *how* to ascertain the major purpose of an organization. Indeed, how the major purpose test works, and to what groups it applies, are at the heart of a debate concerning the circumstances under which non-party organizations and non-candidate committees can constitutionally be considered FECA-regulated “political committees.” Some observers proffer that it is relevant to examine an organization’s activities beyond express advocacy to ascertain its major purpose, while others maintain that Supreme Court precedent still limits FECA regulation through the designation of “political committee” status to only those organizations engaging in express advocacy.<sup>16</sup>

These same constitutional concerns do not arise under the IRC. In other words, the “express advocacy” and “major purpose” tests developed under the Supreme Court’s campaign finance jurisprudence do not apply in determining whether an entity is a § 527 political organization under the tax laws. Thus, an “exempt function” does not necessarily involve explicitly advocating for or against a candidate.<sup>17</sup>

## FEC Rule and Enforcement Action <sup>18</sup>

In 2004, after considering but not adopting several approaches for classifying 527 groups as political committees under FECA, the FEC adopted a regulation relevant to political committees.<sup>19</sup> The rule provides that political groups are regulated under FECA based on whether they conduct fundraising with solicitations that include appeals to “support or oppose” the election of a federal candidate. Funds or anything of value collected as a result of such solicitations are considered a contribution under FECA. Therefore, any organization with \$1,000 or more in such contributions is subject to FECA regulation.<sup>20</sup> Notably, it was reported that the FEC acknowledged that the new rule failed to address the key question of, if and when, based on their solicitation messages, nonparty groups—such as 527s—are required to register with the FEC as political committees.<sup>21</sup>

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<sup>15</sup> See 2 U.S.C. § 431(4)(A).

<sup>16</sup> Compare Edward B. Foley, *The “Major Purpose” Test: Distinguishing Between Election-Focused and Issue-Focused Groups*, 31 N. KY. L. REV. 341, 355 (2004) (arguing that “it makes no sense” to examine only whether an organization spends most of its funds on express advocacy in order to determine whether its major purpose is nomination or election of a candidate) with James Bopp, Jr. and Richard E. Coleson, *The First Amendment is Still not a Loophole: Examining McConnell’s Exception to Buckley’s General Rule Protecting Issue Advocacy*, 31 N. KY. L. REV. 289, 323 (2004) (arguing that “it is only proper” to examine an organization’s express advocacy activity in order to determine whether its major purpose is nomination or election of a candidate).

<sup>17</sup> See, e.g., Rev. Rul. 2004-6, 2004-1 C.B. 328 (the IRS, when determining whether an issue advocacy communication is for an “exempt function,” looks at such things as whether it identifies a candidate, identifies his or her position on the issue and this has been raised to distinguish his or hers from others, is timed to an election, targets voters in a particular election, and is not part of an ongoing series of similar communications by the organization on the same issue).

<sup>18</sup> For more information, see CRS Report RL33888, *Section 527 Political Organizations: Background and Issues for Federal Election and Tax Laws*, by (name redacted), (name redacted), and (name redacted).

<sup>19</sup> See 11 C.F.R. § 100.57.

<sup>20</sup> FECA defines “political committee” as “any committee, club, association, or other group of persons that receives contributions aggregating in excess of \$1,000 during a calendar year.” 2 U.S.C. § 431(4).

<sup>21</sup> Kenneth P. Doyle, “FEC Faces Court Battles Over New Rule Imposing Limits on Section 527 Groups,” *Money & (continued...)*

In 2007, the FEC issued a “Supplemental Explanation and Justification” to more fully explain the basis for its 2004 rule and the reasons it declined to revise the regulatory definition of “political committee” in such a manner to specifically regulate 527 groups.<sup>22</sup> According to the FEC, § 527 status is insufficient evidence *alone* to determine whether an organization is a political committee under FECA. It found that an organization’s § 527 status does not necessarily satisfy FECA and the Supreme Court’s contribution, expenditure, and major purpose requirements.<sup>23</sup> In addition, the FEC determined that the IRS’s requirements for granting tax exemptions under § 527 are based on “a different and broader set of criteria” than is used by the FEC in determining political committee status.<sup>24</sup>

Pursuant to FECA and Supreme Court precedent, the FEC stated that it will continue to determine political committee status based on whether an organization received contributions or made expenditures over \$1,000 in a calendar year and whether the organization’s “major purpose” was campaign activity. To that end, the FEC noted that it will consider whether any of the organization’s solicitations resulted in contributions “because the solicitations indicated that any portion of the funds received would be used to support or oppose the election of a clearly identified Federal candidate,” and will analyze whether any of the organization’s expenditures for communications, made independently of a candidate, “constituted express advocacy” under its regulations.<sup>25</sup> The FEC concluded that its case-by-case enforcement actions and guidance—provided through publicly available advisory opinions and filings in civil enforcement cases—constitute a “very effective mechanism for regulating organizations that should be registered as political committees under FECA, regardless of that organization’s tax status.”<sup>26</sup>

In its first significant 527 enforcement action, in late 2006, the FEC imposed civil penalties totaling approximately \$630,000 on three 527 organizations that had been active during the 2004 election cycle: MoveOn.org Voter Fund, the League of Conservation Voters 527, and the Swiftboat Veterans and POWs for Truth, finding that they were required to register and be regulated as political committees under FECA.<sup>27</sup> Proponents of 527 regulation criticized the ruling as “too little, too late,” while the anti-regulatory community argued that the FEC enforcement action was an unconstitutional infringement on First Amendment rights of speech and association.<sup>28</sup> Because of this tension, this may be an area of law that is ripe for litigation.

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(...continued)

*Politics Report*, January 21, 2005. According to the Money & Politics article, Liz Kurland, of the FEC’s information division, stated that the effect of the new rule on 527 organizations that were involved in federal elections, but claimed exemption from FEC regulation, is “going to be kind of a hairy issue, I have to admit.” *Id.*

<sup>22</sup> Federal Election Commission, *Political Committee Status*, [http://www.fec.gov/law/cfr/ej\\_compilation/2007/notice\\_2007-3.pdf](http://www.fec.gov/law/cfr/ej_compilation/2007/notice_2007-3.pdf).

<sup>23</sup> *Id.* at 10.

<sup>24</sup> *Id.* at 11.

<sup>25</sup> *Id.* at 43, citing 11 C.F.R. §§ 100.22(a) or 100.22(b).

<sup>26</sup> *Id.* at 44.

<sup>27</sup> Federal Election Commission, Case Summary, Swiftboat Vets and POWs for Truth, Dec. 13, 2006, available at <http://eqs.nictusa.com/eqs/searcheqs?SUBMIT=summary&key=0>.

<sup>28</sup> Ronald Hrebenar, Kirk L. Jowers, Audrey Perry, *The Struggle to Regulate 527s: Through the FEC, Congress, and the Courts*, 12 Nexus J. Op. 97, 116 (2007) (quoting *Too Little, Too Late from FEC on 527s*, Posting of Paul Ryan to Campaign Legal Center blog [http://www.clcblog.org/blog\\_item-98.html](http://www.clcblog.org/blog_item-98.html) (Dec. 13, 2006)).

## Summary of Selected Legislation

In the 110<sup>th</sup> Congress, the 527 Reform Act of 2007 (H.R. 420 and S. 463) would have amended FECA to define “political committee” to include any committee, club, association, or group of persons that has given notice to the IRS of its status as a § 527 political organization. Exceptions would have existed for organizations that

- are not required to give the IRS such notification (i.e., small organizations, and state and local candidate and party committees);
- are exclusively for paying certain office-related expenses or expenses of qualifying newsletter funds;
- consist solely of state or local candidates or officeholders so long as the organization refers only to non-federal candidates or applicable state or local issues in all of its voter drive activities and does not refer to a federal candidate or a political party in any such activities; or
- whose election or nomination activities relate exclusively to elections where no federal candidate is on the ballot, to non-federal elections or non-elected offices, or state or local ballot issues. No exception would exist for an organization that spends more than \$1,000 for either (1) public communications that promote, support, attack, or oppose a clearly identified federal candidate within one year of the general election in which that candidate is seeking office or (2) voter drive efforts unless the effort meets strict criteria ensuring the group and its efforts are involved in non-federal election activities.

In addition, the act would have established allocation and funding rules for certain expenses relating to federal and non-federal activities by political committees. It expressly provided that no section of the act would affect FEC regulations, the definition of political organization, or the determination as to whether a tax-exempt IRC § 501(c) organization is a political committee. If an action is brought for declaratory or injunctive relief to challenge its constitutionality, the act would have provided for the action to be heard by a three-judge court convened by the U.S. District Court for the District of Columbia, with direct appeal to the U.S. Supreme Court; would have provided for expedited judicial review; and would have allowed any Member of Congress to bring or intervene in such a case.

If the 527 Reform Act had been enacted, it is likely that its constitutionality would have been challenged. By requiring most 527s to register with the FEC as “political committees,” such groups would have been required to use only federally regulated hard money contributions to fund advertisements that promote or attack federal candidates, without regard to whether the communications expressly advocate election or defeat of a clearly identified candidate. As some interpret Supreme Court precedent to limit regulation through the designation of “political committee” status to only those organizations engaging in express advocacy, it is likely that litigation would have occurred.

Legislation regulating 527 organizations has not yet been introduced in the 111<sup>th</sup> Congress.



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