

## THE FUTURE OF SOFT MONEY IN FEDERAL ELECTIONS: THE 527 REFORM ACT OF 2005 AND THE FIRST AMENDMENT

*Ryan P. Chase\**

Did we expect when we passed campaign finance reform that there would be this kind of loophole exploited? I have to tell you, we were a bit naive.

*Senator John McCain, press conference on the 527 Reform Act (Feb. 2, 2005), commenting on the impact 527 organizations had on the 2004 federal elections.<sup>1</sup>*

[Punxsutawney] Phil came out this morning and saw his shadow. Well, I see a lot of shadows in these 527s. And I am very concerned about what it's going to do to politics in America. I think it's going to be abusive, I think it's going to be negative, I think it's going to be sewer money, and I don't think we can tolerate it.

*Senator Trent Lott, press conference on the 527 Reform Act (Feb. 2, 2005), speaking on Groundhog Day on the perceived dangers behind soft money channeled through 527s.<sup>2</sup>*

### INTRODUCTION

President George W. Bush signed the Bipartisan Campaign Finance Reform Act of 2002 ("BCRA") into law on March 27, 2002, and when it became law on November 6, 2002,<sup>3</sup> BCRA marked the first significant

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1. Press Conference on 527 Reform Act (Feb. 2, 2005), *in* FED. NEWS SERV., Feb. 2, 2005 (remarks of Senator John McCain).

2. *Id.* (remarks of Senator Trent Lott).

3. Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, 116 Stat. 81 (2002) (codified at 2 U.S.C. §§ 431, 434 & 441a-441k (Supp. II 2002)).

revision of the federal laws controlling the financing of campaigns for federal office since the Federal Election Campaign Act of 1971 (“FECA”).<sup>4</sup> Title I of BCRA banned national parties and officeholders from raising and spending “soft money.”<sup>5</sup> Soft money can be defined simply as contributions that are not subject to FECA’s contribution regulations while “hard money” refers to contributions that do fall under FECA’s domain.<sup>6</sup> FECA established a series of mandatory limits on contributions to candidates and mandatory ceilings on expenditures.<sup>7</sup> Senator John McCain (R-AZ), one of the bill’s co-sponsors who has fought for significant campaign finance reform for more than half a decade, hoped the law would “restore the public’s faith in government.”<sup>8</sup> President Bush hailed BCRA by stating that “[a]ll of the American electorate will benefit from these measures to strengthen our democracy.”<sup>9</sup>

However, Senator Mitch McConnell (R-KY) spearheaded a First Amendment challenge to BCRA on the basis that the statute unconstitutionally restricted freedom of speech by regulating soft money political donations and advertising for federal elections.<sup>10</sup> On December 10, 2003, the Supreme Court upheld most of the key provisions of BCRA in *McConnell v. FEC*.<sup>11</sup> In a five-to-four decision, the Court ruled that the two principal features of BCRA, its

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4. Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1972), amended by Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 123 (1974).

5. 2 U.S.C. § 441i (Supp. II 2002).

6. The Federal Election Commission (“FEC”) defines soft money as:

funds raised and/or spent outside the limitations and prohibitions of the Federal Election Campaign Act. Sometimes referred to as nonfederal funds, soft money often includes corporate and/or labor treasury funds, and individual contributions in excess of the federal limits, which cannot legally be used in connection with federal elections, but can be used for other purposes.

FED. ELECTION COMM’N, TWENTY YEAR REPORT 23 (1995), available at <http://www.fec.gov/pdf/20year.pdf> (last visited Oct. 4, 2005).

7. See Pub. L. No. 92-225, 86 Stat. 3 (1972), amended by Pub. L. No. 93-443, 88 Stat. 123 (1974). As originally passed in 1972, FECA required disclosure of all contributions exceeding \$100 and of expenditures by candidates and political action committees that spent more than \$1,000 per year. *McConnell v. FEC*, 540 U.S. 93, 117-18 (2003). The 1974 amendments limited political contributions to any single candidate to \$1,000 per election, with an overall annual limitation of \$25,000 by any contributor. *Id.* at 118. FECA, as amended recently by BCRA, prohibits national party committees and their agents from soliciting, receiving, directing, or spending any soft money. 2 U.S.C. § 441i(a).

8. 148 CONG. REC. S298 (daily ed. Jan. 22, 2001) (statement of Senator McCain).

9. *Statement on Signing the Bipartisan Campaign Reform Act of 2002*, 38 WKLY. COMPILATION PRESIDENTIAL DOC. 517, 518 (Mar. 27, 2002).

10. *McConnell*, 540 U.S. at 93. A total of eighty-four plaintiffs included parties from both sides of the nation’s political divide and some very strange bedfellows such as the American Civil Liberties Union, the National Rifle Association, the Republican National Committee, and the National Right to Life Committee. *Id.* Furthermore, Senator McConnell enlisted high-profile attorneys Kenneth W. Starr and Floyd Abrams, an experienced First Amendment litigator, to argue before the Supreme Court. *Id.*

11. *Id.*

regulation of electioneering communications and Congress's effort to plug soft money loopholes, did not violate the First Amendment and must be upheld.<sup>12</sup> As a result of BCRA and the *McConnell* decision, the tremendous amount of soft money previously raised and spent by the national parties and federal officeholders was eliminated from the campaign finance arena.<sup>13</sup>

Despite the significant campaign finance reforms effected by BCRA, soft money still played a significant role in the 2004 federal elections.<sup>14</sup> Because BCRA banned national parties and officeholders from raising and spending soft money, more unregulated money flowed into and was spent by "527" nonprofit organizations than in any previous federal election cycle.<sup>15</sup> These organizations, nicknamed after § 527 of the Internal Revenue Code ("I.R.C."), became a prime alternative for unions, interest groups, and wealthy individuals who in previous elections donated unlimited amounts of cash directly to the Republican and Democratic parties.<sup>16</sup> Groups organized under § 527 alone spent over \$339 million between July and November 2004 before the presidential election and a total of \$550 million during the entire 2004 election cycle.<sup>17</sup> The pro-GOP "Swift Boat Veterans for Truth" and the anti-Bush "Media Fund" were perhaps the most recognizable of these groups because each aired a series of controversial ads during the presidential campaign.<sup>18</sup>

In response to what they perceived as a gaping loophole in BCRA exploited by § 527 groups during the 2004 elections, Senators John McCain (R-AZ), Russell Feingold (D-WI), Trent Lott (R-MS), and Charles Schumer (D-NY), along with Representatives Christopher Shays (R-CT) and Martin Meehan (D-MA), introduced the "527 Reform Act of 2005" on February 2, 2005.<sup>19</sup> The proposed 527 Reform Act would require § 527 groups to register as political action committees ("PACs") with the Federal Election Commission ("FEC") and would subject them to federal campaign laws under

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12. *Id.* at 224.

13. Of the two major parties' spending, soft money accounted for 5% (\$21.6 million) in 1984, 11% (\$45 million) in 1988, 16% (\$80 million) in 1992, 30% (\$272 million) in 1996, and 42% (\$498 million) in 2000. *Id.* at 124.

14. See CTR. FOR PUB. INTEGRITY, 527S IN 2004 SHATTER PREVIOUS RECORDS FOR POLITICAL FUNDRAISING (Dec. 16, 2004), at <http://www.publicintegrity.org/527/report.aspx?aid=435&sid=300> (last visited Sept. 21, 2005).

15. *Id.*

16. *Id.*

17. *Id.*

18. Bill McConnell, *McCain Goes to Battle; Senator Tackles Campaign-finance Reform*, BROAD. & CABLE, Jan. 10, 2005, at 16.

19. Press Conference on 527 Reform Act, *supra* note 1.

which they could only use federal hard money contributions to finance ads that promote or attack federal candidates, regardless of whether the ads expressly advocate the election or defeat of the candidate.<sup>20</sup>

If the bipartisan legislation becomes law, the 527 Reform Act's effort to regulate § 527 groups the same way BCRA regulates national parties and officeholders must overcome the same constitutional hurdles as BCRA did in *McConnell*.<sup>21</sup> The 527 Reform Act will most likely be challenged as a violation of the First Amendment rights of these organizations, and campaign finance experts believe this issue would be taken by the Supreme Court.<sup>22</sup> In fact, McCain's version of the 527 Reform Act introduced in the Senate on February 2, 2005 provides for a special review process for any constitutional challenge to the statute.<sup>23</sup> Furthermore, if the expenditures of § 527 groups are regulated similarly to the expenditures of national parties, then groups organized under § 501 of the I.R.C. might become the next location for the enormous amount of soft money raised and spent for federal elections.<sup>24</sup> This note will argue that the 527 Reform Act most likely will be upheld by the Supreme Court under the deferential First Amendment standard set forth in *McConnell*.<sup>25</sup> However, this note will also proffer that any proposed attempt to regulate § 501 organizations in the same manner likely will be held unconstitutional. Therefore, despite the best efforts of reformers like Senator

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20. *Id.*

21. See generally Amy Keller, *Campaign Finance to Return to Agenda in 109th*, ROLL CALL, Nov. 17, 2004 (discussing new campaign finance reform legislation and its inevitable constitutional challenges), available at <http://www.campaignlegalcenter.org/press-1385.html>.

22. *Id.*; see also Glen Justice, *Concerns Grow About Role of Interest Groups in Elections*, N.Y. TIMES, Mar. 8, 2005, at A20 (discussing the various § 527 and § 501(c) organizations that intend to challenge the 527 Reform Act on First Amendment grounds) [hereinafter *Concerns Grow*].

23. 527 Reform Act of 2005, S. 271, 109th Cong. § 5 (2005). The judicial review provision provides that any constitutional claim must be filed in the United States District Court for the District of Columbia and will be heard by a three-judge panel in an expedited manner. *Id.* Furthermore, any appeal from the panel's decision shall be taken directly to the Supreme Court of the United States on an expedited basis. *Id.*

24. See Elizabeth Kingsley & John Pomeranz, *A Crash at the Crossroads: Tax and Campaign Finance Laws Collide in Regulation of Political Activities of Tax-Exempt Organizations*, 31 WM. MITCHELL L. REV. 55, 91-98 (2004). Many contributions of soft money were much bigger than the donations of hard money. *McConnell v. FEC*, 540 U.S. 93, 124 (2003). For example, in 1996 the top five corporate soft-money donors gave more than \$9 million in soft money to the two national parties. *Id.* In 2000, the national parties raised almost \$300 million (over 60% of their total soft-money fundraising) from just 800 donors. *Id.* In the 2000 election cycle, thirty-five of the fifty largest soft-money donors gave more than \$100,000 to both parties. *Id.* at 125 n.12. These practices indicate that many corporate contributions were motivated by a desire for access to candidates. *Id.* at 124.

25. 540 U.S. at 137.

McCain, soft money will continue to play a substantial role, in the 2006 federal elections and beyond, through the § 501 loophole.

Part I of this note will discuss BCRA's elimination of the most drastic evils of soft money's effect on federal elections. Building on this foundation, Part II analyzes the Supreme Court's decision in *McConnell* and the First Amendment standard of review used by the Court in dealing with challenges to Congress's regulation of soft money contributions. By scrutinizing the recently introduced 527 Reform Act, Part III focuses on the role of § 527 and § 501 organizations in the 2004 federal elections and the current impetus for regulating these groups. Finally, Part IV applies the Court's constitutional standard in *McConnell* to the 527 Reform Act to predict whether such reforms will be resistant to inevitable First Amendment challenges and whether § 501 groups will become the next major loophole through which unregulated soft money flows into during the 2006 federal election cycle. This paper concludes that the 527 Reform Act will likely survive any First Amendment challenges under the Supreme Court's deferential standard articulated in *McConnell*. However, any legislative attempt to regulate § 501 organizations in a similar fashion likely will be found unconstitutional under this same standard. Therefore, because the spending of § 527 groups will be subject to strict FEC limitations, more soft money contributions are likely to flow into § 501 groups during the 2006 election cycle. Thus, the 527 Reform Act will not force unregulated campaign contributions out of the campaign finance neighborhood entirely but rather redirect them to yet another new address.

## I. DEFINING SOFT MONEY AND THE BIPARTISAN CAMPAIGN REFORM ACT OF 2002

### A. *Soft Money—Unregulated Contributions Before BCRA*

As noted above, soft money commonly refers to funds that are not subject to FECA's contribution limitations and may not be subject to federal disclosure requirements depending on the sponsor.<sup>26</sup> In response to a First Amendment challenge to FECA over its caps and reporting requirements imposed on political contributions, *Buckley v. Valeo* upheld all of the disclosure and reporting requirements in the Act based on three important state interests: providing the electorate with relevant information about the candidates and their supporters; deterring actual corruption and discouraging

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26. See FED. ELECTION COMM'N, *supra* note 6.

the use of money for improper purposes; and facilitating enforcement of the prohibitions of FECA.<sup>27</sup> Furthermore, the *Buckley* Court placed a narrow construction on the interpretations of the terms “contribution” and “expenditure” as used in FECA in order to avoid overbreadth problems.<sup>28</sup> The Court defined a contribution as “money that is completely given over to another entity, whether to a party, candidate campaign, or political action committee.”<sup>29</sup> In contrast, the Court defined an expenditure as “[f]unds used for communications that expressly advocate the election or defeat of a clearly identified candidate.”<sup>30</sup> Finally, the *Buckley* Court held that campaign advertisements were subject to campaign finance regulation while mere issue ads were outside the realm of the FECA.<sup>31</sup>

As a result of FECA and the *Buckley* decision, candidates, parties and groups were allowed to use only hard money to pay for advertisements that expressly advocated the election or defeat of a clearly identified candidate.<sup>32</sup> As stated above, the term “hard money” refers to money raised within the source and contribution limitations of FECA and publicly disclosed to the FEC.<sup>33</sup> Also, under this regime, express advocacy was contrasted with “issue advocacy,” which included communications by parties or groups intended to influence a political issue, policy, or proposed legislation, but not to advocate the election of candidates.<sup>34</sup> Essentially issue ads fell outside the regulatory authority as long as the ads did not use explicit words advocating the “election or defeat of a clearly identified candidate.”<sup>35</sup> The *Buckley* Court listed eight words or phrases that made an ad an electioneering communication as opposed to an educational ad that would be exempt from FECA regulation.<sup>36</sup> Therefore, before BCRA, political advertisements could easily avoid campaign finance regulations as long as they did not employ one of the *Buckley* Court’s words or phrases.<sup>37</sup>

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27. 424 U.S. 1, 66-68 (1976).

28. *Id.* at 79-80.

29. *Id.* at 78.

30. *Id.* at 80.

31. *Id.*

32. Craig Holman, *The Bipartisan Campaign Reform Act: Limits and Opportunities for Non-Profit Groups in Federal Elections*, 31 N. KY. L. REV. 243, 248 (2004).

33. *Id.*

34. *Id.*

35. *Buckley*, 424 U.S. at 80.

36. *Id.* at 44-45. These express words or phrases of advocacy of election or defeat included “vote for,” “elect,” “support,” “cast your ballot for,” “Smith for Congress,” “vote against,” “defeat,” and “reject.” *Id.* at 44 n.52.

37. *Id.* at 79-80.

### B. BCRA—*The Revolution in Campaign Finance*

BCRA is widely considered the most significant campaign finance legislation influencing federal elections in over twenty-five years.<sup>38</sup> Federal campaign finance law had long been governed by FECA.<sup>39</sup> The passage of BCRA culminated a seven-year effort by its congressional sponsors to significantly amend FECA.<sup>40</sup> BCRA's two main amendments are the ban on raising and spending soft money by the national parties, federal officeholders and enumerated candidates,<sup>41</sup> and the expansion of the definition of "electioneering communications" that determine what constitutes a campaign advertisement.<sup>42</sup>

Title I of BCRA also prohibits candidates or federal officeholders from raising or spending soft money in connection with federal election activities.<sup>43</sup>

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38. Holman, *supra* note 32, at 244.

39. Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1972).

40. Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, 116 Stat. 81 (2002) (codified at 2 U.S.C. §§ 431, 434 & 441a-441k (Supp. II 2002)). President Bush called BCRA at the time of its enactment, "the culmination of more than 6 years of debate among a vast array of legislators, citizens, and groups." *Statement on Signing the Bipartisan Campaign Reform Act of 2002, supra* note 9, at 517.

[The] provisions of the bill will go a long way toward fixing some of the most pressing problems in campaign finance today. They will result in an election finance system that encourages greater individual participation, and provides the public more accurate and timely information, than does the present system. All of the American electorate will benefit from these measures to strengthen our democracy.

*Id.* at 517-18.

41. Bipartisan Campaign Reform Act of 2002, tit. I, §§ 101-103. The pertinent sections of Title I effectively ban soft money. They provide that candidates for state and federal office, as well as national, state, district, and local committees, may not: "solicit, receive, or direct to another person a contribution, donation, or transfer of funds or any other thing of value, or spend any funds, that are not subject to the limitations, prohibitions, and reporting requirements of this Act." 2 U.S.C. § 441i(a)(1) (Supp. II 2002). Title I also explains that raising money for fundraising costs is now subject to regulation: "An amount spent by a person described in subsection (a) or (b) to raise funds that are used, in whole or in part, for expenditures and disbursements for a Federal election activity shall be made from funds subject to the limitations, prohibitions, and reporting requirements of this Act." *Id.* § 441i(c).

42. Bipartisan Campaign Reform Act of 2002, tit. II, §§ 201-204. Title II, codified at 2 U.S.C. § 434(f), defines "electioneering communications" as:

any broadcast, cable, or satellite communication which—(I) refers to a clearly identified candidate for Federal office; (II) is made with in—(aa) 60 days before a general, special, or runoff election for the office sought by the candidate; or (bb) 30 days before a primary or preference election, or a convention or caucus of a political party that has authority to nominate a candidate, for the office sought by the candidate; and (III) in the case of a communication which refers to a candidate for an office other than President or Vice President, is targeted to the relevant electorate.

2 U.S.C. § 434(f)(3) (Supp. II 2002).

43. *Id.* § 441i.

Included in Title I is a ban on raising soft money for other groups, except for some limited activities of nonprofit groups.<sup>44</sup> The term “federal election activity” is defined rather broadly as any ad that promotes or attacks a federal candidate, generic party activity, voter mobilization activity, and voter registration drives inside of 120 days of a federal election.<sup>45</sup> However, BCRA allows candidates and federal officeholders to raise up to \$20,000 in soft money from individual contributions for voter mobilization activities of each § 527 or § 501(c) nonprofit group.<sup>46</sup> Although subsequent FEC rulemaking has mitigated the sweeping provisions imposed by BCRA,<sup>47</sup> the 2002 legislation undoubtedly changed the way soft money is funneled into federal election campaigns while not eliminating it completely.<sup>48</sup>

Title II of BCRA expanded the “electioneering communications” definition in FECA to include more than the “magic words” given by the Supreme Court in *Buckley*.<sup>49</sup> The new provision now regulates any broadcast ad that refers to a clearly identified federal candidate within sixty days of a general election or thirty days of a primary election.<sup>50</sup> Any electioneering communication or express advocacy over \$10,000 must be paid for with hard money, and the source of funds and expenditures must be disclosed to the FEC.<sup>51</sup>

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44. *Id.*

45. *Id.* § 431.

46. *Id.* § 441i.

47. See Holman, *supra* note 32, at 257-58 (discussing various FEC regulations that allow a moderate degree of soft money solicitation by federal officeholders and national parties).

48. Glen Justice, *In New Landscape of Campaign Finance, Big Donations Flow to Groups, Not Parties*, N.Y. TIMES, Dec. 11, 2003, at A41 (According to Senator Mitch McConnell, “[t]his law will not remove one dime from politics. . . . Soft money is not gone, . . . it has just changed its address”) [hereinafter *In New Landscape*].

49. 2 U.S.C. § 434.

50. *Id.* § 434(f)(3).

51. *Id.*



## II. *McCONNELL v. FEC*

Within days of the enactment of BCRA, eighty-four plaintiffs<sup>52</sup> filed eleven different lawsuits challenging the new campaign finance law arguing that the soft-money ban and regulations on issue advocacy violated the First Amendment.<sup>53</sup> All the lawsuits were consolidated before a three-judge panel of the United States District Court of the District of Columbia into *McConnell*.<sup>54</sup> This three-judge panel<sup>55</sup> issued a mixed ruling in May 2003 which was stayed on appeal when the Supreme Court took the case on the fast-track schedule provided for in BCRA.<sup>56</sup> In order to hear this important case before the start of the 2004 federal election cycle, the Supreme Court uncharacteristically cut short its summer vacation to hear oral arguments.<sup>57</sup> The Justices recognized that it was crucial to determine the rules for campaign fundraising and spending as soon as possible.<sup>58</sup>

In a five-to-four decision,<sup>59</sup> the Court upheld the two main pillars of BCRA.<sup>60</sup> Justices Stevens and O'Connor wrote the Opinion of the Court

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52. A sampling of the plaintiffs includes Senator Mitch McConnell; Representative Bob Barr; Representative Mike Pence; Alabama Attorney General William H. Pryor; Libertarian National Committee, Inc.; the Alabama Republican Executive Committee; the Libertarian Party of Illinois, Inc.; the DuPage Political Action Council, Inc.; the Jefferson County Republican Executive Committee; American Civil Liberties Union; Associated Builders and Contractors, Inc.; the Center for Individual Freedom; the Christian Coalition of America, Inc.; Club for Growth, Inc.; Indiana Family Institute, Inc.; National Right to Life Committee, Inc.; National Right to Life Educational Trust Fund; the National Right to Life Political Action Committee; the National Right to Work Committee; 60 Plus Association, Inc.; Southeastern Legal Foundation Inc.; U.S. d/b/a ProEnglish; Martin J. Connors; Thomas McInerney and Trevor M. Southerland. See *McConnell v. FEC*, 251 F. Supp. 2d 176, 220-21 n.55 (D.D.C. 2003).

53. *Id.* at 266.

54. Order Consolidating Cases, *McConnell v. FEC*, No. 02-582 (D.D.C. Apr. 24, 2002).

55. The panel included U.S. District Judge Colleen Kollar-Kotelly, U.S. Circuit Judge Karen LeCraft Henderson and U.S. District Judge Richard J. Leon. See *McConnell*, 251 F. Supp. 2d at 177.

56. See 2 U.S.C. § 437(h) (Supp. II 2002).

57. See Charles Lane, *Justices Split on Campaign Finance; Court Will Debate Case This Fall*, WASH. POST, Sept. 9, 2003, at A1.

58. Erwin Chemerinsky, *Unanswered Questions*, 7 GREEN BAG 2d 323, 329 (2004).

59. The decision in *McConnell v. FEC*, 540 U.S. 93 (2003), is the longest Supreme Court decision in campaign finance history and the second longest in terms of word count, 89,694, surpassed only by the 1857 *Dred Scott* opinion, *Dred Scott v. Sandford*, 60 U.S. (19 How.) 393 (1856), at 109,163 words. *Supreme Court McConnell Case Had Biggest Page Count of Any Opinion Issued by Supreme Court*, Money & Pol. Rep. (BNA) (Dec. 22, 2003). However, the *McConnell* decision was the longest ruling by the Supreme Court in terms of pages. *Id.* The opinion is almost 150 pages long in the *Supreme Court Reporter*. See *McConnell v. FEC*, 124 S. Ct. 619 (2003).

60. Bipartisan Campaign Reform Act, 2 U.S.C. §§ 441(i), 434(f) (Supp. II 2002) (setting forth two main pillars of BCRA).

dealing with Titles I and II,<sup>61</sup> which ruled that BCRA's two principal, complementary features—Congress's effort to plug the soft-money loophole and its regulation of electioneering communications—must be upheld in the main.<sup>62</sup> In addition, the Court supported nearly every element of BCRA and of campaign finance reform in general.<sup>63</sup> Most important to the 527 Reform Act was the Court's rejection of the very narrow justification for campaign finance laws argued for by the plaintiffs that campaign finance regulations were only justifiable to curtail the type of corruption that causes a change in legislative votes.<sup>64</sup> The Court held otherwise by stating that soft money not only leads to more than just a possible change in legislative votes, but also to "manipulations of the legislative calendar, leading to Congress's failure to enact, among other things, generic drug legislation, tort reform, and tobacco legislation."<sup>65</sup> The Court opined that to claim that such legislative scheduling changes do not influence legislative outcomes "surely misunderstands the legislative process."<sup>66</sup> Therefore, according to the Supreme Court's analysis, future campaign finance legislation need not be based only upon this narrow interpretation of soft money's corrupting influence but may also be based on the more subtle influences of money unregulated by FECA.<sup>67</sup>

This assertion is vital to determining whether the new 527 Reform Act will withstand almost certain First Amendment challenges if it is enacted in essentially the same form as Senator McCain's proposal.<sup>68</sup> Despite the Court's specific language upholding BCRA's main provisions based on "corruption" or the "appearance of corruption," the Court importantly granted

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61. There is not a single majority opinion in *McConnell*. See 540 U.S. at 114 (Stevens, J., and O'Connor, J., writing the Opinion of the Court with respect to Titles I and II); 540 U.S. at 224 (Rehnquist, C.J., writing the Opinion of the Court with respect to Titles III and IV); 540 U.S. at 233 (Breyer, J., writing the Opinion of the Court with respect to Title V). Most likely this splintered Opinion of the Court is because of the extraordinary length of the opinion and the complexity of the issues. See Chemerinsky, *supra* note 58, at 329.

62. *McConnell*, 540 U.S. at 224.

63. The Court approved of every part of BCRA except for two provisions that banned campaign contributions from minors, *id.* at 231-32, and the requirement that parties choose between making either independent expenditures or coordinated expenditures on behalf of candidates. *Id.* at 219-24.

64. *Id.* at 149-50.

65. *Id.*

66. *Id.*

67. See Holman, *supra* note 32, at 263.

68. See Keller, *supra* note 21. Many campaign finance experts believe any § 527 legislation will run into constitutional roadblocks. *Id.* Rick Hansen, a professor at Loyola Law School in Los Angeles who specializes in campaign finance issues, said "I think ultimately, if these groups are regulated . . . it's probably going to be an issue that the Supreme Court takes up." *Id.*; see also *Concerns Grow*, *supra* note 22.

a great deal of deference to Congress to decide whether any given campaign finance policy is sufficient to meet the corruption standard.<sup>69</sup> The Court stated that the “less rigorous standard of review we have applied to contribution limits (*Buckley*’s “closely drawn” scrutiny) shows proper deference to Congress’s ability to weigh competing constitutional interests in an area in which it enjoys particular expertise.”<sup>70</sup> Furthermore, Justices Stevens and O’Connor explained in reference to the most important pillars of BCRA, Titles I and II, that the Court’s deferential standard “provides Congress with sufficient room to anticipate and respond to concerns about circumvention of regulations designed to protect the integrity of the political process.”<sup>71</sup> While the Court upheld BCRA with sweeping language under a self-described deferential First Amendment standard, it must be remembered that the Court was sharply divided (5-4) on the most important issues and the recent addition of two new Justices to the Court could mean a reconsideration of the First Amendment analysis and the fate of future campaign finance legislation.<sup>72</sup>

### III. THE IMPACT OF § 527 AND § 501 NONPROFIT ORGANIZATIONS ON FEDERAL ELECTIONS

#### A. Types of Tax-Exempt Organizations

The most common type of tax-exempt organizations are those organized under I.R.C. § 501(c)(3).<sup>73</sup> Groups registered under this Section receive tax-deductible charitable contributions<sup>74</sup> and are exempt from paying income tax as an entity.<sup>75</sup> According to this provision, the organizations are limited entirely to religious, charitable, educational, scientific, literary, or other similar activities.<sup>76</sup> Therefore, these organizations mainly include educational institutions, churches and other religious institutions, nonprofit health care

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69. Holman, *supra* note 32, at 263.

70. *McConnell*, 540 U.S. at 137.

71. *Id.*

72. Chemerinsky, *supra* note 58, at 329; *see generally* Elisabeth Bumiller & Carl Hulse, *Bush Picks U.S. Appeals Judge to Take O’Connor’s Court Seat*, N.Y. TIMES, Nov. 1, 2005, at A1; Sheryl Gay Stolberg & Elisabeth Bumiller, *Senate Confirms Roberts as 17th Chief Justice*, N.Y. TIMES, Sept. 30, 2005, at A1.

73. I.R.C. § 501(c)(3) (2000).

74. *Id.* § 170(a)(1).

75. *Id.* § 501(a).

76. *Id.* § 501(c)(3). Other activities include the prevention of cruelty to animals or children and the testing for public safety. *Id.*

providers, and foundations.<sup>77</sup> Groups organized under § 501(c)(3) are strictly prohibited from intervening in campaigns for elected public office,<sup>78</sup> but they may lobby in a very limited capacity.<sup>79</sup>

Groups organized under I.R.C. § 501(c)(4) are “social welfare organizations” or “civic leagues” that may pursue a somewhat broader range of lobbying, educational, and political activities.<sup>80</sup> Section 501(c)(4) groups resemble § 501(c)(3) organizations because they too are exempt from federal taxes,<sup>81</sup> however, contributions to § 501(c)(4) groups are implicitly not tax-deductible.<sup>82</sup> The “primary activities” of § 501(c)(4) entities must be actions that benefit the public.<sup>83</sup>

Section 527 encompasses widely diverse categories of political organizations that include incorporated or unincorporated independent organizations,<sup>84</sup> or PACs organized by a § 501(c) entity under § 527(f).<sup>85</sup> Section 527 groups are usually exempt from federal income taxes<sup>86</sup> and contributions to § 527s are expressly exempted from gift and estate taxes.<sup>87</sup> Section 527 organizations are not registered with the FEC, but must register with the Internal Revenue Service (“IRS”).<sup>88</sup> Therefore even if such groups do not disclose their contributions and expenditures to the FEC, they must file periodic reports with the IRS.<sup>89</sup> The IRS makes these periodic reports and registrations available to the public.<sup>90</sup>

At least until the passage of the 527 Reform Act, § 527 groups may solicit and spend money in federal elections, though not for express advocacy or electioneering communications.<sup>91</sup> This has made § 527 groups an alluring

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77. *Id.*

78. *Id.*

79. *Id.* § 501(h).

80. *Id.* § 501(c)(4).

81. *Id.*

82. *Id.* § 170(c) (defining charitable contributions as excluding those to § 501(c)(4) groups); *see also* Kingsley & Pomeranz, *supra* note 24, at 100-01.

83. I.R.C. § 501(c)(4).

84. *Id.* § 527.

85. *Id.* § 527(f).

86. *Id.* § 527.

87. *Id.* § 2501(a)(4).

88. *Id.* § 527(i). Note that most political parties, campaigns, and PACs are classified for tax purposes under I.R.C. § 527 but must register with the FEC as mandated by FECA as amended by the BCRA. *See* Bipartisan Campaign Reform Act of 2002, 2 U.S.C. § 441i (Supp. II 2002).

89. I.R.C. § 527(i).

90. *See generally* Internal Revenue Service, Tax Information for Political Organizations, <http://www.irs.gov/charities/political/index.html> (last visited Mar. 6, 2005).

91. 11 C.F.R. §§ 114.4, 114.14 (2003). The term “electioneering communications” is used in this

alternative for those who, during the 2004 election cycle, wished to use soft money to promote and attack federal candidates since BCRA prohibited the national committees and federal officeholders from doing the same.<sup>92</sup> Therefore, even though the financial activities of § 527s are no longer as hidden as before BCRA, the financial reports of these groups still do not need to disclose which candidates are being targeted for election or defeat by the election-related activities.<sup>93</sup>

### *B. Section 527 Organizations and the 2004 Federal Elections*

The Supreme Court warned about the impact of 527s in *McConnell* by stating that “[g]iven BCRA’s tighter restrictions on the raising and spending of soft money, the incentives for parties to exploit such organizations will only increase.”<sup>94</sup> Fearing the lack of legislative clarity on § 527 groups, numerous groups petitioned the FEC in November 2003 to issue an advisory opinion outlining the permissible uses of these entities.<sup>95</sup> Some campaign watchdog organizations also filed complaints with the FEC charging that many 527s were being used in schemes to avoid the federal ban on soft money.<sup>96</sup> The FEC responded in a limited ruling in February 2004 which applied to only 527s that registered with the FEC and were already restricted to hard money.<sup>97</sup> The most important decision by the FEC came on May 13, 2004, when it announced that it would not impose new regulations on 527s for the remainder of the 2004 federal campaign season.<sup>98</sup> In response to the FEC decision, pro-Republican groups were forced to match liberal 527s and form their own organizations in order to utilize large quantities of soft money.<sup>99</sup> Senator McCain and his supporters have placed the blame for creating the § 527

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context as broadcast ads mentioning a candidate immediately before an election. *Id.* § 100.29.

92. 2 U.S.C. § 441i.

93. I.R.C. § 527(j).

94. *McConnell v. FEC*, 540 U.S. 93, 177 (2003).

95. Glen Justice, *A Hard Road for Democrats In a Day of No ‘Soft Money,’* N.Y. TIMES, Nov. 20, 2003, at A27.

96. Glen Justice, *Final Word Still to Come On Interest Group Money*, N.Y. TIMES, Feb. 20, 2004, at A18.

97. *Id.*

98. Glen Justice, *F.E.C. Declines to Curb Independent Fund-Raisers*, N.Y. TIMES, May 14, 2004, at A18.

99. Glen Justice, *Republicans Rush to Form New Finance Groups*, N.Y. TIMES, May 29, 2004, at A1.

loophole squarely on the FEC and have defended BCRA against any perceived deficiencies.<sup>100</sup>

For the 2003-04 election cycle, § 527 groups raised and spent over half a billion dollars.<sup>101</sup> Entities organized under § 527 supporting President Bush raised in excess of \$64 million and spent over \$61 million, while 527s supporting Senator John Kerry raised over \$181 million and spent in excess of \$186 million.<sup>102</sup> In 2004 alone, § 527 organizations raised a total of \$434 million, which constituted \$60 million more than for all of the previous three years combined.<sup>103</sup>

Therefore, while BCRA seemed to achieve its main goal of campaign finance reform—“removing unregulated and unlimited soft money from the national parties and federal officeholders and candidates, where it poses the greatest potential for corruption”—it seems to have only changed where the battle is fought in the campaign financing war.<sup>104</sup> This reality echoes Senator McConnell’s statements immediately after the Supreme Court’s ruling on BCRA in which he stated that “[s]oft money is not gone—it has just changed its address.”<sup>105</sup> Furthermore, the Supreme Court in *McConnell* likely was correct in its admonition that soft money would never be completely banned because “[m]oney, like water, will always find an outlet.”<sup>106</sup>

#### IV. THE 527 REFORM ACT AND THE FIRST AMENDMENT

If the 527 Reform Act becomes law, it is likely to face a First Amendment challenge. A preliminary question to consider is why restrictions on soft money contributions have anything to do with the First Amendment because they do not seem to constitute direct governmental interference with speech or the freedom of expression. After this question is answered, it is necessary

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100. Keller, *supra* note 21. Specifically, Senator McCain wrote in a *USA Today* Op-Ed piece that “[t]his new problem is not because of any deficiencies in McCain-Feingold . . . . The loophole for § 527 groups was created solely by the Federal Election Commission.” *Id.* Furthermore, in the official press conference after the 527 Reform Act was introduced in the Senate, Senator McCain stated “[i]t’s unfortunate that we’re having to even introduce this bill today because the 527s are not in violation of BCRA, they’re in violation of the 1974 law, which clearly states that any organization that engages in partisan political activity for the purposes of determining—of affecting the outcome of an election falls under campaign finance laws.” Press Conference on 527 Reform Act, *supra* note 1.

101. See 527s IN 2004 SHATTER PREVIOUS RECORDS FOR POLITICAL FUNDRAISING, *supra* note 14.

102. *Id.*

103. *Id.*

104. See Holman, *supra* note 32, at 288.

105. See *In New Landscape*, *supra* note 48.

106. *McConnell v. FEC*, 540 U.S. 93, 224 (2003).

to consider how a federal court will apply the *McConnell* standard to this new legislation. Finally, since the 527 Reform Act will bar soft money from only one type of nonprofit tax-exempt organization, it is essential to determine if other entities, such as those formed under § 501(c)(3) and § 502(c)(4), will take on a more significant role in the upcoming 2006 federal elections.

#### A. *Money as Speech*

Of course the Constitution does not explicitly provide that the spending of money could be considered a protected form of political speech, as noted by Professor David Ortiz:

One would search the Constitution in vain for any mention of “campaign finance,” let alone “contributions,” “expenditures,” “soft money,” or any of the other specialized terms in the campaign finance vocabulary. Yet despite this silence, the U.S. Supreme Court has firmly and repeatedly held that the Constitution greatly limits what Congress and states can do. This is based on the belief that campaign finance regulations restrict political expression and so implicate the First Amendment.<sup>107</sup>

In *Buckley*, the Court created the framework that guides what Congress can and cannot restrict in the world of campaign finance.<sup>108</sup> The Court, in arguably the most important of its campaign finance reform cases, found that money could find constitutional protection as being analogous to speech.<sup>109</sup>

*Buckley* dealt with a First Amendment challenge to many of the 1974 amendments to FECA.<sup>110</sup> The challengers attacked the amendments’ limits on various forms of election spending.<sup>111</sup> While considering these challenges, the Court created a critical dichotomy between “contributions” and “expenditures.”<sup>112</sup> A contribution was defined as money that is completely given over to another entity, whether to a party, candidate campaign, or political action committee.<sup>113</sup> Essentially, a contribution occurs when the donor retains no control over the future use of the money. An expenditure, in

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107. Daniel R. Ortiz, *The First Amendment at Work: Constitutional Restrictions on Campaign Finance Regulation*, in *CAMPAIGN FINANCE REFORM: A SOURCEBOOK* 63 (Anthony Corrado et al. eds., 1997).

108. 424 U.S. 1 (1976).

109. *Id.* at 19.

110. See Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (1972), amended by Federal Election Campaign Act Amendments of 1974, Pub. L. No. 93-443, 88 Stat. 123 (1974).

111. *Buckley*, 424 U.S. at 11.

112. *Id.* at 20-21.

113. *Id.* at 78.

contrast, was defined in *Buckley* as money given by “organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate.”<sup>114</sup>

The Court found that regulating expenditures raised more serious First Amendment concerns than regulating contributions, because expenditures convey the reasons why a spender supports or opposes a candidate.<sup>115</sup> Thus, limiting expenditures would necessarily restrict the quantity and quality of political discourse.<sup>116</sup> As the Court wrote:

In the free society ordained by our Constitution it is not the government, but the people—individually as citizens and candidates and collectively as associations and political committees—who must retain control over the quantity and range of debate on public issues in a political campaign.<sup>117</sup>

.....

... A restriction on the amount of money a person or group can spend on political communication during a campaign necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of the audience reached.<sup>118</sup>

The compelling governmental interest behind FECA, as articulated in *Buckley* and in BCRA, was to prevent government corruption.<sup>119</sup> The Court said this interest was sufficient to leave the statute’s contribution limits in place, but not the expenditure limits. The Court “struck down all the spending ceilings—on independent expenditures in [or on] behalf of a candidate, on personal funds spent by a candidate in his [or her] own campaign, and on total outlays by the candidate.”<sup>120</sup> The Court concluded that, unlike contribution limitations, the expenditure ceilings failed sufficiently to serve the governmental interest in preventing corruption and that the burden they placed on “core First Amendment expression” was unconstitutional.<sup>121</sup> Therefore, the Court recognized that “money is equal to speech, and that maxim was not simply a theoretical construct in political discourse but instead had a very real

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114. *Id.* at 79.

115. *Id.* at 20-21.

116. *Buckley*, 424 U.S. at 19.

117. *Id.* at 57.

118. *Id.* at 19.

119. *Id.* at 44-45.

120. J. Skelly Wright, *Politics and the Constitution: Is Money Speech?*, 85 YALE L.J. 1001, 1004 (1976).

121. *Buckley*, 424 U.S. at 21.



impact on the ‘quantity and diversity of political speech.’”<sup>122</sup> This decision is consistent with other Supreme Court rulings on “symbolic speech.”

“Symbolic speech” refers to actions or conduct having strong First Amendment protection as mere extensions of pure protected speech.<sup>123</sup> In *Spence v. Washington*, for example, the Court considered the issue of when conduct should be regarded as communicative conduct.<sup>124</sup> This case dealt with an individual who taped a peace sign on an American flag after the killing of students at Kent State University and subsequently was convicted of violating a state law prohibiting flag desecration.<sup>125</sup> The Court reversed the conviction and found that the act was speech protected under the First Amendment.<sup>126</sup> The opinion emphasized two factors in concluding that the conduct was communicative: “An intent to convey a particularized message was present, and in the surrounding circumstances the likelihood was great that the message would be understood by those who viewed it.”<sup>127</sup> Examples of such actions have included refusing to salute the U.S. flag,<sup>128</sup> declining to say the Pledge of Allegiance,<sup>129</sup> the wearing of an armband to protest a war,<sup>130</sup> displaying a flag,<sup>131</sup> and the burning of the United States flag.<sup>132</sup> To be protected under the First Amendment, this type of speech “need not convey a ‘narrow, succinctly articulated message,’ nor even any ‘particularized message’ in order to merit protection.”<sup>133</sup> The Supreme Court has given sweeping protection to such symbolic speech even when it conveys only the most general message.<sup>134</sup> Bradley A. Smith, a former Commissioner of the FEC, has concluded that the spending of money on political campaigns constitutes this type of protected symbolic speech:

Given this case history over many years, it is too late, really, to argue that a gift of money is not a form of protected symbolic speech, at least when made to a political candidate.

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122. ROBERT D. RICHARDS, *FREEDOM’S VOICE: THE PERILOUS PRESENT AND UNCERTAIN FUTURE OF THE FIRST AMENDMENT* 130 (1998) (footnotes omitted).

123. BRADLEY A. SMITH, *UNFREE SPEECH, THE FOLLY OF CAMPAIGN FINANCE REFORM* 113 (2001).

124. 418 U.S. 405 (1974).

125. *Id.*

126. *Id.* at 406.

127. *Id.* at 410-11.

128. *West Virginia Bd. of Educ. v. Barnette*, 319 U.S. 624 (1943).

129. *Elk Grove Unified Sch. Dist. v. Newdow*, 542 U.S. 1 (2004).

130. *Tinker v. Des Moines Indep. Cmty. Sch. Dist.*, 393 U.S. 503 (1969).

131. *Stromberg v. California*, 283 U.S. 359 (1931).

132. *Texas v. Johnson*, 491 U.S. 397 (1989).

133. SMITH, *supra* note 123, at 114.

134. *Id.*

Such a gift is an action intended to convey support for a candidate and, it is generally presumed, his or her views.<sup>135</sup>

Arguably the most prominent challenge to the “money as speech” principle was that campaign giving was largely conduct with only an incidental speech element. Under this argument, campaign giving can and should be regulated under the principles announced by the Supreme Court in *United States v. O’Brien*.<sup>136</sup> The issue in *O’Brien* was “whether an individual could be prosecuted for burning his draft card as a protest against the Vietnam War, or whether . . . [his] act was protected under the First Amendment as symbolic speech.”<sup>137</sup> The Court agreed with O’Brien’s contention that burning his draft card was “symbolic speech.”<sup>138</sup> However, it upheld O’Brien’s conviction for destroying his draft card by holding that symbolic speech could be restricted where such restrictions furthered a significant government interest, provided that the interest was unrelated to the suppression of free expression and the “incidental” restriction on First Amendment freedoms was “no greater than essential.”<sup>139</sup>

Those who favor campaign finance regulation have used the *O’Brien* decision to justify judicial deference to legislative limits on political expenditures and contributions. They contend that “like O’Brien’s draft card, the money at stake in political giving is merely a vehicle for political expression, not political expression itself.”<sup>140</sup> Furthermore, reformers contend that if this is true, such speech may be regulated under legislation that serves an important government interest. Advocates conclude that a law that targets money, rather than speech directly, should therefore be subjected to a less rigorous level of judicial scrutiny.

*B. McConnell v. FEC’s Deferential First Amendment Standard Applied to the 527 Reform Act*

The *McConnell* Court stated that the “less rigorous standard of review we have applied to contribution limits . . . shows proper deference to Congress’s decision to weigh competing constitutional interests in an area in which it

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135. *Id.*

136. 391 U.S. 367 (1968).

137. SMITH, *supra* note 123, at 116.

138. 391 U.S. at 376-77.

139. *Id.* at 377.

140. SMITH, *supra* note 123, at 116.

enjoys particular expertise.”<sup>141</sup> As discussed previously, the Supreme Court in *McConnell* refused to limit Congress’s ability to regulate soft money’s corruptive or apparently corruptive influence in federal elections based on the First Amendment.<sup>142</sup> Although the Court’s discussion of BCRA’s main provisions was phrased in the language of the State’s interest in preventing “corruption” or even the “appearance of corruption,” and although the Court said strict scrutiny was applicable, the Court importantly expressed a great deal of deference to Congress to decide whether any given campaign finance policy was sufficient to meet the corruption standard.<sup>143</sup>

Even under this watered-down strict scrutiny standard, if the 527 Reform Act is to survive a constitutional challenge it must be found to advance a compelling governmental purpose.<sup>144</sup> Therefore, the Court must deem the government’s interest vital or “compelling” and the law must be “necessary” as a means to accomplishing that compelling end.<sup>145</sup> When this test is applied, the government must show proof that the law is the least restrictive or least discriminatory alternative. If the law does not clear this hurdle, it is not “necessary” to accomplish the end.<sup>146</sup>

Under the strict scrutiny test, the government bears the burden of proof, such that the law will be struck down unless the government can show that the law is necessary to accomplish a compelling government purpose.<sup>147</sup> However, although strict scrutiny is normally the most intensive type of judicial review, and laws are generally declared unconstitutional when it is applied,<sup>148</sup> the *McConnell* Court’s version of strict scrutiny was more deferential to Congress than the Court’s regular application.<sup>149</sup>

The effort by Congress, in the 527 Reform Act, to bring all § 527 organizations under FECA’s restrictions on political committees would seek to regulate a wide range of activities that are arguably protected under the First Amendment.<sup>150</sup> In so doing, the legislation would likely be subject to the

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141. *McConnell v. FEC*, 540 U.S. 93, 137 (2003).

142. *Id.* at 134-37.

143. *Id.*

144. *Id.* at 137; *see also* *Wygant v. Jackson Bd. of Educ.*, 476 U.S. 267, 280 (1986) (explaining that “[u]nder strict scrutiny the means chosen to accomplish the State’s asserted purpose must be specifically and narrowly framed to accomplish that purpose”).

145. *Wygant*, 476 U.S. at 280.

146. *McConnell*, 540 U.S. at 137.

147. *Id.*

148. *Id.*

149. *Id.*

150. Kingsley & Pomeranz, *supra* note 24, at 114.

same strict scrutiny standard applied to the soft money ban for federal officeholders and national committees in *McConnell*.<sup>151</sup> Furthermore, the IRS has been explicit in recognizing that its standards for identifying political activity by tax-exempt organizations capture far more activity than is regulated under federal election law.<sup>152</sup> In the context of federal races, there are many activities that the I.R.C. recognizes as § 527 exempt function activities that would “lead the IRS to classify an organization as a 527,” but may be “beyond the constitutional reach of FECA.”<sup>153</sup> However, given the massive flow of soft money that was diverted from national parties and federal officeholders to 527s in the 2004 election cycle,<sup>154</sup> and the appearance that § 527 organizations are now the new face of corruption in national politics,<sup>155</sup> the 527 Reform Act likely will withstand a First Amendment challenge. Senator McCain’s version of the 527 Reform Act seems to have bipartisan support in Congress,<sup>156</sup> and under *McConnell*’s “less rigorous standard of review” in applying a First Amendment strict scrutiny analysis in which the Court will show “proper deference” to Congress, the 527 Reform Act will withstand any constitutional challenges.<sup>157</sup>

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151. *McConnell*, 540 U.S. at 137.

152. Kingsley & Pomeranz, *supra* note 24, at 114.

153. *Id.* at 115.

154. See text accompanying notes 101-03 regarding 2003-04 election cycle statistics.

155. See Press Conference on 527 Reform Act, *supra* note 1 (remarks of Senator Trent Lott).

[A] lot of money now has moved over into, or new money has shown up under the cover of these 527s. . . . And I am very concerned about what it’s going to do to politics in America. I think it’s going to be abusive, I think it’s going to be negative, I think it’s going to be sewer money, and I don’t think we can tolerate it. And so, I think it’s important that we look at solutions among the Republicans and Democrats together on the Rules Committee, in the House, in the Senate to see what we can do about this.

*Id.*

156. See 527 Reform Act of 2005, S. 271, 109th Cong. (2005). The clearest evidence of this is certainly Senator Trent Lott’s decision to co-sponsor Senator McCain’s version of the 527 Reform Act. *Id.* Senator Lott was a staunch opponent of BCRA and previous campaign finance efforts but now has switched camps because of the FEC’s apparent refusal to regulate § 527 groups. See Press Conference on 527 Reform Act, *supra* note 1 (remarks of Senator Trent Lott).

I’m not in my natural habitat—(laughter)—with this group of friends and colleagues over the years. . . . [I]f you’ve followed the legislation over the years of McCain-Feingold, I was not one of its major facilitators. . . . I don’t think the FEC really enforces the campaign finance laws the way they should, aggressively enough. I don’t always agree with what the solutions may be, but there’s a problem. And we need to address it.

*Id.*

157. *McConnell v. FEC*, 540 U.S. 93, 137 (2003).

*C. Section 501(c) Organizations After the 527 Reform Act: Soft Money's New Address*

The 527 Reform Act explicitly says that the provisions of the reform legislation “shall not be construed as affecting the determination of whether a group organized under § 501(c) of the Internal Revenue Code of 1986 is a political committee” under FECA.<sup>158</sup> This is noteworthy because, even under the Court’s deferential First Amendment standard in *McConnell*, a complete soft-money ban on § 501(c) groups would probably be unconstitutional because, for reasons discussed previously, the vast majority of unregulated campaign contributions have flowed through 527s and not 501s.<sup>159</sup> Therefore, since there is little “compelling need” to warrant this infringement on otherwise protected First Amendment expression embodied in the § 501(c) organizations’ activities and no “appearance of corruption” on par with that of 527s, campaign finance reformers likely calculated that legislation going after § 501(c) groups immediately would not pass constitutional muster.<sup>160</sup> Therefore, the 527 Reform Act will probably not disturb the reporting requirements in place for § 501(c)(3) or § 501(c)(4) organizations, at least before the 2006 federal elections, without unexpected additional legislation.<sup>161</sup>

As discussed earlier, § 501(c)(3) groups must be engaged in religious, educational, charitable, scientific, literary, or similar activities.<sup>162</sup> Some groups have successfully argued that because education is an exempt activity for § 501(c)(3) groups, some quasi-political activities are allowable.<sup>163</sup> The IRS has contributed to the confusion by stating that “[s]ometimes . . . the activity is both—it is education but it also constitutes intervention in a political campaign.”<sup>164</sup>

Also, as discussed previously, § 501(c)(4) organizations are permitted to have limited involvement in political campaigns so long as they are *primarily* engaged in nonpolitical activities advancing social welfare.<sup>165</sup> It might seem

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158. S. 271, § 4(3).

159. *See supra* Part III.B.

160. S. 271, § 4.

161. *See supra* Part III.A.

162. I.R.C. § 501(c)(3) (2000).

163. *See* Frances R. Hill, *Softer Money: Exempt Organizations and Campaign Finance*, 91 TAX NOTES 477, 494 (Apr. 16, 2001) (“Section 501(c)(3) organizations argue that they are not intervening in a political campaign but educating the public with respect to certain important issues.”).

164. Judith E. Kindell & John F. Reilly, *Election Year Issues*, in IRS EXEMPT ORGANIZATIONS CPE TECHNICAL INSTRUCTION PROGRAM TEXTBOOK 413 (1994).

165. I.R.C. § 501(c)(4); *see also* Rev. Rul. 81-95, 1981-1 C.B. 332 (providing that a § 501(c)(4)

obvious that, if the 527 Reform Act is passed, § 501(c)(4) groups would be more attractive than § 501(c)(3) organizations for people seeking to use soft money to influence a federal election because of this limited involvement allowance.<sup>166</sup> However, contributors to § 501(c)(4) groups are subject to gift taxation whereas contributions to § 527 organizations are not.<sup>167</sup>

This drawback has not prevented political organizations from coming up with various ways to capitalize on the § 501(c)(4) allowance of a limited involvement in political activity in the past.<sup>168</sup> If § 527 groups are required to register with the FEC as provided by the 527 Reform Act, political organizations and candidates may elect to channel political advocacy through a social welfare organization formed under § 501(c)(4), and thereby shield contributions from FECA disclosure.<sup>169</sup> Furthermore, § 501(c)(4) groups may attempt to slip into the § 501(c)(3) educational exemption.<sup>170</sup> Also, candidates for federal office or other organizations may engage in a complicated shell game of § 501(c)(3) and § 501(c)(4) groups to evade IRS and FEC restrictions on exempt activities.<sup>171</sup> The most egregious example of this practice may be when a corporate or individual donor transfers funds to a § 501(c)(3) group under the guise that it is involved in exempt educational activity and then directs the money to a § 501(c)(4) group which in turn contributes it directly to the candidate. Under this arrangement, the contributor would get a deduction, the § 501(c) organization would remain tax exempt, and the candidate could spend the money. Therefore, despite BCRA and the 527 Reform Act's best efforts, the FEC will continue to play a vital role in regulating soft money's influence on federal elections because § 501(c)(3) and § 501(c)(4) organizations likely will play a huge role in the upcoming 2006 federal election cycle.<sup>172</sup>

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organization may participate in a political campaign as long as its primary function is promotion of social welfare).

166. I.R.C. § 501(c)(4).

167. *Id.* § 527.

168. See Susan Schmidt, *Political Groups Change Status to Avoid Disclosure*, WASH. POST, Sept. 15, 2000, at A1 (discussing how many § 527 groups began converting to § 501(c)(4) status after additional disclosure requirements were added in 2000 but before § 527 groups adapted to the new disclosure provisions imposed by Senator Lieberman's reform legislation).

169. Daniel L. Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 FLA. L. REV. 1, 109-10 (2002).

170. I.R.C. § 501(c)(3).

171. Hill, *supra* note 163, at 495.

172. See generally Press Conference on 527 Reform Act, *supra* note 1 (remarks of Senator John McCain) ("We'll win in court. We'll win over time. But the tragedy of all this really is that the Federal Election Commission has failed to do their duty. We are going to have to reform the commission.").

## CONCLUSION

Senator McCain's bipartisan 527 Reform Act is the latest congressional effort to eliminate the corruptive effects of unregulated contributions influencing elections for federal office.<sup>173</sup> If enacted, the 527 Reform Act will require § 527 groups to register as PACs with the FEC and comply with federal campaign finance laws.<sup>174</sup> Under this new reform legislation, § 527 groups can only use federal hard money contributions to finance ads that promote or attack federal candidates, regardless of whether the ads expressly advocate the election or defeat of the candidate.<sup>175</sup> Just like Congress's last legislative reform effort of BCRA enacted in 2002,<sup>176</sup> the key provisions of the 527 Reform Act will face inevitable First Amendment challenges,<sup>177</sup> because the law will regulate political donations that have been interpreted as expression protected under the Constitution.<sup>178</sup> However, under the Supreme Court's deferential First Amendment standard given in the most recent campaign finance reform case,<sup>179</sup> the 527 Reform Act likely will withstand any First Amendment challenges.<sup>180</sup> Nevertheless, the 527 Reform Act will be far from the panacea for all the supposed problems soft money introduces into federal elections. If the 527 Reform Act is enacted, it is likely to channel considerably more unregulated contributions into a complicated shell game of § 501(c)(3) and § 501(c)(4) groups during the 2006 federal election cycle and beyond.<sup>181</sup> Thus, congressional campaign reform supporters will need to propose additional legislation to deal with the supposed corruptive influences of soft money in yet another arena.

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173. See 527 Reform Act of 2005, S. 271, 109th Cong. § 4(3) (2005).

174. *Id.* § 2.

175. *Id.*

176. Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, 116 Stat. 81 (2002) (codified at 2 U.S.C. §§ 431, 434 & 441a-441d (Supp. II 2002)).

177. See *supra* text accompanying note 68.

178. See *supra* Part IV.A.

179. *McConnell v. FEC*, 540 U.S. 93, 137 (2003).

180. See *supra* Part IV.B.

181. See *supra* Part IV.C.