
No. 02-16283-CC

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

MOBILE REPUBLICAN ASSEMBLY, *et al.*,

Plaintiffs/Appellees,

v.

UNITED STATES OF AMERICA, *et al.*

Defendants/Appellants.

On Appeal from the United States District Court
for the Southern District of Alabama

**BRIEF AMICUS CURIAE OF PUBLIC CITIZEN, INC., IN SUPPORT OF
THE DEFENDANTS/APPELLANTS**

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February 27, 2003

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Mobile Republican Assembly, et al. v. United States, et al., No. 02-16283-CC

**CERTIFICATE OF INTERESTED PERSONS AND CORPORATE
DISCLOSURE**

Pursuant to Federal Rules of Appellate Procedure 26.1 and 28(a)(1) and Eleventh Circuit Rules 26.1-1, 26.1-2, 26.1-3, 28-1(b) and 29-2, counsel for amicus curiae Public Citizen, Inc., certify as follows:

A. Interested Persons

The following is an alphabetical list of persons and entities that have an interest in the outcome of this case or have participated as attorneys or judges in the adjudication of this case:

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Campaign & Media Legal Center — amicus curiae.

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Chockley, Frederick W. — attorney, Baker & Hostetler.

Mobile Republican Assembly, et al. v. United States, et al., No. 02-16283-CC

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Haughton, Paul — appellee.

Jockish, Freeman — County Commissioner, Mobile County Commission,
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Mobile Republican Assembly — appellee.

Morrison, Alan B. — Public Citizen Litigation Group, attorney for amicus
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National Federation of Republican Assemblies — appellee.

Nelson, Scott L. — Public Citizen Litigation Group, attorney for amicus
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O'Connor, Eileen J. — Assistant Attorney General, Tax Division,
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Pietruszkiewicz, Christopher M. — former attorney, Tax Division,
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Public Citizen, Inc. — amicus curiae.

Reno, Janet — former Attorney General.

Rivkin, David B., Jr. — attorney, Baker & Hostetler.

Rossotti, Charles O. — Commissioner of Internal Revenue.

Shor, Glen — attorney for amicus curiae Campaign & Media Legal Center.

Snow, John W. — United States Secretary of the Treasury, appellant.

Summers, Lawrence H. — former United States Secretary of the Treasury.

Tebbetts, Andrea R. — attorney, Tax Division, Department of Justice,
attorney for the appellants.

The Horning 2000 Campaign Committee — appellee.

The Howard Jarvis Taxpayers Association Political Action Committee —
appellee.

The Howard Jarvis Taxpayers Association — appellee.

The Libertarian National Committee, Inc. — appellee.

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The Libertarian Party of Indiana — appellee.

United States of America — appellant.

Vollmer, Richard W., Jr. — Senior United States District Judge, Southern
District of Alabama.

Welsh, Robert L. — attorney, Tax Division, Department of Justice.

York, David A. — United States Attorney, Southern District of Alabama,
defendant.

Zeigler, James W. — attorney.

B. Corporate Disclosure of Amicus Curiae Public Citizen, Inc.

Pursuant to Fed. R. App. P. 26.1, counsel state that Public Citizen, Inc., has no corporate parents and that no publicly held corporation has an ownership interest of any kind in it.

Respectfully submitted,

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February 27, 2003

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INTEREST OF AMICUS CURIAE

Public Citizen, Inc., is a non-profit advocacy group with approximately 125,000 members nationwide. It appears before Congress, administrative agencies and the courts on a wide range of issues involving the protection of consumers and workers, public health and safety, and maintaining openness and integrity in government.

Prominent among Public Citizen's concerns is combating the corruption of our political processes that results when the influence of corporate money is brought to bear on the electoral system. Public Citizen has long supported campaign finance reform, through both advocacy of campaign finance legislation before Congress and involvement in litigation raising campaign finance issues and related First Amendment issues arising out of the electoral process. Public Citizen has filed amicus briefs in a number of cases involving campaign-finance related issues, including *Federal Election Commission v. Beaumont*, No. 02-403, which is currently pending in the Supreme Court of the United States and which, like this case, concerns the asserted First Amendment rights of nonprofit organizations that seek to pour money into the electoral process.

In addition, Public Citizen has studied and reported extensively on the increasing involvement of non-profit organizations in electioneering activities, as politicians and their financial backers have sought to evade both the contribution

limits and the reporting and disclosure requirements applicable to more traditional political organizations. In particular, Public Citizen has focused on the activities of political organizations that claim tax exemption under § 527 of the Internal Revenue Code, 26 U.S.C. § 527, the provision at issue in this case. Public Citizen has analyzed the IRS filings of such organizations and prepared detailed reports on the manner in which “527 groups” from both ends of the political spectrum have increasingly sought to use their financial resources to influence the outcomes of elections. Public Citizen’s reports use the information on file with the IRS not only to reveal the sources of funding of 527 groups, but also to show which candidates they have supported and the amounts and nature of their political expenditures.

To ensure broad dissemination of this information, Public Citizen has made its reports available on its web site, www.citizen.org. *See, e.g.*, Public Citizen, *Cramming for the Midterm: “527” Stealth PACs Raise at Least \$115 Million to Influence 2002 Congressional Elections*, www.citizen.org/documents/527report_pre-election.pdf (Nov. 1, 2002); Public Citizen, *Shadowy 527 Groups Continue Soft Money Grab As 2002 Election Approaches*, www.citizen.org/documents/ACF14F.pdf (Oct. 24, 2002); Public Citizen, *Second Quarter Stockpile: 527 Political Groups Continue Soft Money Grab During 2002 Cycle*, www.citizen.org/documents/527_2ndQ.pdf (Aug. 12, 2002); Public Citizen, *Off to*

the Races: First Quarter Reports Show that 50 Top “527” Organizations Collected Almost \$11 Million in Soft Money; Disclosure Problems Continue, www.citizen.org/documents/1stQ2002_527Report.pdf (June 5, 2002); Public Citizen, *Deja Vu Soft Money: Outlawed Contributions Likely to Flow to Shadowy 527 Groups that Skirt Flawed Disclosure System*, <http://www.citizen.org/documents/ACF8D5.PDF> (April 5, 2002). Public Citizen’s reporting on the activities of 527 groups has provided it with a perspective that, we believe, can assist this Court in reaching a proper result in this case.

In particular, Public Citizen is concerned that affirmance of the district court’s decision in this case could seriously impede its access, and that of the public, to important information about how the large (and increasing) amounts of money being collected by 527 groups are being spent to influence elections in this country. Such information is critical to help citizens understand where candidates derive their support and the interests to which they may be sympathetic — if not beholden. Thus, Public Citizen has an intense interest in the issues presented by this case.

STATEMENT OF ISSUES

In this case, the district court held that § 527(j) of the Internal Revenue Code violates the First Amendment and the equal protection principle of the Fifth Amendment insofar as it requires political organizations that claim tax exemption

to report their campaign-related expenditures to the IRS. In addition, the court held that § 527(j) violates the Tenth Amendment to the extent that it applies to political organizations that involve themselves only in state and local political campaigns. The issues presented by this appeal are:

1. Does IRC § 527(j)'s denial of a tax subsidy to political organizations that refuse to provide modest amounts of information about their campaign expenditures violate the First Amendment or the Fifth Amendment's equal protection principle?

2. Does IRC § 527(j)'s application to state and local political organizations that claim the benefit of tax exemption under federal law violate the Tenth Amendment?

STATEMENT

This case concerns the constitutionality of reporting requirements imposed by the Internal Revenue Code on groups claiming tax exemption as “political organizations” under § 527 of the Internal Revenue Code — organizations commonly known as “527 groups” and sometimes also referred to as “stealth PACs” because of their avoidance of the more elaborate reporting requirements imposed on political committees by the Federal Election Campaign Act, 2 U.S.C. §§ 431 ff., or “FECA.”

Section 527 was first added to the Internal Revenue Code in the mid-1970s, as part of the post-Watergate reforms of federal campaign practices — reforms that also included significant amendments to FECA. In Section 527, Congress developed a unique provision in the tax code primarily intended to shield contributions and transfers to political parties and party and candidate committees from taxation. See D. Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 Fla. L. Rev. 1, 71 (2002); D. Storey, *The Amendment of Section 527: Eliminating Stealth PACs and Providing a Model for Future Campaign Finance Reform*, 77 Ind. L.J. 167, 173 (2002). Section 527 created a new form of tax-exempt group: the “political organization,” defined as an entity that is organized and operated primarily to accept contributions and make expenditures to influence the election of candidates to federal, state, or local office. 26 U.S.C. §§ 527(e)(1) & (2).

The tax exemption received by a 527 group is similar to that of a “social welfare organization” under IRC § 501(c)(4) (and unlike that of a charitable organization under § 501(c)(3)) in that it is only the income of the organization itself that is exempt; contributions to the organization are not deductible by the

giver. 26 U.S.C. § 162(e).¹ Unlike a 501(c)(4) organization, however, a 527 group may engage in unlimited electoral activity. Indeed, that is its *raison d'être*. A 501(c)(4) organization, on the other hand, must have a principal purpose other than engaging in electoral activity, although it may engage in electoral activity that is incidental to its goals. *See* D. Simmons, *supra*, 54 Fla. L. Rev. at 66. In even starker contrast, a 501(c)(3) organization is not permitted to engage in any partisan electoral activity at all. 26 U.S.C. § 501(c)(3).

Section 527 thus created a form of tax exempt entity that receives a tax subsidy for electoral activity that far exceeds the scope of permitted electoral activity for any other tax exempt entity. Indeed, no other form of tax exempt organization may devote itself exclusively to raising and spending money on elections, as may a 527 group. And as originally enacted, § 527's subsidy came with very few strings attached: Section 527 groups were not required to account to the public for where they got their money or how they used it. R. Kornylak, *Disclosing the Election-Related Activities of Interest Groups Through § 527 of the Tax Code*, 87 Cornell L. Rev. 230, 245 (2001).

¹ While neither contributions to a 527 group nor those to a 501(c)(4) group are deductible, there is one major difference between them: Contributions to 501(c)(4) organizations exceeding \$10,000 are subject to gift tax, *see* 26 U.S.C. §§ 2501 & 2522, but large contributions to 527 groups are not. 26 U.S.C. § 2501(a)(3)(5).

The apparent reason for the absence of such requirements in § 527 as first enacted was that Congress expected that most if not all 527 groups (such as political parties, candidate committees and PACs) would also qualify as “political committees” under FECA, which imposes detailed reporting requirements concerning both contributions and expenditures on parties, candidate committees, and PACs. 2 U.S.C. §§ 432-34. FECA also subjects parties, candidate committees and PACs to strict contribution limits. 2 U.S.C. § 441a. Thus, § 527 was designed to give a tax benefit to a type of organization that Congress thought it had already regulated to achieve the goals of political accountability and suppression of corruption that FECA is designed to advance. *See* 146 Cong. Rec. S5995 (June 28, 2000) (statement of Sen. Lieberman); *id.* at S6044 (June 29, 2000) (statement of Sen. Levin).

The Supreme Court’s decision in *Buckley v. Valeo*, 424 U.S. 1 (1976), however, changed all that. In *Buckley*, the Supreme Court gave a narrowing construction to the term “expenditures” under FECA, so that it covered only campaign expenditures for communications that expressly advocate the election or defeat of a specifically identified candidate. *Id.* at 44, 78-80. Because FECA’s definition of “political committee” and its reporting requirements are tied to its definition of “expenditure,” *see* 2 U.S.C. §§ 431(a)(4), 434(b)(5), the effect of *Buckley* was to exclude from the category of FECA-regulated PACs any

organization whose electoral activities stopped short of the “magic words” that most courts have held define the bounds of “express advocacy” under *Buckley*. See, e.g., *FEC v. Central Long Island Tax Reform Immediately Comm.*, 616 F.2d 45 (2d Cir. 1980).

Buckley, however, did not affect, either directly or indirectly, the definition of “political organization” under § 527. Section 527 continued to offer a tax exemption to any organization principally devoted to influencing elections, whether or not its expenditures constituted “express advocacy.” The disconnect between the definition of “political committee” under FECA and that of “political organization” under § 527 created a window of opportunity for political entrepreneurs. As long as an organization avoided the magic words of “express advocacy” in its electioneering activities, it could enjoy the benefit of tax exemption under § 527 while avoiding the disclosure obligations and contribution limits FECA imposes on PACs. Section 527 thus allowed tax exempt groups to receive unlimited funds from wealthy individuals, corporations, and labor unions and to spend them to influence elections — all under the cloak of anonymity. See R. Kornylak, *supra*, 87 Cornell L. Rev. at 245.

Despite the advantages § 527 offered to those who might wish to bring large amounts of unregulated money to bear on elections, 527 groups did not immediately come to the fore, perhaps because of the relative obscurity of the

Internal Revenue Code and the greater fanfare received by FECA and the long string of Supreme Court decisions construing and limiting its provisions. Thus, the 1980s saw the rise of PACs in response to the Supreme Court's recognition of their First Amendment right to engage in unlimited independent expenditures in support of candidates. *See California Medical Ass'n v. FEC*, 453 U.S. 182 (1981). PACs, though, had their limitations: they could not directly receive corporate or union money; individual contributions to them were subject to fairly tight per-PAC and aggregate limits; and their contributions and expenditures were subject to strict FECA reporting requirements.

The search for new ways to raise and spend money free of FECA restrictions led in the 1990s to a tremendous expansion in the use of "soft money" — non-FECA-regulated contributions to the political parties that could be raised from corporations and unions and used for significant electioneering activity (though not express candidate advocacy). By the end of the decade, each political party received and expended hundreds of millions of dollars in soft money in each national election cycle — a practice outlawed in 2002 in the Bipartisan Campaign Reform Act. *See* 2 U.S.C. § 441i.

Even when it was legal, however, soft money had a significant disadvantage from the standpoint of a contributor: It had to be turned over to the political parties, which then controlled how it was spent. Section 527 organizations, by

contrast, offered many of the advantages of soft money, including the ability of corporations and unions to contribute, the absence of contribution limits, and the absence of FECA reporting requirements. At the same time, however, they offered greater freedom than did the major political parties for an organization's creator (often a political officeholder) or its big contributors to dominate it and shape the message it sent. Thus, two decades after the Watergate reforms, 527 groups came to play an ever larger role as recipients and spenders of campaign cash, which they could use with impunity and anonymity to attack and support candidates as long as they avoided the magic words of express advocacy that would subject them to the obligations imposed by FECA.

The Sierra Club was among the first non-profit groups to register as a 527 group and was quickly followed by dozens of other non-profits when the IRS issued a letter ruling stating that the group's planned activities would fall within § 527. R. Kornylak, *supra*, 87 Cornell L. Rev. at 245. What these groups discovered was not so much the tax benefits of § 527 status as the fact that federal law did not require non-party 527s to disclose their contributions and expenditures. For groups that were not party committees, § 527 status was subject only to the tax code, which did not require public disclosure of financial activity. Section 527s became known as "Stealth PACs" and mushroomed in number and spending activity in the late 1990s.

During the 2000 presidential election cycle, the increasing use of 527 groups to funnel money into campaigns without any semblance of accountability attracted the attention of Congress.² In that year, Congress enacted Public Law 106-230, 114 Stat. 477 (July 1, 2000), which provided the modest amendments to § 527 that are at issue here. Specifically, Congress provided in new § 527(i) that, in order to claim tax exemption, a political organization had to make a filing with the IRS identifying itself as such. An organization that elected not to make the filing called for by § 527(i) would not be treated as a “political organization” under § 527 for any purpose: It would not receive the subsidy of tax exemption, but at the same time it would not be subject to additional conditions that Congress placed on that status in new § 527(j). Section 527(j) required, for the first time, that a 527 group make periodic filings with the IRS identifying large contributors as well as the

² In one incident that received wide publicity, a 527 group calling itself “Republicans for Clean Air” ran a series of television advertisements during the Republican presidential primaries attacking Senator McCain (without crossing the line into express advocacy). The ad depicted McCain as an opponent of clean air and George Bush as a leading environmentalist. The ad never used the “magic words,” but concluded: “Governor Bush, leading, for each day dawns brighter.” The group was in fact sponsored by two millionaire friends of George Bush, Sam and Charles Wyly. Although the group had the legal ability to keep the identity of the funders secret, one of the Wyly brothers could not resist calling a press conference after the fact and revealing their handiwork in influencing the Republican primary contest. *See* J. Mintz, *Texas Aired Clean Air Ad*, Washington Post, March 4, 2000, at A6; *see also* R. Kornylak, *supra*, 87 Cornell L. Rev. at 230-31.

recipients of large electioneering expenditures made by the group. If a group elected tax exempt status under § 527 and failed to make the required reports, § 527(j) further provided that each unreported contribution or expenditure would be subject to a tax at the highest corporate rate provided in the Code.

These new requirements resulted in little apparent chilling effect on the activities of § 527 groups: In the 2002 congressional midterm election cycle (the first to which the new requirements applied), those 527 groups that submitted their required reports to the IRS revealed that from January 1, 2001, through October 16, 2002, the 170 largest 527 groups had raised over \$115 million for their electioneering activities, approximately \$81 million of which was accounted for by the 25 largest groups. Total spending by 527 groups since the enactment of the reporting requirements in July 2000 had exceeded \$200 million by October 2002. Although many 527 groups either ignored the filing requirements or filed incomplete reports, the IRS did not bring a single enforcement action against a 527 group for violation of the reporting law. *See Public Citizen, Cramming for the Midterm: "527" Stealth PACs Raise at Least \$115 Million to Influence 2002 Congressional Elections* 2, 25, www.citizen.org/documents/527report_pre-election.pdf (November 1, 2002)

While not deterring the growth of 527 groups, the reporting requirements at least allow the public to see where much of the 527 groups' money comes from:

labor organizations such as AFSCME and the AFL-CIO; large corporations and trade groups such as the Pharmaceutical Research and Manufacturers of America, AT&T, AIG, and Phillip Morris; law firms, securities brokers and investment companies; and wealthy individuals such as Jane Fonda. *Id.* at 8-15. And while far from perfect, the expenditure reporting requirements (together with other publicly available information) allow significant insights into which candidates specific 527 groups support and how they spend their money.

In November 2002, after the district court's ruling in this case, Congress approved Public Law 107-276, 116 Stat. 1929 (Nov. 2, 2002), modifying the § 527 disclosure requirements. The new disclosure law significantly strengthened the reporting provisions of § 527(j) by (1) adding the requirement that a 527 group report not only the recipient of its electoral expenditures, but also the purpose of the expenditures, and (2) mandating that the IRS provide improved access on its web site to disclosures by 527 groups. These requirements, which the law imposed only prospectively, should make the required reports even more useful for citizens seeking to learn how 527 groups spend their money and which candidates benefit from those expenditures.³

³ Also of significance here, the 2002 amendments to § 527 provide that the amounts assessed on unreported expenditures and contributions may be forgiven if the failure to report was not "due to willful neglect." 26 U.S.C. § 527(k). In
(footnote continued)

SUMMARY OF ARGUMENT

The district court correctly held that § 527(j)'s requirement that contributions be reported is not a regulation of speech subject to heightened scrutiny under the First Amendment, but is merely a condition on the grant of a tax subsidy that is subject to rational basis scrutiny — which, as the district court recognized, it easily passes. The district court erred, however, in failing to apply the same standard to the parallel requirement that expenditures be reported.

Like the contribution reporting requirement, the requirement that expenditures be reported is no more than a condition on a tax subsidy — a condition that an organization can avoid altogether *simply by not claiming the tax subsidy*. An organization that does not claim tax exemption under § 527 is free to keep its contributions and expenditures secret, and will suffer no penalty for doing so, other than the denial of a subsidy, which infringes no First Amendment rights. Only if an organization claims the tax subsidy, and then refuses to comply with the conditions placed on it, does it face even the possibility of an exaction that may exceed the value of the tax benefit. But even that possibility does not render the

addition, the amendments provide that the reporting requirements do not apply to “qualified State or local political organizations” — that is, organizations that are already subject to comparable disclosure requirements under state law. 26 U.S.C. §§ 527(e)(5) & (j)(5)(C).

statute a regulation of speech subject to heightened scrutiny under the First Amendment (or the Fifth Amendment's equal protection component).

Moreover, even if the expenditure reporting requirement were subject to First Amendment scrutiny, the district court erred in holding that it did not serve a sufficiently powerful government interest because it did not go far enough. In other words, the district court took the unusual view that, in order to be constitutional, the reporting requirement would have to be *more intrusive*. The notion that the reporting requirement is unconstitutional because it is not intrusive enough is neither legally nor factually sustainable, because even as it stood at the time of the district court's ruling, the expenditure reporting requirement provided the public with very valuable information that could assist it in understanding how much benefit individual candidates were receiving from expenditures by 527 groups. In any event, even if a more intrusive reporting requirement for 527 groups were constitutionally necessary, Congress has now provided it by requiring that 527 groups report the purposes as well as the recipients of their expenditures. The district court's analysis is thus no longer applicable to the statute as it now exists, which is the relevant focus since the plaintiffs seek — and the district court granted — only prospective relief.

Finally, the district court's Tenth Amendment analysis was erroneous. Whether or not Congress has any independent regulatory power over matters

relating to state and local elections, its taxing power provides ample support for § 527(j). Indeed, if Congress has the power to *grant a tax exemption* to state and local political organizations (which the plaintiffs in this case understandably never contested), it necessarily has the power to place conditions on that grant. That is all it has done here.

ARGUMENT

I.

THE DISTRICT COURT ERRED IN CONCLUDING THAT THE EXPENDITURE DISCLOSURE PROVISION OF § 527(j) IS A DIRECT REGULATION OF SPEECH RATHER THAN A CONDITION ON A TAX SUBSIDY.

The district court correctly recognized that, under the Supreme Court's rulings in *Regan v. Taxation with Representation*, 461 U.S. 540 (1983), and *Cammarano v. United States*, 358 U.S. 498 (1959), the denial of a tax subsidy for speech does not implicate the First Amendment. The district court properly recognized that the tax exemption § 527 grants to political organizations for what would otherwise be taxable income is a tax subsidy, the grant of which is conditioned on the contribution disclosure requirements of § 527(j). As a condition on a tax subsidy, the court held, the contribution disclosure requirements are not subject to heightened First Amendment (or equal protection) scrutiny and must be sustained as long as they have a rational basis, which the court found no difficulty in discerning. So far, so good.

The same analysis should have sustained the expenditure reporting requirements of § 527(j), which, like the contribution reporting provisions, are a condition on the grant of the subsidy of tax exemption to political organizations. The court declined, however, to apply the same analysis to the expenditure disclosure requirements, because it concluded that to apply those requirements to a 527 group would result in a “penalty” or “additional exaction” that exceeded the value of the tax subsidy.

The court based this conclusion on the supposition that an organization that violated the expenditure disclosure requirements would probably also have violated the contribution disclosure requirements. The consequence of failing to disclose contributions, the court noted, was simply that those contributions would be taxed at the same rate that would otherwise apply if the organization was not tax exempt in the first place. Thus, by violating the contribution disclosure requirement, the organization would lose nothing more than the benefit of the tax subsidy. However, if the organization also went on to fail to disclose the way it *spent* those contributions, it would, the court reasoned, effectively be taxed twice on the same income, and would be worse off than if it had simply not received a tax subsidy to begin with. According to the district court, the reasoning of *Regan* and *Cammarano* could not support the imposition of such a “penalty” for engaging in arguably protected First Amendment activity; hence, the expenditure disclosure

requirement could only be sustained if it could withstand exacting scrutiny under the First Amendment standards announced in *Buckley* and its progeny.

With all due respect to the district court, however, whether § 527(j)'s expenditure reporting requirement qualifies as a permissible condition on a tax subsidy does not turn on whether the consequence of *violating* the condition results in a “penalty” that exceeds the value of the tax subsidy. Rather, under *Regan*, the issue turns on whether the organization has the option of *avoiding* the requirement without losing anything more than the tax subsidy. Section 527 gives the organization precisely such an option: It can simply not claim tax exemption in the first place by not making an election under § 527(i). Because, as the district court recognized, an organization that does not make such an election is not treated as a “political organization” for purposes of any of the provisions of § 527 — including § 527(j) — it will be free not to report expenditures or contributions without fear of incurring any “penalty.” The possibility that an organization that *claims* tax exemption under § 527 and then (willfully) fails to comply with the conditions on that exemption could under some circumstances face an “exaction” that exceeds the subsidy of tax exemption is simply not relevant under *Regan* — all that matters is that the organization can avoid the condition by declining the subsidy.

That this is so is evident from the facts of *Regan* itself. There, what was at issue was the prohibition on “substantial lobbying” by an organization claiming tax

exemption under § 501(c)(3). The consequences of a violation of that prohibition for a 501(c)(3) organization may be severe: It can lose *both* of its tax subsidies (its own exemption and the deduction offered to its contributors), making it worse off from a tax standpoint than a 501(c)(4) organization that is free to lobby.⁴ Thus, to use the terminology of the district court, the consequence of a violation may be an “additional exaction” that far exceeds the value of the tax subsidy it receives for accepting the condition that it not lobby.⁵

The Supreme Court, however, did not concern itself at all with whether the organization would face a “penalty” if, having chosen tax exempt status under § 501(c)(3), it violated the conditions on that status by engaging in excessive lobbying. Rather, what mattered to the Court was that it could avoid the condition

⁴ Indeed, the Code specifically provides (and provided when *Regan* was decided) that if an organization that has claimed tax exemption under § 501(c)(3) loses that exemption for excessive lobbying, it cannot thereafter be treated as a tax exempt organization under § 501(c)(4). *See* 26 U.S.C. § 504. Since *Regan* was decided, the consequences of excessive lobbying by a 501(c)(3) organization have been made even more severe with the enactment of excise taxes on improper lobbying expenditures, which make it even more likely that an organization that violates the lobbying condition will lose more than the value of its tax subsidy. *See* 26 U.S.C. § 4955. The district court’s analysis would call into question the constitutionality of such an exaction.

⁵ Note that the value of that subsidy is only the value of the tax deductibility of contributions, since the organization could lobby and still be tax exempt if it claimed exemption only under § 501(c)(4).

simply by declining the tax subsidy — for example, by forming a 501(c)(4) organization (which receives a lesser subsidy) to do its lobbying. *Regan*, 461 U.S. at 544. Because a “political organization” can similarly avoid the § 527(j) disclosure requirement simply by not electing tax exemption in the first place, *Regan* requires that the requirement be treated only as a condition on a tax subsidy subject only to rational basis scrutiny, without regard to whether the consequence of a violation of the condition is a “penalty.”

The D.C. Circuit faced a similar issue in *American Society of Association Executives v. United States*, 195 F.3d 47 (D.C. Cir. 1999), which, like *Regan*, concerned provisions of the Internal Revenue Code designed to avoid the subsidization of lobbying that would occur if lobbying expenses were deductible. In 1993, Congress prohibited businesses from deducting lobbying expenditures as business expenses. To make the prohibition effective, Congress also had to provide that deductible dues paid to “business leagues” under § 501(c)(6) could not be used to support lobbying. Congress did so by providing alternative mechanisms under which business leagues that engaged in lobbying would be required either to pay a “proxy tax” on their lobbying expenses or to inform their members that a certain percentage of their dues would not be deductible. A business league challenged the statutory scheme on First Amendment grounds, arguing that the effect of the proxy tax provisions was, at least in some cases, to tax lobbying by a

business league at a *higher* rate than the rate that would be paid by its members if they lobbied themselves. Thus, the challenger claimed, the scheme “burdened” First Amendment activity (or, to use the terminology of the district court in this case, subjected it to an “additional exaction”).

The D.C. Circuit, while acknowledging that the proxy tax scheme could in some cases have the result claimed, held that this was constitutionally irrelevant “because a tax-exempt organization that engages in lobbying can altogether sidestep the specified dilemmas.” *Id.* at 50. Specifically, a business league could separate itself into two 501(c)(6) organizations, one of which refrained altogether from lobbying (and thus offered members the ability to deduct their dues fully), while the other devoted itself solely to lobbying (and did not permit its members to deduct any part of their dues). The availability of this option, the court held, ensured “a generally applicable tax system that, although it does not subsidize lobbying, imposes no burden on it by comparison with other activities.” 195 F.3d at 50. Because the organization had the option of avoiding any burden (beyond the simple denial of a tax subsidy), the statute was subject only to rational basis scrutiny under *Regan*. *Id.*

The same analysis applies here. Any political organization that wishes to engage in electoral expenditures without disclosure has an option that will enable it to do so without any burden other than the denial of a tax subsidy: It can choose

not to claim tax exemption. Thus, viewed in the context of § 527 as a whole, the expenditure reporting requirement is no more than a condition on a tax subsidy, and does not implicate heightened First Amendment (or equal protection) scrutiny. And as the district court acknowledged, the provisions of § 527(j) easily pass muster under rational basis scrutiny.

II.
**THE DISTRICT COURT ERRED IN HOLDING THAT THE
EXPENDITURE DISCLOSURE PROVISION OF § 527(j) DOES NOT
SERVE A SUBSTANTIAL GOVERNMENT INTEREST.**

Even accepting the district court's erroneous premise that the expenditure reporting requirement of § 527(j) is subject to heightened First Amendment scrutiny, the court's conclusion that the requirement does not survive such scrutiny cannot be sustained. The district court erred in two ways: first, by demanding that Congress enact a more intrusive statute in order to satisfy First Amendment review; and second, by failing to recognize that even the limited disclosure required by the statute provides important public benefits. In any event, because the statute has now been amended to remedy the shortcoming perceived by the district court, the district court's injunction could no longer be justified even if it had been proper when issued.

The district court acknowledged that a requirement that a political committee report its campaign expenditures can survive even the heightened standard of First Amendment review applied in *Buckley* (which, as explained

above, is not properly applicable to the withholding of a tax subsidy). Indeed, *Buckley* itself affirmed the constitutionality of FECA's requirement that PACs report their campaign expenditures. *See* 424 U.S. at 66-67. Thus, the district court correctly recognized that “*Buckley*'s analysis controls this case unless a political organization can be meaningfully distinguished from a political committee or unless Section 527(j)'s expenditure disclosure requirements can be meaningfully distinguished from those of FECA.” 218 F. Supp. 2d at 1331.

Once again, the district court's analysis was unimpeachable up to this point. The court's error lay in its identification of what it saw as the “meaningful distinction” between FECA's (constitutional) disclosure requirement and § 527's — namely, that FECA requires more disclosure. FECA requires PACs to disclose not only the identity of the recipients of their expenditures, but also the purpose of each expenditure and what candidate each expenditure is intended to assist or oppose. 2 U.S.C. §§ 434(b)(6)(B)(iii). At the time the district court ruled, § 527(j) required only information about the recipient, not information about the purpose of the expenditure or the candidate supported. Thus, according to the district court, FECA's expenditure disclosures serve the substantial interest of increasing public information about who supports which candidates, but § 527's did not. In other words, because § 527 required *less* disclosure, it was *more* suspect constitutionally.

The district court’s holding that an expenditure disclosure provision *less intrusive* than the one sustained in *Buckley* must be struck down ignores one of the fundamental lessons of *Buckley* itself: “[I]n deciding the constitutional propriety of the limitations in such a reform measure we are guided by the familiar principles that a ‘statute is not invalid under the Constitution because it might have gone farther than it did.’” *Buckley*, 424 U.S. at 105 (quoting *Katzenbach v. Morgan*, 384 U.S. 641, 657 (1966) and *Roschen v. Ward*, 279 U.S. 337, 339 (1929)). Or, as the Supreme Court elsewhere put it, “a legislature need not run the risk of losing an entire remedial scheme simply because it failed, through inadvertence or otherwise, to cover every evil that might conceivably have been attacked.” *McDonald v. Board of Election Com’rs of Chicago*, 394 U.S. 802, 809 (1969). Congress’s failure to require as much disclosure by 527 groups as it demanded of PACs cannot provide a basis for invalidating § 527(j) under the First Amendment.⁶

⁶ The supposed constitutional flaw identified by the district court in this part of its analysis was not “underinclusiveness” in the sense of what entities or activities were or were not covered by the statute, which in appropriate circumstances can be a part of the basis for invalidating a law under the First Amendment, *see City of Ladue v. Gilleo*, 512 U.S. 43 (1994). Rather, the problem identified by the district court was that the statute was insufficiently burdensome on those whom it did cover — not a normal basis for finding a First Amendment violation.

Moreover, the district court was simply wrong in concluding that the information required by § 527(j) did not serve the interest of informing the public about who was providing financial backing for efforts on behalf of particular candidates. To begin with, in many instances, identifying the recipient of an expenditure will directly disclose what candidates the 527 group is supporting. But even where that is not the case, as when the recipient of the expenditure is an advertising agency, a media organization, or a political consultant, other publicly available information (such as what advertisements are being run in a particular market) can be linked with a 527 group's expenditure reports to determine how much the group is spending on, say, issue advertising attacking or supporting a particular candidate.

For example, the expenditure disclosures of 527 groups in the most recent election cycle allowed Public Citizen to report that:

- A group called the “Club for Growth” spent “more than \$600,000 on an ad portraying Senate Majority Leader Tom Daschle (D-S.D.), Sen. Edward Kennedy (D-Mass.) and Sen. Hillary Clinton (D-N.Y.) as bobblehead dolls shaking their heads ‘no’ to ‘job-creating tax cuts,’ ‘homeland security’ and ‘eliminating the unfair death tax.’”
- A group called “New American Optimists,” organized by North Carolina Senator John Edwards, “spent nearly \$1.4 million on TV ads in 2002”

featuring Senator Edwards sitting on a porch and “urging viewers in North Carolina to vote in the upcoming election.”

- A group called the “Reform Voter Project” “spent at least \$263,000 on electioneering ads focusing on Senate candidates in competitive races,” including advertisements attacking New Hampshire Senate candidate John Sununu and Arkansas Senator Tim Hutchinson — ironically, for voting against campaign finance reform.

Public Citizen, *Cramming for the Midterm: “527” Stealth PACs Raise at Least \$115 Million to Influence 2002 Congressional Elections* 18, 16, 23 (Nov. 1, 2002) (available at www.citizen.org/documents/527report_pre-election.pdf). These are but a few examples. To be sure, the disclosure requirements of § 527(j) are not perfect, but to say, as the district court did, that they do not advance the objective of “increas[ing] the fund of information concerning those who support the candidates” (*Buckley*, 424 U.S. at 81) and, just as importantly, the dollar amount of the support, is incorrect.

In any event, the statute has been amended since the district court ruled. Even if the district court’s injunction against the law as it existed in August 2002 were proper, it is no longer, for Congress has done what the district court demanded: It has required more disclosure. The statute now more closely tracks FECA’s PAC disclosure provisions by requiring not only identification of the

recipients of expenditures by 527 groups, but also disclosure of the purposes of such expenditures. 26 U.S.C. § 527(j)(3)(A). Even if, as the district court supposed, there was a “large extent” to which disclosure only of the recipients of expenditures would not reveal the connection between expenditures and support of particular candidates, the additional requirement of disclosure of the purpose of each large expenditure should help substantially narrow the category of instances where the disclosure fails to serve the statutory purpose.⁷ Thus, even if § 527(j) was “underintrusive” when the district court ruled, it is not any longer. The propriety of enjoining enforcement of the statute must be determined based on what the statute now says, not what it said before its amendment.⁸

The public utility of information on electioneering activity provided under § 527 as opposed to the information provided by other non-profit groups is the

⁷ Section 527 disclosures do not occur in a vacuum: There is a great deal of other information in the public domain, such as press releases by § 527 groups, newspaper reports, and attribution statements at the end of political advertisements (e.g., “Paid for by People for Good Things”), that can help citizens link up the expenditures reported to the IRS with the actual electioneering communications with which they are bombarded by radio, television, and print media.

⁸ The question whether the expenditure disclosure provisions as they stood prior to their amendment could be enforced against the plaintiffs is now a moot issue.

difference between day and night. The disclosures required of 527 groups offer the public a meaningful picture of where the money comes from and who the expenditures are intended to benefit. Without § 527's disclosure requirements, these groups would be subject to no more than the reporting requirements applicable to other non-profit groups — in other words, filing an annual hard copy IRS Form 990. The Form 990 financial activity disclosure requirements for 501(c) non-profit groups are woefully inadequate for determining electioneering activity. Under Form 990, itemized contributors are not disclosed, itemized expenditures are not disclosed, the purposes of campaign expenditures are not disclosed, and when and where expenditures are made for electioneering activity are not reported. In fact, groups rarely distinguish even in the aggregate between electioneering expenditures and lobbying expenditures on their Form 990s, rendering disclosure of political activities outside § 527 completely useless.

III.
THE DISTRICT COURT ERRED IN CONCLUDING THAT THE TENTH
AMENDMENT PREVENTS CONGRESS FROM CONDITIONING A
GRANT OF TAX EXEMPTION TO STATE AND LOCAL POLITICAL
ORGANIZATIONS.

Finally, the district court's Tenth Amendment analysis, although less significant now that the statute's reporting requirements have been amended to exempt state and local political organizations already subject to reporting requirements under state law, is fundamentally erroneous. As this Court has

recognized, the Tenth Amendment only “reserves to the States those matters that are not delegated to the federal government,” and thus “Congress’s ‘valid exercise of authority delegated to it under the Constitution does not violate the Tenth Amendment.’” *United States v. Williams*, 121 F.3d 615, 620 (11th Cir. 1997) (quoting *Cheffer v. Reno*, 55 F.3d 1517, 1519 (11th Cir. 1995)).

The Constitution confers on Congress no general power to regulate state and local elections, but that is not the issue here. Rather, the question is whether Congress’s power under Article I, section 8, clause 1 (the Taxing and Spending Clauses) may be exercised to exempt state and local political organizations from otherwise applicable federal income taxes on the condition that they report on their exempt activities. So put, the question virtually answers itself.

Presumably, no one — least of all the plaintiffs in this case — would assert that Congress’s lack of power to regulate state and local elections denies it the ability to exert its authority under the Taxing and Spending Clauses to grant a subsidy in the form of tax exemption to political organizations engaged solely in state and local electoral activities. If that is the case, it surely follows that Congress has the authority to place conditions on the subsidy. *See South Dakota v.*

Dole, 483 U.S. 203, 206-07 (1987).⁹ The plaintiffs cannot have it both ways: They cannot assert both that Congress has the power to encourage their activities by exempting them from taxation and that Congress lacks the power to ensure that it is subsidizing only what it wants to subsidize by placing conditions on the exemption. Neither the exemption nor the conditions placed on it can conceivably be deemed a violation of the Tenth Amendment.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

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⁹ *Dole* concerned the Spending Clause, but its analysis should apply equally to a tax subsidy, both because the source of Congress's authority to tax and to spend is the same constitutional provision, and because, as the Supreme Court put it in *Regan*, "tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income." 461 U.S. at 544.

RULE 32(a)(7)(C) CERTIFICATE

I hereby certify that the foregoing Brief Amicus Curiae of Public Citizen, Inc. in Support of the Defendants/Appellants complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B). The Brief is composed in a 14-point proportional typeface, Times New Roman. As calculated by my word processing software (Microsoft Word) the Brief (exclusive of those parts permitted to be excluded under the Federal Rules of Appellate Procedure and the local rules of this Court) contains 6,977 words.

Scott L. Nelson

CERTIFICATE OF SERVICE

It is hereby certified that two copies of the foregoing Brief Amicus Curiae of Public Citizen, Inc. in Support of the Defendants/Appellants were, this 27th day of February, 2003, served by Federal Express overnight delivery service on counsel for the defendants/appellants:

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Because the docket for this appeal does not reflect the entry of appearances by or on behalf of any of the appellees, undersigned counsel certifies that he has followed the procedure used by counsel for defendants/appellees and, this 27th day of February, 2003, sent a courtesy copy of this brief by first-class mail, postage prepaid, to trial counsel for the appellees at the following addresses:

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Finally, pursuant to Federal Rule of Appellate Procedure 25(d)(2), undersigned counsel certifies that this brief was dispatched to the clerk by Federal Express overnight delivery service this 27th day of February, 2003.

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