

HEARING TO EXAMINE AND DISCUSS S.271,
A BILL WHICH REFORMS THE REGULATORY AND REPORTING
STRUCTURE OF ORGANIZATIONS UNDER SECTION 527
OF THE INTERNAL REVENUE CODE

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TUESDAY, MARCH 8, 2004

United States Senate,
Committee on Rules and Administration,
Washington, D.C.

The committee met, pursuant to notice, at 9:31 a.m., in Room SR-301, Russell Senate Office Building, Hon. Trent Lott presiding.

Present: Senators Lott, Stevens, Bennett, Hagel, Dayton, and Nelson.

Staff Present: Susan Wells, Staff Director; Ken Jones, Chief Counsel and Deputy Staff Director; Alexander Polinsky, Legislative Director; Kennie L. Gill, Democratic Staff Director and Chief Counsel; Veronica Gillespie, Democratic Elections Counsel; and Sue Wright, Chief Clerk.

Chairman Lott. Good morning. The hearing will come to order. Thank you all for being here, my colleagues, Senator McCain, Senator Feingold, getting to be regular visitors here. We are always glad to see you, and there are a number of Committee meetings going on this morning, so I am sure we will have Senators coming in and out as the morning

progresses, and I am sure that when we go to markup here in short order, we will have full attendance, because there is a lot of interest and concern in this area, and I want to thank the leadership of you two gentlemen on this legislation and in this area altogether.

We will examine this morning the bipartisan legislation that I have introduced along with the primary sponsors, Senators McCain, Feingold, Collins, Schumer, Lieberman, Snowe, Jeffords and Salazar, a very interesting mixture of Senators from both parties and of all persuasions within our parties, but I think it reflects the interest and the concern in this area.

Today, we will look at the proliferation of organizations whose purposes are to influence the outcome of Federal elections but have chosen to either ignore current law or found a way to circumvent it. These entities are commonly known as 527s, referring to the section of the Internal Revenue Code under which they are required to register. Last year, we had a hearing here in the Committee looking into this issue of 527s. We discussed it at length. We were told that Congress needed to change the law to deal with the problem. We were told that the FEC was powerless unless we changed the law, so we are planning to do just that, change the law.

I believe that this issue must be resolved before we have a campaign finance train wreck in the 2006 and 2008 election cycles. Many of us thought that when McCain-Feingold became law, the issue of campaign finance reform was finally settled, thanks to the tenacity and determination and over my objections by the two gentlemen here today.

But although McCain-Feingold was certainly well-intentioned, one of the outgrowths of it is that it appears to have breathed life into these 527s and allowed them to operate without a clear set of rules. Some 527s permitted to raise soft money, where others are not. Some 527s register with the FEC, while others do not. Some 527s disclose finances on a regular basis, but others do not.

Truth be told, I was afraid something like this might happen, but I must say it happened to a much larger degree and much quicker than I ever dreamed, and I really do feel like this has become a repository for sewer money that needs some sun light on it, and this legislation is an attempt to do that.

Although the McCain-Feingold law put the political parties out of the soft money business, an unintended by-product of law is that soft money has been outsourced from the parties to, I think, these 527s. As a result, we have allowed newly-created 527s to perform the same activities

that the political parties once did and, in fact, are on track to raise more money than political parties have ever raised. We have simply shifted the money from one side of the street to the other. That was not the intent, obviously, and these 527 groups are on both sides of the aisle, from Swift Boat Veterans to Moveon.org, so this is not a partisan issue, as you can tell by the sponsors of the legislation.

I want to draw your attention to a chart that appeared in a newspaper just before the 2004 general election, and obviously, this chart could be updated, and there would be a lot more money to be revealed. It shows how complex this whole business and this whole mess has become. Following the money trail is dizzying. On the left side of the chart, we have the old system of money going from individuals to the parties. All of this money was fully disclosed on a monthly basis, and we had some sunshine on it. Under today's regime, these same individuals give tens of millions of dollars to a myriad of shadowy, intertwined 527 organizations that at best disclose their finances only sporadically and at worse do not disclose at all. This is what I call unintended consequences of what happened.

So, you see the money that was going to the parties from these individuals now are going to all these different groups. They are intertwined and interrelated, and it is

going to become a billion dollar business, I project, unless we deal with this issue appropriately.

The bill we have introduced levels the playing field among those 527s who participate in the Federal election process. If an organization claims a tax exemption under Section 527 and attempts to influence the outcome of a Federal election, then, that organization would be required to register and report its financial activity to the FEC. More importantly, they would be subject to the same limits as the political parties, and I am sure that our first two witnesses will get into some more specifics about the limits on the amount of money from individuals and how hard money would be required.

The witnesses today are well-versed on the 527 matter, and I look forward to hearing their views on the legislation. We collaborated with experts in the field. Senator Dodd made some recommendations. And I do not claim that this legislation is necessarily a panacea, but it is certainly a good start. We may want to do more than this bill initially calls for. I hope we can have a productive hearing, review what we learned and move forward on a bill. I am sure Senator Dodd will be in later, and I would ask permission that we put his statement in the record in its entirety when he does arrive.

Before I go to the witnesses, Senator Stevens, thank you for being here. I understand that you have a Commerce Committee hearing that will be taking place shortly, but thank you for coming by. I know a lot of our younger members are very busy, but you, of course, being the chairman of the Commerce Committee, President Pro Tem and a myriad of other titles and positions find time to attend these hearings, and it is appreciated.

Senator Stevens. Thank you. I have a defense hearing, but I am here really to hear our two colleagues. I just would make this statement. I think we can see now that some of the nonprofits, the 501(c)(3)s, are actually employing the people who are handling these 527s. I do not believe that a tax exempt organization should be allowed to be involved in the political process, and I hope to pursue that further as we go along. I am pleased to be here to listen to our colleagues.

Chairman Lott. Thank you very much, Senator Stevens.

Chairman Lott. Each witness will have five minutes to make a statement followed by questions from the Committee members. Our first panel will be Senators McCain and Feingold. The second panel is FEC Chairman Scott Thomas and Commissioner David Mason. On the third panel is Dr. Michael Malbin, executive director of the Campaign Finance Institute; Mr. Robert Bauer, a senior partner of the law firm of Perkins Coie; and finally Professor Frances Hill, dean of the tax law department at the University of Miami School of Law.

We are pleased to have you here this morning and look forward to your testimony.

Senator McCain, please proceed.

STATEMENTS OF HON. JOHN McCAIN, A U.S. SENATOR
FROM THE STATE OF ARIZONA; AND HON. RUSSELL D.
FEINGOLD, A U.S. SENATOR FROM THE STATE OF
WISCONSIN

Senator McCain. Thank you very much, Mr. Chairman. I want to thank you for holding this hearing and being an original cosponsor and your outspoken leadership. I greatly appreciate the opportunity to be working again with my partner, Senator Feingold, and I would like to thank our cosponsors. I ask consent my full statement as well as three other documents be made part of the record.

Chairman Lott. Without objection, it will be.

Senator McCain. One is a statement by 501(c) nonprofit organizations that support this legislation; a memorandum from Professor Daniel Ortiz; and a copy of a letter dated May 26, 1997, from Mr. Robert Bauer to the Attorney General asking that criminal proceedings be initiated against Congressman DeLay and others.

[The information follows:]

Senator McCain. Mr. Chairman, last year, we saw first hand, as you said, how a number of 527 groups raised and spent a substantial amount of money. It turns out that almost half of the financing for 527 groups came from a relatively small number of very wealthy individuals who made huge soft money contributions. According to campaign finance scholar Anthony Corrado, 25 wealthy individuals accounted for \$146 million raised by Democratic-leaning and Republican-leaning 527 groups. This included 10 donors who gave at least \$4 million each and two donors who contributed over \$20 million.

At the same time that this was happening, the new campaign finance law was successfully accomplishing its goals. As David Broder wrote in a February 3, 2005, column in the Washington Post, quote: "As one who has been skeptical of the claimed virtues of the McCain-Feingold campaign finance law, I am happy to concede that it has, in fact, passed its first test in the 2004 campaign with flying colors. This was accomplished at the same time that all of the predictions about how the national political parties would be financially undermined without soft money were proven to be wrong. The national political parties raised more hard money in the 2004 election cycle than they raised

in hard and soft money combined during the last presidential election in 2000."

In fact, Republican and Democratic national parties raised a record \$1.2 billion for the 2004 elections. In doing so, the parties greatly increased their small donor base and their number of contributors. According to Tony Corrado, the DNC had more than two and a half million new donors and the RNC more than 1 million new donors. So the law worked, Mr. Chairman; the law worked. What happened, again, because of a feckless Federal Election Commission, we allowed 527s, which is clearly in violation not of the McCain-Feingold law but of the 1974 law; the Supreme Court made clear in 1976 that the so-called 527 groups cannot escape Federal campaign finance laws by claiming their ads about Federal candidates do not contain any express advocacy and are therefore not making expenditures to influence Federal elections. The so-called express advocacy standard established by the United States Supreme Court in 1976 was never applicable to groups like 527 groups that are, by definition, in the business of influencing legislation.

This legislation we are introducing is bent on solving the problem with 527 groups and must remain so. The bill must not be a vehicle for increasing the Federal hard money limits or other monies that need limits. We spent a long time on BCRA, Mr. Chairman, and we do not need to reopen

BCRA at this time. All we need to do is make sure that 527s play by the rules; that candidates, political parties, and all other political committees are bound by the rules that Congress has enacted to protect the integrity of our political process.

By the way, Mr. Chairman, again, the United States Supreme Court in 1976, Buckley v. Valeo, said that any organization that engages in partisan political activities for the purposes of affecting the outcome of an election fall under campaign finance limits. That is what 527s do. But the Federal Election Commission, the same one that opened the soft money spigot in 1988, the same one that recently, a Federal judge ruled 13 of the 15 regulations that the FEC issued to implement the BCRA were declared unconstitutional and, in the words of the judge, blatantly outrageous interpretations of the law.

Now, this is the same FEC that believes that 527s do not fall under campaign finance limitations, and again, Mr. Chairman, it clearly does. It clearly does. So we are having, now, and by the way, there will be some conversation about the intent of Congress when we did BCRA. Look, if we thought 527s were going to do what they were doing, we clearly would have addressed 527s, and do not think we would not, and we would have had the votes to do it.

So finally, could I say it sets new rules for Federal political committees that spend funds on voter mobilization efforts, and at least half the funds spent on these voter mobilization activities by Federal political committees would have to be hard money from their Federal account. More importantly, the funds raised for their nonfederal account would have to come only from individuals and would be limited to no more than \$25,000 per year per donor; in other words, George Soros could give \$25,000 per year to the nonfederal account of a single political committee as opposed to \$10 million which he gave in order to finance these activities.

The legislation we have offered, I want to repeat, Mr. Chairman, would not have been necessary if the Federal Election Commission had enforced existing 1974 law as interpreted by the Supreme Court of the United States, which raises a raises a larger issue about what we are going to do about the Federal Election Commission. Any organization that 13 of the 15 regulations that they wrote are declared unconstitutional by the Federal courts of the United States and then says that their answer is to appeal rather than rewrite the regulations, sir, we are in very, very sad shape.

I thank you, Mr. Chairman, and I thank you for holding this hearing, and I thank you for your support. I believe

again, according to objective observers, BCRA worked. BCRA worked in the year 2004, and I believe it will work again. We now have to close what you called sewer money, and unfortunately, we cannot rely on the enforcing body to do that. We have to do that here in Congress.

I thank you, Mr. Chairman.

[The prepared statement of Senator McCain follows:]

Chairman Lott. Senator McCain, you will be able to stay for a few questions.

Senator McCain. Yes, sir.

Chairman Lott. Senator Feingold.

STATEMENT OF HON. RUSSELL D. FEINGOLD

Senator Feingold. Thank you, Mr. Chairman, members of the Committee. I want to thank you for this opportunity to testify in favor of S.271, the 527 Reform Act. As you indicated for John and myself, this Committee is sort of becoming a home away from home. This is our third appearance here, and it is good to be back.

I am very pleased that you have joined us in this reform effort, Mr. Chairman, and indeed taken the leadership role on the bill. I enjoy working with you, and I am very hopeful about what we can accomplish here together this year. I also want to thank the Ranking Member, Senator Dodd, not only for what he will do with regard to this legislation but for all his work on campaign finance reform over the years, including his terrific job of managing, in part, the BCRA bill on the floor of the Senate. I look forward to working with him on this legislation as well.

Mr. Chairman, let me be very clear: the reason we are here today is, as Senator McCain has indicated, is not because of a loophole in the McCain-Feingold bill. That is just a myth. It is simply false, and we should get beyond it. Rather, we are here because the FEC has failed to do its job of enforcing a law that is now over 30 years old. Senator McCain said that our bill was only concerned with

the raising and spending of soft money by the political parties and with phony issue ads run by outside groups in proximity to an election.

And it worked despite a campaign of misinformation that lives on today with false and misleading attacks. For example, just last week, we heard another one, and this was the charge that the McCain-Feingold bill would go after bloggers. Nothing could be further from the truth, as you know. The fact is the real result of the McCain-Feingold bill is that members of Congress are no longer calling up CEOs or union leaders and asking them for huge contributions to the political parties. We ended the corrupting influence of unlimited corporate, union, and individual contributions.

Some, as you indicated, Mr. Chairman, thought that this would destroy the parties. In fact, they have flourished. In the last election, for the first time in nearly two decades, our parties and our candidates concentrated on raising money from average citizens, empowered by our reform effort. And they raised more hard money in 2004 than they had raised in soft and hard money combined in the 2000 cycle. So I enjoy and appreciate your analogy that the money has gone from one side of the street to the other. What I would say is it has gone to a better side of the street. It is still dilapidated; it still needs work, but

the side of the street it was on was simply a cesspool, and we have effectively eliminated that.

John McCain said at every single press conference for seven years: after we finish this, people will find other loopholes. We predicted it, and what they did was find it in the 1974 law, and that is what we need to address now. The last thing we need to do now is to reopen the big money game by raising the hard money limits, as I have heard that some want to do. We significantly raised those limits in the McCain-Feingold bill. We also indexed most of those numbers for inflation. That is already taking effect. The parties are doing fine under these new limits. Let us not tempt fate by reopening that issue on this bill. Indeed, this bill must not be used to reopen any provision of BCRA.

As I said for over a year, the question of whether and how 527s should be regulated in their fundraising and their spending on other activities is a question that should have been answered under the Federal Election Campaign Act passed by Congress in 1974 and upheld and modified by the Supreme Court in the Buckley case. Our position is and has been from the outset that Senate Bill 271 is simply a clarification of existing law.

I was struck by the testimony of Professor Hill, who you will hear from later today, about the game of what she calls statutory arbitrage that has been going on. Lawyers

for politically active organizations realize the tax advantages of the 527 tax status, which also dates back to the 1974 law. And then, they worked really hard to convince the IRS that they qualified for it, because their work is partisan and political, while at the same time arguing with the FEC that they are actually engaged in issue advocacy and nonpartisan efforts, so they should not have to register as political committees.

The FEC could have easily called a halt to this last year prior to the general election, but it dropped the ball. Congress now has to end this game, and this bill is the way to do it. I say this bill is the way to do it, but that does not mean that I am wedded to every section and every provision or that improvements cannot be made. This is complicated stuff, because we do not want to regulate 501(c) organizations, and we do not want to regulate organizations who work only on State elections and whose activities do not influence Federal elections.

As I said before the Senate Rules Committee nearly one year ago today: care must be taken not to chill the legitimate activities of 501(c) advocacy organizations that do not have the primary purpose of influencing elections. We remain very serious about that today. I urge the Committee to work with us and help us repair any problems you may find. Do not just assume, as some of our critics

do, that if there is a flaw in the language, we have some dark and hidden motive. I think, for example, Commissioner Mason, who we will hear from later, has identified some important points that may need to be clarified or fine-tuned in this bill. Even though he was a part of the group at the FEC who rejected the effort to regulate the 527s last year, I do not by any means reject this constructive criticism and analysis out of hand.

But I also ask you to make sure to read the bill carefully before believing that the critics have really found a flaw. I have heard, for example, that one critique floating around says that our bill will cover State candidates and parties. It will not. Note the reference to Section 527(i)(5) of the Internal Revenue Code and the exceptions on page 3 of the bill. One of your witnesses in this hearing argues in his testimony that since our bill applies to organizations, quote: "described in Section 527," unquote, that means that the FEC can go after 501(c) organizations and claim that they are really 527s and should be covered. That is also simply not true. Read Section 527(i)(1) of the Code, which states very clearly: "an organization is not described in 527 unless it has given notice to the IRS that it should be treated as a 527." Our bill covers groups that have self-declared themselves as 527s, meaning they are partisan political organizations.

Mr. Chairman, I simply mention a couple of these arcane and technical issues as a word of caution to the Committee. There are a lot of people out there who like the status quo just fine. They will come at you hard with more misinformation, obscure hypotheticals and doomsday scenarios. For example, there is a petition circulating around for groups to oppose this bill because they say it will cause State ballot initiatives to become Federal political committees. The fact is we have an explicit exception, Mr. Chairman, for State ballot initiative groups. It is there in Subparagraph (c)(2) on page 4 of the bill. If we have written it wrong, we will be happy to work with the Committee and fix it.

But the folks who circulated this petition are not interested in fixing that provision. They are interested in killing the bill. Why? Because they want very rich individuals to be able to continue to give millions of dollars for ads and GOTV drives that attack one or the other of the presidential candidates. They want to see a system that brought us Swift Boat Veterans for Truth on the right and the Media Fund on the left in 2004 to survive and flourish in 2006 and 2008 and beyond.

These same people wish we had not banned soft money to the parties and ended phony issue ads paid for with soft money in BCRA, but we did, and we are not going back. Now,

they do not want to put a stop to the statutory arbitrage that is letting 527 organizations do an end run around the campaign laws, but we will with your help. Our citizens deserve a political system that empowers them, as McCain-Feingold did, not wealthy individuals and powerful special interests. This bill is yet another step in putting average citizens in control of their democracy and in ending the cynicism and apathy that result from a system where their voices are drowned out by powerful special interests.

Working together, we can take this next important step, and I thank you for the chance to testify.

[The prepared statement of Senator Feingold follows:]

Chairman Lott. Senator Stevens, would you like to ask any questions at this point?

Senator Stevens. No, I want you to know, Mr. Chairman, I was on the committee and on the conference committee on the bill that was declared unconstitutional in Buckley v. Valeo. I go back a long way on this, and I have not changed my mind. I think there should be limits on contributions, but above all, and Senator Feingold, I do not seek to regulate 501(c)(3)s. I just seek to prohibit them from being involved in the political process or hiring people who run 527s, and I will try to pursue that through the course of this bill.

Thank you very much.

Chairman Lott. Thank you, Senator Stevens, for your participation and for being here this morning.

Senator Hagel, you came in after we got started, and if you would like to make a statement at this point and/or address some questions to the two colleagues, we would be glad to hear from you at this point.

Senator Hagel. Mr. Chairman, I have no statement, no questions other than to thank our colleagues for once again weighing in to an issue that is important. Some of you may recall that I had the alternative to McCain-Feingold a few years ago, and might I be as bold as to say I think I

actually improved it with a couple of amendments. They may not agree, but nonetheless, they have shown remarkable--

Senator McCain. They definitely improved it. Thank you, Senator.

[Laughter.]

Senator Hagel. Thank you, sir.

They have shown remarkable leadership on a tough issue, Mr. Chairman, and it is one that has to balance the constitutional rights that all citizens have in this country, but I have always gone back to one principle, and I think if we allow this one principle to be our guiding principle, we will find that responsible course, and that is full disclosure.

Chairman Lott. Yes.

Senator Hagel. Full disclosure of everything in, everything out, and do not complicate it.

Thank you.

Chairman Lott. Senator Nelson, welcome to the Committee. Glad to see you are here this morning. If you would like to make a brief opening statement or address any questions, we would be glad to hear from you at this time.

Senator Nelson. Well, thank you, Mr. Chairman, and I, too, want to thank our colleagues for coming forth with additional testimony in support of additional legislation and to say that I, too, am concerned about the tying

together of 501(c)(3) and 527, and I am hopeful that throughout these hearings and with further deliberations, we will find a way to separate with the appropriate separation of these two categories so that they do not blur together.

I think that there are those who are concerned that they will lose their tax status, and there are those who should be concerned about losing their tax status. So I am hopeful that we will be able to sort our way through that, and as time goes on here, we will have an opportunity to ask more questions, and I thank you very much.

Thank you, Mr. Chairman.

Senator McCain. Mr. Chairman, could I respond to that, since--

Chairman Lott. Please.

Senator McCain. --it has been brought up now twice?

The legislation does not affect 501(c) nonprofit organizations. The legislation was carefully drafted to apply only to 527s. It explicitly states it does not apply to 501(c) groups and does not change either the tax laws or the campaign finance laws that apply to 501(c) groups. 501(c) groups, the criticism has no basis. The fact that opponents of the legislation resort to this argument illustrates as clearly as anything that the bill does not apply to 501(c) groups, and opponents are left to resort to unfounded claims that 527 reform legislation has to be

defeated in order to prevent a coming next legislative effort at 501(c) groups.

I want to point out again, Mr. Chairman, the 527s, by definition, are engaged in partisan political activity. That is why they are 527s. 501(c)s are not engaged in partisan political activities. That is why they are under that category. Now, if 501(c)s engage in partisan political activity, then, that is a matter for the IRS and others to make judgments. But there is a clear difference between a 527, which is set up, organized, and dedicated to the proposition of affecting the outcome of an election for partisan political purposes and a 501(c), which is clearly prohibited from doing so. So the opponents of what we are trying to do here are trying to blur that distinction, and there should be clearly no blurring of that distinction.

If I could finally mention one other thing, Mr. Chairman, you know, all this 527 money went into the Presidential campaign. We have 2006 coming up. Suppose that Mr. Soros or others--I hate to keep mentioning his name, because he is one of many--decided to spend \$10 million on a Congressional race or on a Senate campaign, come in with--as you know, these are all negative ads. I mean, an average candidate might be overwhelmed by it. So we not only have to look at the 527s' impact on the presidential campaigns but on other Federal campaigns which

I think could have tremendous impact, far more than they did on the Presidential campaign, and I think that is one reason why there is some urgency associated with this legislation.

Thank you, Mr. Chairman.

Chairman Lott. Senator Dayton.

Senator Dayton. Thank you, Mr. Chairman.

I want to commend both of you also for your leadership on this. I like your bill. I like it even more now that I am not running for reelection.

[Laughter.]

Senator Dayton. And I certainly support what Senator Hagel said about disclosure. I think that is critical, that any dollar that is spent on any political or campaign-related activity by anybody ought to be disclosed immediately. And I would like to just ask either of you in retrospect now, do you think the law is working as you intended it? Is there any other aspect to it that you think should be addressed or improved upon?

Senator Feingold. Mr. Chairman, if I could answer that, the law is working exactly as we intended as to its two main provisions. One is to ban soft money contributions to political parties, members of Congress raising that money and dealing with the phony issue ads, which, of course, you do not see anymore, because they have been effectively not made advantageous.

As Senator McCain indicated, if we had anticipated that the loophole in the 1974 law would have been exploited that way, we may have tried to deal with it. I do not know if I agree with Senator McCain that it would have been easy to add that onto the bill. Maybe it would have been. But I have a suspicion that we would have tried to deal with it at that time, but I do not think we would have jeopardized the entire legislation in order to do that. But if we could have anticipated that aspect, we might have tried to do it, but as far as the bill goes, and what it does, it has worked and done what it intended to do.

Senator McCain. Could I just mention, before I came in, I quoted David Broder, who was very cynical about BCRA. He wrote on February 3, this February 3, quote: "As one who has been skeptical of the claimed virtues of the McCain-Feingold campaign finance law, I am happy to concede that it has, in fact, passed its first test in the 2004 campaign with flying colors." I think he reached that conclusion because of information including the fact that both parties were strengthened, and the amount of hard money went up, contributions by small donors, which was the intent of our law, went up dramatically as well.

Senator Dayton. Thank you, Mr. Chairman.

Chairman Lott. Thank you very much.

Let me, before you leave, just very briefly, Senator Feingold, this is really a pretty simple piece of legislation. While I know Senator McCain would like to go even further and do more about the FEC, he has some very strong feelings about the FEC, but this really is a pretty limited, targeted bill at the abuses we have seen from the 527s. Again, just enumerate them 1, 2, 3, 4. Obviously, disclosure is an important part of it, but identify the limitations again, just so everybody will understand really how simple this bill is and what it does, and that way, we will understand what it does not do.

Senator Feingold. Well, as you indicated, had the FEC done its job, we would not even need this bill, and perhaps the most important provision is that it simply explicitly requires 527 groups to register as political committees with the FEC and comply with the Federal campaign finance laws. But we also take the opportunity to make sure that we do some things that we fear, frankly, that the FEC might not do, and it should.

We add on that when a 527 is registered as a Federal political committee, and it makes expenditures for voter mobilization activities or public communications that affect both Federal and nonfederal elections, at least 50 percent of the costs of such activities would have to be paid for with Federal hard money contributions; in other words, a

provision that actually provides some guidance and specific rules as to how a 527 can stay within the rules.

Finally, and I think this is the main point of your question, once an entity is a 527, it can still receive money from individuals, \$5,000 per year of hard money to their Federal account and up to \$25,000 per year from an individual to a nonfederal account. Those are the kinds of limits that we have placed in the legislation to make sure we do not have to do this all over again so that everybody knows exactly what the rules are.

Chairman Lott. Anything else, Senator McCain?

Senator McCain. No, sir, except that, of course, the FEC has distorted this soft money/hard money in Federal accounts that we have to balance it back to 50 percent, again, trying to pervert the intent of the law as well as the letter of the law.

Chairman Lott. Well, thank you for your time. We have got two more panels to go, so we will give them a chance to be heard, and the next panel is FEC Chairman Scott Thomas and Commissioner David Mason. Welcome, gentlemen, and we do have your prepared statement. We will make your full statement a part of the record. If you could summarize your thoughts on this legislation in five minutes so we will have a chance to ask some questions, we will appreciate it.

While they are being seated, Senator Bennett, welcome. Would you like to make any kind of an opening statement before we proceed with this panel?

Senator Bennett. Thank you, Mr. Chairman. I am hear to learn this morning.

Chairman Lott. All right; thank you very much.

Mr. Chairman, welcome. You have been mentioned, or the FEC has been mentioned a couple of times here this morning, so now is your chance to tell your side of the story.

STATEMENTS OF SCOTT E. THOMAS, CHAIRMAN, FEDERAL
ELECTION COMMISSION, WASHINGTON, D.C.; AND DAVID
M. MASON, COMMISSIONER, FEDERAL ELECTION
COMMISSION, WASHINGTON, D.C.

Mr. Thomas. Thank you, Mr. Chairman and Members of the
Committee.

Yes, the Federal Election Commission is universally
unpopular. We, on various occasions, are way too tough, and
on other occasions, are way too soft, but it is not an easy
job, and I hope that the Committee will, above all else, as
we go through these proceedings, appreciate that the
Commissioners have all got, I think, the best of intentions,
and I think they are all intelligent, bright people who are
trying to do the best. There are obviously philosophical
disagreements, and I think that Commissioner Mason and I
will probably exhibit some of those philosophical
disagreements in the course of this hearing here today.

I would, just as you indicated, I would like to make
sure that the Committee has access to my full statement, and
beyond that, I would just summarize it quickly by saying
that we have, ourselves, at the Commission, tried to take a
stab at figuring out how to define what kind of a group is a
political committee that ought to be registering and

reporting with the Federal Election Commission and living by those contribution limits that you mentioned.

Last year, Vice Chairman Michael Toner and I introduced a proposal that was very similar to S.271 in terms of how it approached this issue. That went down to a fiery defeat at the Commission, but I am sure by the end of the hearing today, hearing from Commissioner Mason, you will have a pretty good appreciation for the kinds of considerations that went into the thinking on that.

I would note that the views I am going to express really are my own. They do not reflect the views of the Agency as a body, per se, but I hope you will appreciate that we do come at this seriously, and we try to work with the law that Congress has given us and try to interpret it as best we can.

The definition of political committee, actually, as you know, is fairly broad. It basically treats as a political committee any group of persons that receives contributions or makes expenditures aggregating in excess of \$1,000 during a calendar year, and those terms contribution and expenditure are defined to reach funds given or paid for the purpose of influencing any election for Federal office. That is a fairly broad definition. And if you think about it, if some partnership were to give a \$2,000 contribution

to some Federal candidate, in theory, that would trigger that political committee definition.

Now, I note in *Buckley v. Valeo*, as has been alluded, the Supreme Court dealt with this political committee issue, and it gave a narrowing construction. It basically said that a political committee would cover only organizations that are under the control of a candidate or the major purpose of which was the nomination or election of a candidate. And later, in *FEC v. Massachusetts Citizens for Life*, the Court further clarified that a group's spending might become so extensive organization's major purpose may be regarded as campaign activity, and as such, it would automatically be subject to the obligations and restrictions applicable to those groups whose primary objective is to influence political campaigns.

So we have been living with a major purpose gloss on the political committee definition that helps us confine it to groups who are really devoted to affecting elections or campaign activity, as the Court has directed. And the FEC has applied that approach over the years with some success. We have had fits and starts, and we have had deadlocks on some cases when we are trying to figure out whether a group should be viewed as a political committee, but the basic approach at the Commission has always been that if a group does cross that threshold of having its major purpose being

campaign agree, and it undertakes at least \$1,000 of Federal election-related expenditures, it will be regulated by us, but we say that a group might also have a nonfederal component, and so, we let it basically set up a separate nonfederal account, and it does not have to report that account to the Federal Election Commission, and that account is not subject to the contribution restrictions in terms of the resources that it raises.

We have set up some fairly elaborate allocation rules over the years that help these committees know what percentage of hard money, the Federal money, they are supposed to use to pay for allocable expenses and accordingly what sort of percentage of soft money, or the nonfederal money, they can use to pay for those allocable expenses.

Now, the IRS definition of a political organization, which is the 527 provision we all hear about, is different, but it is also very similar. It defines a political organization as a committee, association, fund or other organization organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures or both for an exempt function, and then, it goes on to define exempt function as the function of influencing or influence the selection, nomination, election, or appointment of any individual to any Federal,

State, or local public office. So, it is a fairly broad definition, but it uses a primary purpose analysis.

The 527 provision in the Tax Code is designed to be broad, and it picks up both political committees that register with the Federal Election Commission as well as political committees that are reporting only at the nonfederal level, and in some cases, it picks up 527 organizations that do not report to any election official agency. But it is a much broader concept. It picks up the nonfederal as well as the Federal.

Now, in 2000 and 2002, as you all know, Congress responded to reports that there were some 527 groups out there that appeared to be involved in supporting particular candidates, sometimes Federal, sometimes nonfederal, but they were not reporting anywhere, so Congress amended the Internal Revenue Code to require disclosure at the IRS by some of these larger 527s to the extent that they were not already reporting with the Federal Election Commission or with some State or local election office.

But that statutory change did not affect at all what kind of resources those groups could raise to undertake their activities. That kind of a concept, what kind of resources they can raise, is regulated really by the statutes like the Federal Election Campaign Act, and that is where the contribution limits and prohibitions that apply to

political committees are laid out, so it is really a Federal Election Campaign Act issue in terms of what groups should report.

As I mentioned, Commissioner Toner and I, now Vice-Chairman Toner and I, introduced a proposal. It went down to a 2 to 4 defeat at the Commission, but it was designed to do much of what this bill before us talks about. Now, instead, the Commission adopted some regulations which go about this in a different way, in a more limited fashion, as I describe it. These new rules do not rely on 527 status to help determine a group's responsibility for registering with the FEC and abiding by the contribution limits. Nor do they, as Vice-Chairman Toner and I suggested, apply a promote, support, attack, or oppose standard to determine what types of public communications or voter mobilization efforts by 527s would count as expenditures under the law.

We did impose a suggestion that there be a 50 percent minimum Federal share for most of the generic type of allocation matters, but in the Toner-Thomas approach, this regulation approved by the Commission, however adopted a slightly different approach. It did apply a 50 percent minimum in some areas, but it dealt with the concept of whether or not the communications make a reference to a Federal candidate or not or make a reference to a nonfederal candidate, and it attempted to apply, in some cases, just a

pure--if it refers to Federal only, you have to pay for it 100 percent with hard money, but if it only makes reference to nonfederal candidates, you can pay for it 100 percent with soft money. So that is the kind of approach that we have got.

We also have a provision which tries to define what a contribution coming in would be, and we say that if the solicitation involved indicates that any portion of the funds received will be used to support or oppose the election of a clearly identified Federal candidate, we will treat those proceeds as a contribution. So that is one way of getting at the political committee definition, and we have been working with that approach at the Commission.

Bottom line, I do think that the bill before you is a good, positive step. I philosophically have always taken the approach that these kinds of groups, given their tax status, should be reporting to us and regulated as Federal political committees, and I would be happy to take any questions on any of the specifics. I would note that Commissioner Mason has been much more thorough than I at analyzing the nuances of the actual language of the legislation, and he is probably the best one to get us started on those kinds of specifics.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Thomas follows:]

Chairman Lott. Thank you, Mr. Chairman. I appreciate your testimony.

Commissioner Mason, we appreciate your understanding of the nuances. Do not overload us here with nuances.

[Laughter.]

Chairman Lott. Let us get to the bottom line as fast as you can and as effectively as you can.

STATEMENT OF DAVID M. MASON

Mr. Mason. Thank you, Senator. I am delighted to be here, and I appreciate Commissioner Thomas' comments and Senator Feingold's comments, because there have been some references made to philosophical positions and so on, and I have philosophical positions about this, but that is not what I have principally tried to express, nor, in my view, is that the major source of division on the Commission. Commissioner Thomas is a Democrat; Commissioner Toner is a Republican, and the opposition to that was also even on partisan lines. It is really a question of legal interpretation.

As to the Commission's rulemaking, yes, major purpose was always a part of the law. The question has been how to interpret that, and Commissioner Thomas read the entire judicial canon on major purpose, from two Supreme Court cases, and that is it. And that is one of our problems is it is very spare, and unlike a lot of other parts of Buckley, it was never incorporated in the statute, and it does not fit very well with how the basic statute operates, because the statute starts with expenditures and contributions. It says if you make expenditures and contributions, then, you are a political committee, and the Supreme Court put this gloss on it, and now, it is being

suggested that we first decide if they are a political committee without reference to whether they have made expenditures and contributions and then jump back.

And so, we end up in a sort of circular argument, where we have three different definitions of expenditure or contribution: one for groups that are not political committees; one for groups that are; and one for use in determining whether or not you are a political committee, and none of that is in the statute.

And that is basically why I felt like the Commission did not have authority to go back and rework not just the concepts in the statute but the whole way that it worked. So I think we are in the proper place today, and one of the things that I hope the Committee will address as you go forward is how this particular application of major purpose in a 527 concept works in the rest of the statute, because the problem we are going to have is okay, what about some group that is organized as a 501(c)(4) that is also allowed under the tax code to do certain political activity? How are we going to assess that? How are we going to apply a major purpose test? Should we apply the 527 categories?

And if Congress said to do that, that would be a very helpful answer to the Commission on how it was to proceed, but it then would get you involved in this question of whether this bill somewhere down the road is implicitly

going to affect some of those 501, probably not (c)(3) but (c)(4) and (c)(6) organizations.

I do want to raise an issue for the Committee's consider regarding independent expenditure PACs. George Soros' name has come up a lot, and one of the elements is that Mr. Soros made independent expenditures in the 2004 elections in addition to the contributions he made. If he chooses in 2006, he can make independent expenditures, \$10 million or any amount in connection with a particular campaign.

And so, when you are regulating organizations that only make independent efforts, that are not controlled by parties, not controlled by candidates, not coordinating, there is a live and open constitutional question as to whether or not that can be limited. It was specifically reserved in California Medical Association. It is under review in the Second and Fourth Circuits right now, and it would simply be unwise for Congress to forge ahead, knowing that this is under judicial review and not do a careful job of enunciating why you think it is constitutionally permissible and necessary to limit this. I will not go any further than that other than just to say it is something you ought to think about.

I want to address a few difficulties in interpreting the bill, and these are the sort of things that I think you

can fix and improve. And the first one is who interprets Section 527? It is part of the tax code, but this bill amends the Federal Election Campaign Act to talk about groups that are described in Section 527.

Senator Feingold pointed out that 527s have to register with the IRS. That is not true of all 527s. If you register with the Federal Election Commission, then, you do not have to file with the IRS. So what is going to happen under this bill is the Federal Election Commission will get a complaint that says this organization is described in Section 527. They are not exempt; therefore, they ought to register with the FEC, not with the IRS.

And the question is at that point, who makes the threshold determination? Does the FEC make the threshold determination about whether the organization is described in Section 527? Do we ask the IRS to do it? Do both of us have authority to do that? And if we do, is the Commission making determinations and enforcement actions? If we can do that, can we offer advisory opinions? Can we issue regulations? And Commissioner Hill has referred to this concept of tax arbitrage. I agree it is a problem, but it is one we ought to think about in terms of how we ought to enforce this statute.

I would urge you to look at harmonizing the local exemptions in the 527 legislation for tax purposes and in

this bill. In 2002, you made some changes to the 527 legislation to exempt groups involved in State and local politics from having to file with the IRS. S.271 also has a State and local exemption, but it is different. And if the theory is that political for tax purposes is political for FECA purposes, then, I would ask the question why is local not the same rule? And I have made a suggestion that since some of the concern seems to be about groups that ran voter drives in multiple States but still claimed to be local, the fix might be to limit it to organizations that are just working within one State. I think that would work better than, for instance, the voter drive definitions that are in S.271 that I think may sweep a little bit too far.

In the allocation area, I have made a number of specific suggestions. I think that the two biggest concerns are, one, that the bill could be read as not permitting the Federal Election Commission to require allocation of more than 50 percent. It could be read another way, but here, again, it is something that Congress and the Senate could take care of in the bill.

For instance, under our time-space allocation rules right now, if you have a publication that mentions three Federal candidates, and it mentions one nonfederal candidate, and it mentions them equally, that would be 75 percent Federal. Under this bill, that would arguably only

be 50 percent Federal, and so, if you want us to be able to ratchet up in that circumstances, you need to say so. And frankly, I think there is nothing wrong with being able to get below 50 percent on the time-space; I do not think that that has been a big problem.

I have raised a number of other specific comments in my prepared testimony the that I urge you to look at, and lastly, I want to note that the transition time, depending on what you do could be a problem. I have outlined that under this bill, we would have to have new regulations, new forms, amendments to our reporting software, and if we have to do all of those things, we cannot do it in 60 days. We are going to work as hard as we can to get this done as quickly as possible, but I would urge you to take a look if this gets near passage at what is a reasonable time frame.

Thank you.

[The prepared statement of Mr. Mason follows:]

Chairman Lott. Thank you both for your testimony, Mr. Chairman and also Commissioner Mason; very thoughtful testimony. You pointed out three, I believe, or so, four specific areas where you had some concerns with some recommendations, particularly on the time frame. How long do you think it would take legitimately, if not 60 days, 90 days?

Here is why: let us just be optimistic, and let us say that we move this out of Committee sometime this month or early next month, get it through the floor of the Senate, the House acts, we get something done, let us say, by the 1st of June. Then, you need a period of time, but we need to get all this process done if we are going to do it, so that everybody knows what the law allows and what the forms are and everything before the '06 election kicks in.

So that is one reason why I want to keep it as tight as we can.

Mr. Mason. Let me try to answer by saying it depends in part on whether you address some of the details I have asked about. I have tried to suggest the Commission's allocation regulations perhaps go further than maybe people thought in terms of already getting us to 50 percent in most circumstances. And if you made less extensive changes to

our allocation regulations, we might not have to change the forms, and that would take a big issue off the table.

If you harmonized the local exemption in Section 527 and in S.271, we might not have to issue very many regulations, very extensive regulations. And those kinds of adjustments might make it doable in 60 days, whereas if you have a whole separate exemption category, we are going to have to go through a regulatory process, and one of the reasons we got in trouble with Judge Kollar-Kotelly on that 13 out of 15 thing is we had 180 days or 90 days in some provisions under BCRA and she said, well, we did not do a good enough job then. We may have learned something in that process, but I cannot--if you simplify the bill, we can do it in 60 days. If it stays as it is, it may take twice that or more.

Chairman Lott. Well, we will certainly look at all of these issues that you have raised and see if we can appropriately address them, and again, I think you have done a thoughtful job here, and I know you were well-trained in your previous life as a young man--

Mr. Mason. I was very well trained.

Chairman Lott. --when you worked with me.

[Laughter.]

Chairman Lott. And you learned at that time, I hope, do not be too legalistic or too bureaucratic or too dilatory

or any of that. We have a problem here, I think, and it is more than perception. I think clearly, we need to act, and while my colleague and friend Senator McCain would like to go much further than what this bill does, I said no, let us go after it in this limited, targeted way to try to address a serious problem.

So if we make, you know, a few changes in the areas that you have suggested, do you think this legislation is a good idea or not? Can you administer it or not?

Mr. Mason. We can administer it. We could administer it as it is. It would be a bigger problem. If you simplify it, it will be easier to administer. The biggest problem, I fear, with this legislation is that if you pass it, 527s will disappear. Organizations currently operating under Section 527 will stop operating, and a lot of that money will go to 501(c)(4)s, and you will have changed the address again. It may still be worth doing, but in that process, you will lose disclosure, and that is my fear.

Chairman Lott. I worry about that. I mean, I have always maintained that this money is going to ooze around in different places. If you try to cut it out--obviously, I thought it was a mistake in limiting it going to the parties. I thought we should be, you know, committed to building and strengthening our national parties and State parties.

But I lost that debate, and now, it is over here in 527s, and then, it will probably go somewhere else. But what I want is no limits and full disclosure, full disclosure, but we are not going to get that. All I know right now is we have a huge--I believe a serious problem with the 527s, and they ought to at least have to disclose where they are getting their money, where they are spending it, who they are, and they should comply with campaign limits if, in fact, they are doing Federal campaigns. Pretty simple.

Mr. Mason. And what is interesting is that right now, they do have to disclose everything. I mean, all these organizations that we are worried about, we have the studies, because they have complete IRS disclosure, all the money coming in, all the money going out except for the very small contributions. And so, we have got that piece of it. We obviously do not have the limits, and that is the big issue you have got to consider in the bill, but that is why I am afraid we will lose something if we are not careful about how we do this.

Chairman Lott. Let us see here: Senator Bennett, do you have any questions at this point?

Senator Bennett. Mr. Chairman, I am with you as to what I would like, and we lost that debate. I do remember during that debate, we were told by our colleagues are you

not sick of going over to the Senatorial Committee and making all those phone calls, and will you not be grateful when we pass campaign finance reform, and you will not have to do that anymore?

And somehow, I missed something, because we passed campaign finance reform, and I spend more hours over there making those phone calls than I did before, and I am not sure personally how I got the promised benefit out of the bill we have. But we are where we are. Those who said campaign finance reform would take big money out of politics. We spent more money in 2004 than any campaign in our history, and it just took us a little longer to find out who was spending it and what they were spending it on.

But let me understand: you are saying that this bill would probably simply move the money from 527s to someplace else where it would be hard to trace, or is that an oversimplification?

Mr. Mason. No, that is not an oversimplification. I think just as McCain-Feingold had the effect of moving much, not all, but much of the soft money from political parties to 527s, I fear that this legislation could have the effect of moving much, perhaps not all, money from 527s to 501(c)(4)s, because 501(c)(4)s may do voter drives. They can do communications that criticize members of Congress, and they may even, under the tax code, do exempt function

activities under Section 527 with certain tax consequences; however, they are not disclosed.

So most of the things that 527s can do, 501(c)(4)s and (c)(6)s may also do as long as it is not their major purpose, and so, if the group is big enough, or they spent money on other things, that money could go over there with very few organizational changes, very few operational changes, and perhaps with only minor tax consequences. And so, while I understand the urge to let us get this into the system, I am just afraid that it may evaporate and go somewhere else.

Mr. Thomas. Senator, could I just--

Senator Bennett. Yes, Mr. Chairman, I was going to ask you if you agree with that.

Mr. Thomas. Well, I think there is the potential for some organizations attempting to switch over some of the activity to the (c)(4) front, maybe even the (c)(3) front. But there is an interesting legal issue that is percolating in that area. If you give money to a 527, there is no gift tax consequence. If you give money to a 501(c)(3), there is no gift tax consequence. I think that there is a raging debate right now. I think some of the folks in this field are saying (c)(4)s do not have that same protection, and if you give money to a 501(c)(4), it is possible that you, as a

donor, would be subject to the gift tax, which would have a substantial deterrent effect on going to that vehicle.

And as Commissioner Mason noted, there is a separate income tax consequence: the tax code already provides that if a 501(c)(4) group undertakes exempt function activity, in other words, this influencing election type of activity, they will be subjected to an income tax on the income used for that kind of activity up to the lower of their net investment income or the amount spent for that. So there are some practical tax consequences, and I would urge the Committee to sort of look into those issues to see if those kinds of practical restraints might be clarified.

Senator Bennett. Well, as my colleagues know, I am unburdened with a legal education, so let me ask you a question that as a politician strikes me as the core of this: the one concern that I have in all of this debate is that candidates and, to a certain extent, parties as an extension of candidates are losing control of their own campaigns.

We have seen it in Utah. I can give you an example of a campaign that was probably lost by a particular candidate because of outside groups coming into the State, running heavy advertising without understanding the State or without understanding the race and damaging irreparably the campaign of the candidate they wanted to win. And I remember how

helpless that particular candidate felt as she saw this inflow of outside money, and she got blamed for the ads they were running, and her protests that she had nothing to do with them never caught up with the public perception that she was running a campaign of personal attack.

I have seen another one where the outside ads came in, but they came in from a national committee of one of the major parties, and in this case, we were able to say to the national committee you are doing a stupid thing, and they would listen to us, because we were members of that same party. Now, unfortunately, they did not listen enough, and they continued to do the stupid thing, and the Republican lost in that situation.

But looking at it from the standpoint of intelligent campaigns for the voter, every time we take a step that dilutes the ability of a candidate to control his or her own campaign, we move farther and farther away from the kind of election campaigning that we really want. And eventually, I fear we get to a situation where the candidate becomes irrelevant as the campaign is fought out between well funded groups that have their own agendas, their own financing sources, and their own view of how a campaign ought to be run, and they can overwhelm the individual candidate in his or her ability to get the real message out.

Now, examine the bill before us in the context of that situation, which I believe is real.

Mr. Thomas. Well, Senator, I think the sponsors of the bill would want to argue very strenuously that the very purpose of this bill is to put some practical constraints on the ability of those outside groups to get huge unlimited donations that enable them to carry on their kind of outsider message, if you will.

So I think that this bill is intended to carry out that desire that I think you expressed, which is to try to put some practical constraints on outside groups being able to basically use huge, unlimited sources to go into campaigns, and that should perhaps help move the money back toward the party committees. And I should also note there is an important development: the Supreme Court has clarified that party committees can make unlimited independent expenditures. Now, it presents some awkwardness if they are trying to avoid coordinating with their own candidate.

Senator Bennett. Yes.

Mr. Thomas. But nonetheless, they can undertake an unlimited amount of spending for direct, hard-hitting express advocacy ads.

So, I think we have seen in this last election cycle a dramatic increase, and I think you have got a witness in particular coming later who has some good evidence on how

the independent expenditure effort in many races by the party committee exceeded the amount expended by the candidate. So it may not be quite as wonderful a result, but there is at least the party committee undertaking a greater role.

There may be some opportunity for the Committee to consider whether the coordinated expenditure limits are set at the right levels. Maybe you could allow a little bit more coordinated expenditure support from the party along as this process develops.

Chairman Lott. Senator Nelson.

Senator Nelson. Thank you, Mr. Chairman.

Thank you, gentlemen, for being here today. It seems like one of the difficulties we have in trying to deal with campaign finance is the Court's interpretation of free speech, and as long as money is going to be defined as free speech rather than property, we are going to be chasing this problem with money migration from one group to another.

I did not know what we had against political parties back when this McCain-Feingold legislation was passed, because it seemed to me that we were going to exactly what has been done. Now, we chase money from one group to the next through money migration, and we are going to play catch-up trying to regulate wherever the money goes. I have felt for a long time that you need to deal with this on the

basis of full and early disclosure and some limitations on the amount of contributions.

So until we are able to get more realistic limitations on contributions, are we not going to have the current dilemma that we have trying to chase the money from one group to the next and then play catch-up with regulations on the next group?

Mr. Thomas. Well, Senator, you point to a problem that has been with us for a long time. I was happy to hear Senator Stevens note how long he has been working at this area of law, and I, too; I came to the Commission in 1975 after my first law school as a summer legal intern, and I have been there ever since.

Senator Nelson. It is sort of a life's work.

Mr. Thomas. It is a life's work.

But I think that this process that we are in today is a good, healthy process. For many years, there was kind of a drought of legislative attention to the campaign finance situation, and I have got to give credit to all of my friends out there who are political consultants and campaign finance lawyers. They are very good at working at ways to find nuances that will allow them to get some of the big money donations back into the process.

Senator Nelson. They are playing offense, we are playing defense.

Mr. Thomas. Exactly. And I have been told many times that our responsibility at the Commission is to push back when folks like that are pushing us to move away from the intended scope of the law.

So it is a never-ending process. I think what we have here today is a chance to deal with something that we know about, and I think there is a fairly strong legal predicate for taking the action that is being suggested in the bill. I agree that there might be some fine tuning that perhaps would reduce some overbreadth concerns, but there are always going to be other options for folks to explore. Nothing in this legislation will affect what the Supreme Court has said is an individual's absolute right to, on their own, go to a vendor and develop an ad and spend as much as they want.

So we may see activity moving to just pure independent expenditures as opposed to this situation where we have folks just giving huge money donations over to these political groups to let them decide how to spend it. But that is something that we have to put up with.

Senator Nelson. If we were to, and this is hypothetical; it is not forecasting action on my part, but if we were to move for a constitutional amendment that defines money as property, not free speech, would it be then easier to begin to control how much, where, and under what circumstances?

Mr. Thomas. Well, I would say certainly yes, but you have a constitutional scholar here who is not even a lawyer, so I will let him take a crack at that one as well.

Senator Nelson. That might be helpful.

Mr. Mason. I was just going to observe that I do a small amount of farming part-time, and I know that your farming constituents in Nebraska would be highly disturbed if you told them you were going to come and control their property, so I think the short answer is I do not think that particular fix would get you there.

I do want to suggest, you talked about the relationship between limits and control, and the analogy I sometimes use is a leaky garden hose, and that is the campaign finance law. And there is a lot of pressure in the hose, and so, the leak is going to come somewhere, and this is an effort to put a patch on that leak. You can do that. But there is a relationship between how big the hose is, i.e., what the limits are, and how much pressure there is. And so, sometimes, you may simply have to bow to reality and say we have got a lot of political activity and a lot of interest groups that want to be active, and we can relieve the pressure by patch, patch, patch, or we can relieve the pressure by easing up some on the limits, and that is the kind of tradeoff that I think Congress has to make.

Senator Nelson. Thank you, Mr. Chairman.

Chairman Lott. Senator Dayton.

Senator Dayton. Thank you, Mr. Chairman.

I am also unburdened by a legal education, so bear with me here, but it seems to me, Mr. Chairman, that if we are going to address this issue of unlimited funds being able to be used for influencing campaigns that we need to be as comprehensive as possible. To my mind, based on what you said, to take this action as it applies to 527s and leave the door open for these activities to go elsewhere where we can identify in advance where that is likely to be, the 501(c)(4) or 501(c)(6), if that is the case; it seems to me to be missing half the boat, then, to do that.

I mean, that is why we are here today, is because the law and the law of unintended consequences applying as it does, at least the authors of the legislation said that they thought they had prevented this, and now, it has occurred. So I would urge, Mr. Chairman, that we look at this comprehensively and look at the functions that are being performed that this bill addresses and rather than limit it to one particular category of the IRS or whatever that we apply it to any organization that is engaged in those purposes and apply that standard to them.

I guess my question would be are there other places that you can foresee that this money would go? As you said, obviously, somebody could act individually, but are there

other legally, you know, established entities where this could go?

Mr. Thomas. Well, I think we have covered the major opportunities that I think are out there. Now, even though these 501(c)(4)s might become the vehicle of choice for some of these kinds of ads or voter education or voter drive efforts, keep in mind that the IRS, not just the FEC, is going to be looking over the shoulder of these groups.

And so, it may be that this is an area where these groups are going to resist going into this field because of things like the tax consequences. I think it would be helpful to the Committee to try to gather some information about the tax consequences to some of these groups if they undertake this kind of exempt function activity in a (c)(4) form. It may be that you will hear enough to suggest that this will not actually become a total end run. But again, I come back to it: I want this kind of proceeding to be viewed as sort of the normal course, if you will.

If an obvious problem develops, I think Congress should be willing to take a quick look and respond quickly. I know that that suggests, in the hearts of many of the folks out there, a never ending need to sort of reappraise and readvise their people about what laws are, and the laws would always be changing.

But if you are going to make a system like we have developed, which has not just disclosure but also limits and restrictions on campaign funding support, if you are going to make that work, you really have to stay vigilant.

Senator Dayton. Commissioner.

Mr. Mason. As best I can tell, the 501(c)(4), (5), and (6) are the likely next places that you would have to look at.

Senator Dayton. Okay; well, I would like to work with you, Mr. Chairman, if you are agreeable or with you to get some way to make this comprehensive so we do not have to keep coming back. As somebody inevitably will find some other way to set something up. I am quite sure of that. As you said, sir, when I am along with you, I would say we ought to just have absolute immediate disclosure, but not to deal in advance with what we know is a likely consequence to me seems short-sighted.

Commissioner Mason, could I ask you on your testimony, or at least your written page 7, where you talk about Congress and the IRS encouraging these groups to go into these activities, and the first paragraph, if Congress is concerned that a favorable tax treatment should be restricted to small rather than to million-dollar donations, using the tax code to limit the scope of, for instance, the gift tax exemption might be preferable to effectively

banning large donations to independent political groups altogether.

Could you elaborate on that, please?

Mr. Mason. Yes; one of the major advantages of 527 status, as Commissioner Thomas pointed out, is a complete exemption from the gift tax. And if there is a concern that we do not want to be advantaging \$10 million gifts for these purposes and that it really was intended for \$100 or \$1,000 or even \$10,000, then, that would be a fairly simple way to get at that, at least to discourage those very large donations. If, for instance, you are not permitted, if you get a Supreme Court decision that says, well, no, you cannot ban those, then, at least you could discourage them by simply not giving them the favorable treatment under the Tax Code that they get now. And that is clearly discretionary on the part of Congress.

Senator Dayton. And then, in the next paragraph, where you say attempting to do so without adjusting the contribution limits for IEPACs would almost certainly result in a net loss and probably a significant loss in disclosure.

Mr. Mason. That is what I discussed before: that if you try to put all of this under the \$5,000 limit, then, the smart political operatives and the politically interested donors, and some of this is being driven by the operatives who go out and seek the money; some is being driven by

donors who want to be active, they are going to try other places to put that money, and at least some of that money is going to be able to find other places to go.

And so, the question is how you balance off this limit issue with the disclosure issue, because right now, the bargain you have struck is you can spend all of the money you want, but you have to disclose it. And if you change that bargain, you change that condition and say you can only spend up to \$5,000, that is going to change the behavior of both donors and organizations, and you will get less disclosure.

Senator Dayton. Thank you, Mr. Chairman.

Chairman Lott. Thank you, Senator Dayton.

Chairman Lott. Thank you very much, gentlemen, for your comments.

Now, let us go to the third panel: Dr. Michael Malbin, executive director, Campaign Finance Institute; Mr. Robert Bauer, senior partner with the law firm of Perkins Coie, I guess it is; and finally, Professor Frances Hill, dean of the Tax Department of the University of Miami School of Law. Your entire statements will all be put in the record as they have been presented, because you were kind enough to give us those statements in advance so we could read over them.

I would like to ask if you could to limit your remarks to five minutes if at all possible so we would have some time left for attempted questions and your answers. All right; well, let us see: Dr. Malbin, why do we not start with you first? Let me see here; Malbin, if you would.

Mr. Malbin. Sure.

Chairman Lott. And then, we will go to you, Mr. Bauer, and save the Professor for last.

STATEMENTS OF MICHAEL J. MALBIN, EXECUTIVE
DIRECTOR, CAMPAIGN FINANCE INSTITUTE, WASHINGTON,
D.C.; ROBERT F. BAUER, SENIOR PARTNER, POLITICAL
LAW GROUP, PERKINS COIE, LLP, WASHINGTON, D.C.;
AND PROFESSOR FRANCES R. HILL, UNIVERSITY OF MIAMI
LAW SCHOOL, CORAL GABLES, FLORIDA

Mr. Malbin. Mr. Chairman and members of the Committee, thank you for asking me to testify on 527s. The Campaign Finance Institute is a nonpartisan research organization affiliated with George Washington University. I am CFI's executive director, as you said, as well as a professor at the State University of New York, Albany.

CFI has been looking at 527 issues since we began five years ago last month. As part of our coming book on the impact of BCRA, we released a draft chapter on 527s. I did submit a copy of that chapter with our written testimony and ask that you make that part of the record.

Chairman Lott. It will be made a part of the record.

Mr. Malbin. Mr. Chairman and Members of the Committee, 527 political groups by definition are organizations whose primary purpose is to influence elections. For this, they receive an advantageous tax status. Unlike candidates, parties, or PACs, they may also raise contributions without limits, and in our view, there is no rationale for this.

Here are a few numbers from the CFI study. Federally-active 527 groups raised \$405 million net in 2004. This is more than two and a half times the \$151 million they raised in 2002.

Who gave the money? Our research looked at all of the contributions of \$5,000 or more. Businesses and trade associations were responsible for only \$30 million; labor gave \$94 million. Most of the large 527 money came from individuals, a jump of from \$37 million in 2002 to \$256 million in 2004. Now, among the individuals who gave \$5,000 or more, there was a huge shift toward the very biggest donors. In '04, 88 percent of that money came from only 265 people, who gave \$100,000 or more. Even more impressive, 70 percent came from only 52 people, who gave \$1 million or more.

Now, there is a really stark contrast between the 527s and the political parties in this respect. When soft money was banned, as has been said earlier, many people said the parties would be starved, and we now know that the parties did very well. Even though none of the party money came in in amounts above \$25,000, the parties raised 13 percent more in hard money alone in 2004 than they ever did before in hard and soft money combined. What is more, a record amount of this money came in small contributions below \$200. And Commissioner Thomas said, record amounts of that party money

was spent on independent spending by the parties in support or in opposition to candidates.

So the parties have been depending on smaller contributions, while the 527s rely on a handful who gave millions. Will these 527 numbers grow? We think so, for three reasons: first, now that the huge donations are out of the bottle, we just suspect that that genie is likely to go back. Second, Republican 527s started slowly in '04. These numbers will grow rapidly if 527s are not regulated.

And finally, let us look at the relationship between 527 donors and the old soft money donors and do it from two different angles: first, were most of last year's soft money donors also soft money donors under the old system? Answer, yes, they were. About two-thirds of them used to give soft money. But let us flip the question around: did most soft money donors later give to the 527s? Answer, no, they did not. For every former soft money donor who did give to the 527s, seven others did not. So, in other words, most of them will not transfer; a lot of them will not, but as big as the 527s were in '04, there clearly is a lot of room for growth in this sector.

Briefly on the constitutional issue, the reigning legal justification for contribution limits is preventing corruption or the appearance of corruption. The following findings would be used to support contribution limits:

first, now that so many of the large 527s have associated themselves with the major parties or associated their positions clearly with one or the other party, their multi-million donors are, again, clearly in a position to get attention after the fact from the parties and office holders.

Second, visible political professionals closely associated with both of the parties and the presidential campaigns helped establish, manage, and raise money for the key 527 groups. This is all detailed in the report. We are not saying and did not say that the organizations or parties violated the solicitation or coordination rules. Nevertheless, we were struck by what looked like a nexus of reciprocity.

In some ways, the major 527s have become institutionalized as quasi-party surrogates. This creates a risk that 527s will recreate a barely one step removed version of the old party soft money system. All of this is what led the CFI Task Force on Financing Presidential Nominations to endorse the principle of contribution limits for 527 political committees.

Last point: there have been questions about how this bill or its context might relate to 501(c) organizations. We go into this in the written testimony. The one-sentence version is that we think that many of the concerns raised

about the (c)s have been based on speculation. Some of the money may move to (c)(4)s, but there are, as has been mentioned, significant barriers in current tax law. I do not pretend to be an expert on tax law, but this will not happen so easily, and it will depend on IRS enforcement. In any case, this issue is not now before the Committee. It does not necessarily need to be.

Finally, just to go back to a point that is removed but to go back to a point that you made earlier, I agree completely with you, Senator, and with others on the importance of disclosure, and therefore, I want to thank you for your support of immediate electronic filing and disclosure for Senate campaigns and hope that the Senate will move on that, too.

I would be pleased to answer your questions.

[The prepared statement of Mr. Malbin follows:]

Chairman Lott. Thank you very much for your being here today and for your testimony and for your report. I find it extremely interesting and helpful.

Let us go ahead and hear from the other two witnesses, and then, we will take a couple of questions.

Mr. Bauer.

STATEMENT OF ROBERT F. BAUER

Mr. Bauer. Thank you, Mr. Chair and Members of the Committee for the invitation to speak here today, and of course, I understand that my full written statement will be incorporated into the record, so I am briefly going to summarize it here and perhaps refer to some of the testimony we have already heard today.

You said, Mr. Chairman, you wanted us to get to the bottom line and avoid overloading you with technical details, particularly on the part of those of us who, to cite Senator Bennett are, indeed, burdened by a legal education, so I will indeed address the bottom line here.

The question, it seems to me, that we have to ask is why are we here only two years with experience of BCRA once again before the Congress with a major piece of campaign finance reform legislation? Senator McCain today said it was not because BCRA had a loophole. The question, it seems to me, has not been answered clearly, and I would like to answer it, because I think it is critical to the deliberations of this Committee.

We are here today even though BCRA was concerned with severing the link, we were told, between parties and candidates on the one hand with their control over legislation and special interests on the other. We are here

today to consider restricting organizations that by the definitions we are using here and as a practical matter are not controlled by candidates, are not controlled by parties, and do not, in fact, present the set of concerns that were fundamental to the structuring and crafting of BCRA.

So we are striking out in a different direction. It is not, however, correct that the drafters of BCRA or those who voted on it did not contemplate the existence of 527s or their activities. The text of BCRA itself makes specific reference to 527s, and for that matter, to 501(c)s, and again, in keeping with the concern of separating money from the legislative process, the statute attempts to restrict transactions between officeholders and parties on the one hand and 501(c)s and 527s on the other.

So this was not an unanticipated problem, but Congress chose not to address it, believing that the link between officeholders and parties and money was, indeed, the proper business of the Congress, concerned, as it was, with protecting the anticorruption rationale of our campaign finance laws.

So why do we have the provisions today of the bill that we are discussing before us? What is this really designed to accomplish? In my view, this legislation is the product of three forces that are converging and that take this country in a wholly different direction in the regulation of

political activity: number one, we have to make note of the fact that we have a reform industry in this country which is forever generating new proposals for the extension of regulation of political activity, and their spending for this purpose has recently been estimated independently to come to \$140 million over a measured period campaigning for the campaign finance laws. I believe that was a 10-year period over which that \$140 was raised and spent.

There is an enormous amount of this activity, and we even heard a short time ago Commissioner Thomas saying that really, we are committed now to an enterprise of appearing before the Congress fairly regularly to make sure that we are chasing after the most recent alleged circumvention, the most recent opening of a loophole.

Secondly, I believe that this reform activity joins together with increasing belief on the part of partisan interests that if we are going to have a regulated political process, the regulations should be manipulated to serve partisan ends.

And thirdly, those who wish to see this development continue have taken comfort from the McConnell decision, which provides a wholly new and rather amorphous set of theories under which circumvention and other vaguely described goals allegedly justify continued Congressional involvement in the regulation of the political process.

So that is the landscape that we are looking at: a wholly new landscape of virtually endless reregulation of the political process. As to the matter before this Committee, which is S.271, and seeing that I have a minute and 26 seconds left, let me say very quickly that it incorporates a view, a very dangerous view, that any activity that can be deemed to be election influencing is presumptively subject to Federal regulation. It would not matter if the organizations in question were expressly advocating the election or defeat of candidates. It would not matter if the organizations were controlled by candidates or parties or coordinating their activities with them. The mere assessment of an impact on elections from, say, speech on issues would be enough to presumptively subject the activity to Federal regulation.

And indeed, I note that under this standard, and I note this in my written testimony, reform organizations that are 501(c) organizations would fall within the category of organizations that could indeed be thought to have influence on elections, and lo and behold, hardly had I written that when, this morning, the New York Times, on the front page, seems to take Senator McCain to task, and I think quite unfairly, for setting up a tax exempt organization with which he is openly affiliated that purportedly provides access to donors and purportedly obligates or could be seen

to obligate him in some fashion to the sources of support for this issues-based activity of his own.

But this is the perverse logic of reform. It just simply is headed right now into a rather unattractive direction, and I believe this statute continues to move the line in the direction of the broadest possible assessment of regulable election influencing activity.

In my testimony, and I am going to sum up here in 10 seconds, Mr. Chair, I believe this bill also puts the FEC in the position of defining activity it is ill-equipped to define. It puts the IRS and the FEC in the position, essentially, of conflicting with each other and achieving a coordination that has so far escaped them. It puts 501(c) organizations in the line of fire almost certainly, and furthermore, it unfortunately upends the expectation of organizations that were encouraged by the IRS to conduct their issues-based activity through the 527 format.

And last but not least, I do not want to neglect to mention that it Federalizes State and local elections activity and has the result of unjustifiably imposing major new costs on Federal political committees that are active in both Federal and nonfederal elections and Federalizes their nonfederal elections activity as well.;

I apologize for going slightly over, and I will conclude my remarks with that.

[The prepared statement of Mr. Bauer follows:]

Chairman Lott. Well, thank you very much, and it was time well spent when you went over. We are glad to have you back before the Committee. I know you do a lot of work in this area; you are very thoughtful, and it is appropriate that you raise some red flags for us to consider before we move forward on this legislation, and we certainly will do that.

Professor Hill.

STATEMENT OF PROFESSOR FRANCES R. HILL

Ms. Hill. Thank you, Senator Lott. I appreciate the opportunity to appear today, and I particularly want to thank you and the Committee for inviting a tax lawyer to appear in foreign terrain. It cannot be too welcome to have on a rainy Tuesday a tax professor, of all people, talking to about this legislation.

Why are we doing this? We are doing this because the tax predicate of the 527s is widely misunderstood, widely misrepresented and perhaps should just be discussed in a neutral way. The 527s at issue planned their way into the 527s for the benefit of exemption and did so through activity that took extraordinary creative legal reasoning. The legal reasoning was that although our activities appear to be the things that a 501(c)(3) or a 501(c)(4) could routinely do without threatening their exemption at all, issue ads or legislative lobbying, we are going to represent affirmatively with the IRS that we intend to influence the outcome of elections. We are going to have our boards pass resolutions saying we intend to have this result.

One organization even received an opinion letter from a political scientist, which I find extraordinary, having once been a political scientist at the great State University of

Texas at Austin, and I did not know that we issued opinion letters when I was in that profession.

Having represented to the IRS that they intended to or that their activities would have this result, they felt free to ignore the FEC, because at that time, magic words controlled, and if they avoid the magic words, they would exempt under 527, free of any gift tax exposure and not a political committee.

When *McConnell v. FEC* took the position that the magic words test was not a constitutional requirement, reengineering was called for. The arguments made to the IRS initially now had to be turned on their head and presented to the FEC.

Those 527s that had planned their way into 527 for exemption purposes now represented to the FEC that in fact, their activities were, in essence, lobbying or issue advocacy, certainly not political in any way, certainly not the activity of a political committee. Instead, issue advocacy is issue advocacy is issue advocacy; if only Gertrude Stein were with us today.

They went to the FEC and negated the very proposition that had been the core of their tax planning. The first phase of the 527 planning, the tax law phase, planning in; second phase, planning out of the FEC; classic statutory

arbitrage, and now, we are before Congress for guidance on coordinating these two statutes.

In my view, S.271 is a principled and coherent approach to achieving the statutory coordinate. The idea that one has to coordinate statutes is certainly not new to the U.S. Congress. I am sure you have faced issues of this type before. You are on familiar terrain. What S.271 does says if you have planned your way into 527, and you want the advantages, like all tax planning, it may have non-tax consequences. Therefore, you have many choices under tax law. You are free to follow this one.

There are appropriate exceptions for activities that are not properly subject to FECA, and I think it is not a far-reaching bill. In my view, this kind of tax planning and coordination of statutes is in the course of things. As a tax lawyer, it has never occurred to me that the statute I deal primarily would ever become perfect, actually, that we sometimes do come to Congress with little bumps in the road of the Internal Revenue Code. It has been known to happen, as I am sure you have great experience with. What is unusual is to deny that tax planning has occurred or that tax planning should have consequences.

The idea that 501(c) organizations will be inexorably swept into this is something that I simply feel is erroneous. First of all, the bill states explicitly in

Section (4)(3) that it does not include 501(c) organizations, but as a tax lawyer, a 501(c)(4) political committee cannot exist, because no (c)(4) that is going to be exempt can satisfy the primary purpose test to be a political committee under FECA. And therefore, I do not see the danger to a properly administered 501(c)(4). 501(c)(3)s should be even safer. They have this absolute political prohibition, and the benefit is, of course the 170 charitable contribution deduction.

Of course, one has many alternatives in tax planning. One lives with the consequences of one's choices. This is the structure of S.271 and why I think it is legislation worthy of the consideration of this Committee and the U.S. Congress.

I thank you for the opportunity to be here today before this Committee.

[The prepared statement of Ms. Hill follows:]

Chairman Lott. Thank you very much, Professor Hill.

Being a lawyer or at least having graduated law school, I have known a few tax law professors and tax lawyers, and I must say you are the most articulate and entertaining tax lawyer I have ever known. [Laughter.]

You could have bored us to tears, you know, with great recitations on, you know, the intricacies of tax law, and you did not do it. You did a magnificent job. I am persuaded. [Laughter.]

Thank you for being here and brightening this day.

Senator Dayton, would you like to address questions to any members of this panel?

Senator Dayton. I would share your sentiments. I thought all three witnesses were concise and understandable for a layperson like myself, so I thank you for that.

Professor Hill, regarding your last point, because this question about, you know, this money migrating elsewhere, is there anything now in 501(c)(4), (5), or (6) that should be strengthened to prevent that from occurring? And my second part of the question, is there somewhere else in this, you know, all these tax entities that this money could migrate to?

Ms. Hill. It is always difficult to know how creative the legal advisors are going to be, the people who advise large contributors.

Senator Dayton. You said extraordinarily creative legal reasoning, I know that, yes.

Ms. Hill. Yes, extraordinarily creative, which is a good thing in the law. We are a free people. We are free to be creative, and then, Congress is free to reconsider. I, as a tax lawyer, live with imperfections in my statute every day.

Will the money migrate? I am with Senator Lott: I think it is not clear to me some of it will not just go to parties in the appropriate, limited amounts. I do not know. Some money may simply be spent on issue ads and 501(c)(3)s. They might decide to just fight the issues. Frankly, I was struck in this election when we had a big issue election about things of grave consequence to our country. I think we all agree on that, whatever side of the political divide we are on: war and peace, our economy, the nature of our civil society. We had big issues. And our candidates, I think, were attempting to address them.

What I did not hear were the 501(c)(3)s, the 501(c)(4)s out bringing us issue advocacy just unrelated to particular candidates. Now, perhaps I am from an era where teach-ins were the thing, and perhaps I am just passe, but I would

have loved people coming to my campus in Florida just wanting to talk about war and peace. They could have done this not only with limited money but with tax deductible money, charitable contribution money.

Now, I live, work, and vote in a battleground State, and I expect that every political person in America came to visit us, although I did not see all of you personally, and we welcome you back whenever. We like having you. But where were the 501(c)(3)s airing the issues in a nonpartisan way?

So I think some of the money may simply go to truly nonpartisan issue ads, because the big issues are not going away. And I would encourage that, because frankly, as a native Wisconsinite, I believe in organizations that band together to speak truth to power however ordinary citizens see it and taking diverse views, whether in an election cycle or not. So maybe, if less money can be put into the 527s, some of it will just go to (c)(3)s and (c)(4)s, and we will have a clash of views expressing all sides of an issue, the classic issue ad, the classic role of a (c)(3) or, indeed, a classic role (c)(4).

It is possible, but I do not know where the money is going to go.

Senator Dayton. Could I just ask the witnesses, is there anywhere else that you are aware that this money could migrate to?

Mr. Bauer.

Mr. Bauer. First of all, I also, having recently spent a weekend with Professor Hill, want to commend her. I did not realize until I met Professor Hill that when Patrick Henry said "give me liberty or give me death," he was promoting tax law statutory arbitrage. [Laughter.]

In any event--

Senator Dayton. Is that the liberty or the death portion? [Laughter.]

Mr. Bauer. No, he would rather have tax law statutory arbitrage than die, like the rest of us, I think.

In any event, I think it is entirely--the line of questioning, Senator, that you are raising is precisely the direction that we are going to travel. We are going to be looking obsessively now in every direction where new money surfaces to influence elections through speech on issues. Professor Hill expresses the wish that it be potentially safe and nonpartisan and that it not raise any of the concerns that issue advertising that, quote, "promotes, opposes, supports and attacks," unquote Federal candidates' races.

Well, the truth of the matter is that we are a feisty people, and our speech is unruly, and very frequently, it takes precisely that edge. We express ourselves on issues by attacking Federal elected officials and promoting their replacements, and we do sometimes in very uncomfortable terms for those who are involved in it. And there is no escape from that, and if it is not done through 527 activity as we have seen it, it will be done in other ways, and I think Commissioner Mason is quite correct: you will find it in the 501(c) community, and without tipping the hand of myself or anybody else who is endeavoring to be professionally creative, there are other directions, to be sure, that people are actively considering as we speak.

[Laughter.]

Mr. Malbin. Senator, under the tax law, a 501(c)(4) cannot have elections as their primary purpose. And that is a major barrier. If a person wishes to spend money to influence the outcome of an election, he has to give it to an organization and perhaps pay a gift tax. The net value of every dollar given is something like 33 cents.

But let us suppose the hypothetical works out. I have labeled it as speculation. Under the Constitution, you are permitted--it is not just a constitutional matter but a matter of prudence--when you are doing something that might conceivably, that will restrain speech, all of this is about

balancing that does affect speech. You are expected to be responding to evidence. There should be a fact record.

Now, one can always speculate that a fact record will develop, and I think it is prudent course to say let it develop, and let us respond to the facts.

Senator Dayton. Mr. Chairman, I thank you for holding this hearing. Thank you.

Chairman Lott. Well, thank you. It has been very informative. Thank you to this panel for being here and for your presentation. Thank you all for attending. We will move to markup legislation in this area within the next month, and we will be seeking your counsel as we prepare to do that.

Thank you very much. This hearing is adjourned.

[Whereupon, at 11:15 a.m., the Committee adjourned.]