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CORPORATE PHILANTHROPY AND CAMPAIGN FINANCE: EXEMPT ORGANIZATIONS AS CORPORATE CANDIDATE CONDUITS

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CORPORATE PHILANTHROPY AND CAMPAIGN FINANCE:
EXEMPT ORGANIZATIONS
AS CORPORATE-CANDIDATE CONDUITS

FRANCES R. HILL*

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Corporations are significant contributors to charitable causes.¹ Corporate philanthropy has become an element of corporate citizenship; the idea that corporations play a role in the community not solely defined by being a part of a community's economy.² Corporations are also significant contributors to political campaigns.³ This article explores the relationship between corporations' philanthropic and political roles, suggesting that there is significant overlap in what appear to be discrete activities. The overlap arises from the use of certain exempt organizations⁴ as conduits between corporate contributors and candidates

1. "Corporations" refers to business corporations that are taxable entities and which exist in the first instance to provide a return on the capital advanced by its shareholders. Many, probably most, exempt organizations are also organized in corporate form, either under special state laws for non-profit corporations or under state general corporation laws. Exempt organizations, whether organized as corporations, trusts, or unincorporated associations, are defined by federal and state tax laws.

2. The use of corporate assets for charitable contributions remains controversial and raises fundamental questions about the nature of a corporation. *See, e.g.,* Rikki Abzug & Natalie J. Webb, *Rationale and Extra-Rationale Motivations for Corporate Giving: Complementing Economic Theory With Organizational Science*, 41 N.Y.L. SCH. L. REV. 1035 (1997); Jayne W. Barnard, *Corporate Philanthropy, Executives' Pet Charities and the Agency Problem*, 41 N.Y.L. SCH. L. REV. 1147 (1997); Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579 (1997); Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity*, 44 DEPAUL L. REV. 1 (1994); Michelle Sinclair & Joseph Galaskiewicz, *Behavioral Approaches to Studying Corporate Charitable Contributions*, 41 N.Y.L. SCH. L. REV. 1059 (1997); Linda Sugin, *Theories of the Corporation and the Tax Treatment of Corporate Philanthropy*, 41 N.Y.L. SCH. L. REV. 835 (1997).

3. A corporate contribution is one made using funds of the corporate treasury. Contributions of corporate treasury funds are distinguishable from contributions made through corporate political action committees ("PACs"), which do not draw on corporate treasury funds but are instead funded by employees and shareholders directly. *See infra* Part II.B.4 (discussing corporate PACs).

4. *See* I.R.C. § 501(c) (1986). Section 501(c)(3) organizations may neither support nor oppose candidates for public office. However, labor organizations described in § 501(c)(5), business leagues described in § 501(c)(6), agricultural organizations described in § 501(c)(5), and civic associations described in § 501(c)(4) may support or oppose

for public office.⁵ Such conduit relationships raise significant issues under both election law and tax law as well as broader issues of public discourse consistent with democratic values.⁶

The article begins by analyzing the mosaic of prohibitions and limitations placed on corporation political contributions in both election law and tax law. This is the legal predicate for corporate-candidate conduits. The article then examines the concept of a conduit and explores the particular benefits available to both corporate contributors and candidates from using tax-exempt organizations as conduits. This examination defines the intersection between corporate philanthropy and corporate political activity. Next, the article considers broader issues of the relationship of conduits to democratic discourse and social justice. Finally, the article examines approaches to campaign finance reform as they bear on questions of exempt organizations as corporate-candidate conduits. The article suggests that disclosure remedies will be either ineffective because of the use of corporate-candidate conduits or so costly and invasive that other avenues of political campaign finance reform merit further consideration.

I. CORPORATE POLITICAL CONTRIBUTIONS: PURPOSES AND CONTROVERSIES

A. *Understanding Political Campaigns*

When one thinks of a campaign for public office, one tends to think in terms of an individual candidate seeking to persuade voters to support him or her with votes or contributions or both. This is a deceptively simplistic model that wrongly specifies the players and the nature of their interaction. The model is misleading because it is based on the unarticulated assumption that campaigns are interactions between individual candidates and individual voters. Today, however, a candidate may spend less time discussing ideas with individuals in their capacities as voters than she spends persuading corporations, unions, trade associations, and interest

candidates for public office directly or through affiliated PACs, provided that their primary purpose is an appropriate exempt purpose and provided that the political activity does not exceed certain thresholds. For an analysis of tax-exempt organizations, see FRANCES R. HILL & BARBARA L. KIRSCHTEN, *FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS* (1994 & Supp. II 1996).

5. Conduit relationships also exist between individual contributors and candidates, as the Gingrich matter indicated. See *infra* Part IV.B.3. Much of the analysis presented here applies to individual contributors as well.

6. See *infra* Part V.A.

groups to fund the campaign.⁷ In a large and complex country with large voting districts, retail campaigning for all but local offices in small jurisdictions has become virtually a thing of the past and a physical impossibility. We now communicate through television, a rather expensive medium.⁸ Candidates seek financial support from as many sources as possible, and have become extraordinarily entrepreneurial in facilitating contributions that appear to be barred by federal election law or tax law or both.⁹ This is the case with corporate political contributions.

The model is also deceptively simplistic in its unarticulated assumptions about the organizational structure of campaigns. A campaign is a conglomerate, a complex structure of organizations designed primarily to raise money. Neither election law nor tax law limits the number of organizations a campaign may involve. While a candidate may have only one principal campaign committee,¹⁰ the campaign may involve several

7. Candidates commonly complain that they are forced by the costs of political campaigns to spend too much of their time raising money and one rarely hears of a politician who enjoys fund-raising. There are few recent studies of how candidates actually use their time. For one such study of selected Senate campaigns, some going back to the 1970s, see RICHARD F. FENNO, JR., *SENATORS ON THE CAMPAIGN TRAIL: THE POLITICS OF REPRESENTATION* (1996). Fenno devotes only passing attention to fund-raising, which highlights the disjunction between the public face of the candidate at campaign events and the more private fact of the campaign finance operation. The connection between these two faces of a campaign and the candidate's subsequent performance in public office remains to be explored and analyzed. Most contemporary information comes from journalists who have become sophisticated observers of the political money trails of campaigns.

8. See, e.g., Max Frankel, *It's the Demand, Stupid*, N.Y. TIMES, Feb. 2, 1997, § 6 (Magazine), at 24 (arguing that reform attempts which limit the supply of political money to candidates for advertising are doomed without efforts to limit the demand for it).

9. See Peter Applebome, *In Gingrich's College Course, Critics Find a Wealth of Ethical Concerns*, N.Y. TIMES, Feb. 20, 1995, at A12 (Speaker Newt Gingrich is quoted as saying of the funding of his controversial lectures through tax-exempt organizations, "It's aggressive, it's entrepreneurial, it's risk-taking."); see also REPORT OF THE SELECT COMMITTEE ON ETHICS, IN THE MATTER OF REPRESENTATIVE NEWT GINGRICH, EXHIBIT 144, H.R. REP. NO. 105-1, 105th Cong., at 1212 (1997).

10. See 2 U.S.C. § 432(e)(1) (1994). Under I.R.C. § 527(h)(2)(A) (1986) and Treas. Reg. § 1.527-2(e) (1996), a principal campaign committee enjoys certain tax benefits; see also Milton Cerny & Frances R. Hill, *Political Organizations*, 13 EXEMPT ORG. TAX REV., 591, 605-06 (1996); Milton Cerny & Frances R. Hill, *The Tax Treatment of Political Organizations*, 71 TAX NOTES 651 (1996).

other authorized committees¹¹ and other organizations, generally those exempt from tax. The candidate is like a chief executive officer of a complex structure and not simply a citizen presenting himself to his fellow citizens as voters. This structural complexity results largely from fund-raising concerns.¹²

Much of this article is devoted to showing how corporations can make political contributions. However, the inquiry necessarily begins with the questions of why corporations make political contributions and why these contributions are controversial.

B. *Why Corporations Contribute*

Why does a corporate person that does not have the right to vote seek to influence the voting behavior of individual persons who have the right to vote? While much of the recent discussion focuses on the rights of corporations to make political contributions,¹³ there has been less attention to why corporations choose to do so and what these reasons suggest about campaign finance law.

There are two broad sets of reasons that corporations make political contributions. The first relates to corporate business purposes and the second relates to corporate executive preferences.¹⁴ First, corporations

11. See, e.g., 2 U.S.C. § 432(e)(3)(A) (1986) (stating that authorized committees under § 432(e)(1) may support only one candidate); *id.* §§ 433-34 (setting forth the registration and reporting requirements applicable to authorized committees, like those applicable to principal campaign committees); *id.* § 441(a)(4) (allowing "transfers between and among political committees . . . of the same political party"); see also DAVID B. MAGLEBY & CANDICE J. NELSON, *THE MONEY CHASE: CONGRESSIONAL CAMPAIGN FINANCE REFORM 95-97* (1990).

12. Such structural complexity makes enforcement of current election law limitations more difficult and renders proposals to reform campaign finance through greater effective disclosure more problematic. For a discussion of conduits and approaches to campaign finance reform, see *infra* Part VI.

13. See, e.g., Randall P. Bezanson, *Institutional Speech*, 80 IOWA L. REV. 735 (1995); Victor Brudney, *Association, Advocacy, and the First Amendment*, 4 WM. & MARY BILL RTS. J. 1 (1995); Carl J. Mayer, *Personalizing the Impersonal: Corporations and the Bill of Rights*, 41 HASTINGS L.J. 577 (1990); Daniel R. Ortiz, *The Engaged and the Inert: Theorizing Political Personality Under the First Amendment*, 81 VA. L. REV. 1 (1995); Andrew Stark, *Strange Bedfellows: Two Paradoxes in Constitutional Discourse Over Corporate and Individual Political Activity*, 14 CARDOZO L. REV. 1343 (1993); Charles D. Watts, Jr., *Corporate Legal Theory Under the First Amendment: Bellotti and Austin*, 46 U. MIAMI L. REV. 317 (1991).

14. These two purposes parallel the reasons generally given for corporate philanthropy. See *supra* note 2. Both corporate philanthropy and corporate political contributions are part of the continuing controversy over the nature of a corporation and

seek to influence the composition and behavior of government because government actions directly affect corporate business success.¹⁵

Influencing the composition of government is one means of influencing the behavior of government. This proposition might seem self-evident. However, the assertion of a direct connection between the composition of government and the policy outcomes of government rests on problematic assumptions about the influence of one or even several officials on policy outcomes. Even the President cannot assure contributors of a particular outcome, although a presidential candidate, like a candidate for any other office, can promise to attempt to deliver an outcome. In American politics, buying a legislative majority for one issue would be prohibitively expensive since the majority would have to be purchased one member at a time. American political parties are more like coalitions of elected officials than like programmatically coherent organizations with shared policy positions and the ability to enforce conformity to them. This porous quality of the two major American parties and the fluid nature of the policy process mean that supporting particular candidates does not guarantee particular outcomes.

In this environment, neither candidates nor parties seem, in many cases, to offer particular outcomes but rather access to the policy process.¹⁶ Such access may be the most valuable benefit in a fluid policy process. Politicians threaten a loss of access, not an adverse vote on

the extent to which an entity can have purposes independent of those of its managers. See A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

15. The denial of a deduction under I.R.C. § 162 for a campaign contribution by a corporation does not support the argument that such contributions are not in substance ordinary and necessary business expenses. It suggests instead that such expenditures must be treated in the same way for tax purposes as individual political contributions, and that neither can be deducted.

16. Classic quid pro quo arrangements are by no means obsolete. Controversies over campaign finance in the 1996 election center on allegations of promises for cash. These allegations center on the Clinton campaign at least in part because, as the winner, he is in a position to keep any promises he might have made while Bob Dole, whatever he might have promised, is unable to deliver. One of the now-famous Clinton coffees with political contributors has raised significant questions about a quid pro quo because the Comptroller of the Currency, Eugene A. Ludwig, who is responsible for bank regulation, met with several leading bankers. See, e.g., Clay Chandler & Michelle Singletary, *Comptroller of the Controversy: Bank Regulator Eugene Ludwig Faces Skepticism About His Role at Clinton Fund-Raiser*, WASH. POST, Jan. 30, 1997, at D1; Alison Mitchell, *President Regrets Top U.S. Regulator Met With Bankers*, N.Y. TIMES, Jan. 29, 1997, at A1; David E. Sanger & Stephen Labaton, *Billions in Profits Were Issue as Clinton and Bankers Met*, N.Y. TIMES, Jan. 31, 1997, at A1.

particular legislation. A primary example is the threat of the House Republican leadership to the Business Roundtable that they would lose access if they did not stop contributing to Democrats and direct their contributions exclusively to Republicans.¹⁷

There is evidence that money flows to power and that power demands money. After the Republican party gained a majority in Congress in the 1994 election, the new Congressional leadership told important constituencies that they would be expected to make contributions to the new majority.¹⁸ This may be a more troubling pattern than having contributors gamble on picking winners and then confronting the need to deal in the policy arena with those they had not supported politically. Now, it appears, all politicians are offering themselves to the same contributors and all contributors are facing demands for money from the same politicians. The systemic consequences of this pattern of money in the policy process is a fertile topic for future study.

Evidence that corporate contributors routinely contribute to both parties, and often to both candidates in a particular race, suggests that contemporary government requires corporations to pay an access charge in the form of a campaign contribution. The broad question of a market in political access requires sustained inquiry beyond the scope of this article. It is far from clear why any person, natural or corporate, should have to pay a toll charge in the form of a campaign contribution to gain sufficient access to public officials. It is also unclear why public officials should be in a position to direct public resources to private interests in exchange for campaign contributions. Any debate over the right of corporations to make campaign contributions should proceed in the context of why corporations feel the need to make such contributions.

The second reason advanced to explain corporate political contributions is that corporate managers are using corporate assets to support their own political preferences and to advance their own public careers, perhaps in a quest for appointive public office or to raise their

17. See Helene Cooper, *GOP to Rebuke Companies for Bipartisan Donations*, WALL ST. J., Jan. 9, 1997, at A14 (detailing efforts of Republican leaders of the House of Representatives to convince corporate leaders to contribute solely to Republican candidates). "Companies that want to have it both ways, vows one top GOP strategist, no longer will be involved in Republican decision-making 'or invited to our cocktail parties.'" *Id.* One corporate leader responded that, "America . . . is a bipartisan country. It doesn't want to be a single-party country." *Id.*

18. See David Maraniss & Michael Weisskopf, *Speaker and His Directors Make the Cash Flow Right*, WASH. POST, Nov. 27, 1995, at A1.

profile within the business community.¹⁹ This raises the fundamental question of the nature of the corporation and how theories of the corporation affect views about the rights of corporate entities to make political contributions.²⁰ Are corporations aggregates of diverse interests or are they entities? What role should managers play in making various types of decisions?

C. Rationales for Limiting Corporate Political Contributions

The prohibition on corporate political contributions rests on three distinct rationales. The first is concern about impropriety or the appearance of impropriety in shaping electoral and policy outcomes. The second is a concern about the effect of concentrated wealth on elections. The third is the problem of compelled contributions arising when the

19. The same two reasons are often advanced for corporation philanthropy. These explanations can be complementary but are not necessarily so. The question with respect to both corporate philanthropy and corporate political contributions is whether there has been a wastage of corporate assets. Assertions of the tailoring of corporate philanthropy or corporate political contributions to the preferences of corporate executives are by no means indisputable evidence that corporate assets have been wasted. In the corporate philanthropy area, a significant dispute arose when Mary Cunningham Agee, the wife of William Agee, who was then the chief executive officer of Morrison Knudsen, operated the corporation's philanthropic activities in a manner consistent with her preferences and those of certain members of the board of directors, but not necessarily in a manner that promoted the image of the corporation. The foundation had originally been established to assist the corporation's employees, but Mary Agee directed virtually all of its contributions to social service organizations affiliated with the Catholic Church. The debate intensified when the company sought protection from its creditors under Chapter 11 of the Bankruptcy Code. The question was not whether the charity's operations were inappropriate, but of what relation they bore to the corporation's legitimate business interests and the foundation's own history. See Julie Bailey, *MK Charity Funded Mary Agee's Pet Projects*, IDAHO STATESMAN, Feb. 8, 1995, at 1A; Jim Hopkins, *Knights of the Board Table*, IDAHO STATESMAN, June 9, 1995, at 7A; Jim Hopkins, *Mary Agee's Charity Raised Eyebrows*, IDAHO STATESMAN, Feb. 27, 1995, at 1A; *MK Charity Mission Off Track*, IDAHO STATESMAN, Feb. 9, 1995, at 12A. William J. Agee defended his wife in an opinion piece entitled *Idaho Statesman Didn't Tell Real Story of Mary Cunningham Agee*, IDAHO STATESMAN, Feb. 14, 1995, at 8A. After William Agee was removed from the corporation and Mary Agee no longer managed the foundation, the paper began to report positively on the new foundation. See Julie Bailey, *MK Foundation Resumes Its Mission*, IDAHO STATESMAN, Dec. 8, 1995, at 1A; *MK Charity Back on Track*, IDAHO STATESMAN, Dec. 9, 1995, at 8A; The story was also reported in the national press. See Diana B. Henriques, *A Celebrity Boss Faces Exile from 2d Corporate Kingdom*, N.Y. TIMES, Feb. 10, 1995, at A1; Diana B. Henriques, *Ties that Bind: His Directors, Her Charity*, N.Y. TIMES, Mar. 21, 1995, at D1.

20. See generally *supra* note 2.

contributor corporation's shareholders do not all agree on the candidate or cause that the corporation supports.

The first concern, corruption or the appearance of corruption, has been defined narrowly by *Buckley v. Valeo*.²¹ In explaining its approval of limitations on political contributions, the Court noted, "[t]o the extent that large contributions are given to secure a political *quid pro quo* from current and potential office holders, the integrity of our system of representative democracy is undermined."²² The Court found the problems arising from the appearance of impropriety almost as troubling as instances of actual exchanges of contributions for favors.²³ This is a quasi-criminal concept reflecting the post-Watergate mentality of a search for a 'smoking gun' to establish culpability. While Watergate is synonymous with campaign finance abuses, it was more importantly an impeachment inquiry in which the search for a specific act was arguably appropriate. The result is a narrow focus on specific acts and not on the systemic consequences of political money.

The second rationale, the effect of concentrated wealth on elections, focuses more broadly on the contest between the power of money and the power of the vote.²⁴ In this perspective, both contribution and expenditure limitations help ensure that money, especially concentrated wealth, does not undermine the effect of numbers of votes.²⁵ This perspective was

21. 424 U.S. 1 (1976) (per curiam).

22. *Id.* at 26-27. "Although the scope of such pernicious practices can never be reliably ascertained, the deeply disturbing examples surfacing after the 1972 election demonstrate that the problem is not an illusory one." *Id.* at 27.

23. *See id.* at 27 ("Of almost equal concern as the danger of actual *quid pro quo* arrangements is the impact of the appearance of corruption stemming from public awareness of the opportunities for abuse inherent in a regime of large individual financial contributions."). In its analysis of the appearance of corruption, the Court came close to an analysis of honest elections in creating and maintaining the legitimacy of the American political system. To have done so, however, would have undermined the Court's distinction between contributions and expenditures and broadened its concept of corruption beyond specific exchanges of contributions for favors and into questions of voting and concentrated wealth; analytical approaches that the Court specifically rejected. *See id.*

24. This was a theme in the Watergate scandal, which involved corporate contributions. *See* HERBERT E. ALEXANDER, FINANCING THE 1976 ELECTION (1979); HERBERT E. ALEXANDER, FINANCING THE 1972 ELECTION (1976).

25. This concern was the foundation of the Court of Appeals' decision that both the contribution and expenditure limitations of the Federal Election Campaign Act were consistent with First Amendment protections of political speech. *See Buckley v. Valeo*, 519 F.2d 821 (D.C. Cir. 1975). For a broader discussion of concentrated wealth and the First Amendment protection of political speech by a member of the circuit court panel deciding *Buckley*, see J. Skelly Wright, *Money and the Pollution of Politics: Is the First*

rejected in substantial part by *Buckley*, which held that "the concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment."²⁶ The effect was to limit scrutiny of political money to narrow and separable instances of misbehavior and to reject the idea that political money should be analyzed in systemic terms. The Court's decisions in *Austin v. Michigan Chamber of Commerce*²⁷ and *Federal Election Commission v. Massachusetts Citizens for Life, Inc.*²⁸ turned in part on the relative economic power of the two organizations and their members. But, in both cases, the Court also invoked the relative opportunity for corruption and the captive member problem as well, thereby blunting the force of its discussion of concentrated wealth.²⁹

The third rationale, compelled contributions, grows out of analyses of the corporate form. This is the argument that the use of corporate treasury funds does not reflect a choice by shareholders or employees to take a political position by supporting or opposing one or more candidates.³⁰ This line of reasoning grows out of the Court's *Buckley* assertion that the amount of money contributed is a reasonably reliable indicator of public

Amendment an Obstacle to Political Equality?, 82 COLUM. L. REV. 609 (1982).

26. *Buckley*, 424 U.S. at 48-49. "The First Amendment's protection against governmental abridgement of free expression cannot properly be made to depend on a person's financial ability to engage in public discussion." *Id.* It is not accidental that the Court's rejection of the concentrated wealth rationale appeared in the context of its rejection of limitations on expenditures.

27. 494 U.S. 652 (1990) (holding that a trade association may not use treasury funds to make an independent expenditure expressly advocating the election of a particular candidate).

28. 479 U.S. 238 (1986) (holding that a single-issue organization created for the express purpose of taking a stand in opposition to abortion may make an independent expenditure expressly advocating the election of a particular candidate).

29. In *Massachusetts Citizens for Life*, the Court indirectly distinguished this organization from the Michigan Chamber of Commerce discussed in *Austin*. The three features accounting for this holding are: 1) the organization was "formed for the express purpose of promoting political ideas" and not for engaging in business activities; 2) the organization has no shareholders or others with a claim to its assets or earnings and thus "persons connected with the organization will have no economic disincentive for disassociating with it if they disagree with its political activity"; and 3) the organization does not accept contributions from corporations or labor unions and "[t]his prevents such corporations from serving as conduits for the type of direct spending that creates a threat to the political marketplace." 479 U.S. at 263-64.

30. See *Austin*, 494 U.S. at 662-63; *Massachusetts Citizens for Life*, 479 U.S. at 260-61.

support.³¹ While not explicitly stated, the Court implies that contributions of corporate treasury funds are not considered political speech because they do not necessarily reflect the choice of the shareholders or voters. This is based on a theory of whether membership in an organization or holding shares in a corporation could serve as a reasonable proxy for a direct political preference. The Court held that it could in the case of ideological organizations,³² but it could not when those who withdrew could do so only at the cost of foregoing other, non-political benefits that explained their affiliation, such as earning dividends or participating in non-political programs.³³

The first of the three rationales has become paramount in the Court's recent reasoning. The effect on corporate political contributions is to provide a rationale for a narrow interpretation of the prohibition on corporate political contributions. Even more importantly, it provides a rationale for permitting corporate political contributions that are not made directly to a candidate, earmarked for a particular candidate or coordinated with a particular candidate. The result is a constitutional jurisprudence that grows not out of a systemic concern with government legitimacy and individual rights, but instead reflects a quasi-criminalized concept of the First Amendment.³⁴ The analysis centers not on constitutional matters, but on a search for indictable offenses, and not on the requisites for representative democracy, but on crimes by politicians.

II. CORPORATE ROLES IN FINANCING POLITICAL CAMPAIGNS: STATUTORY LIMITS AND OPPORTUNITIES

Understanding why exempt organizations become conduits for corporate contributions to political candidates requires an understanding of the transaction represented by a political contribution and of the legal categories created to apply to this transaction. As this article suggests, judicial modifications of the original statutory scheme for post-Watergate

31. See *Buckley*, 424 U.S. at 56. Although *Buckley* did not involve corporations or other organizations, the Court did not expressly exclude them from the analysis.

32. See *Massachusetts Citizens for Life*, 489 U.S. at 258.

33. See *Austin*, 494 U.S. at 662-63; see also *Communications Workers of America v. Beck*, 487 U.S. 735 (applying this reasoning to the use of treasury funds by labor unions). The issue of captive union members became politically controversial in light of organized labor's major effort in support of Democratic candidates in the 1996 election. See, e.g., *Exempt from Reform*, WALL ST. J., Feb. 10, 1997, at A18.

34. See, e.g., *Buckley*, 424 U.S. at 40-43 (expressing concern with vagueness when a First Amendment issue could result in criminal penalties). The Court should also have been concerned about the detrimental effect of introducing concepts derived from criminal law into First Amendment jurisprudence.

campaign finance reform has resulted in a disjunction between political contribution transactions and the statutory categories applied to them.

A. *The Language of Current Campaign Finance Law*

The language of campaign finance has become a specialized language not directly accessible to ordinary English-speaking voters. Statutory categories are expressed in terms bearing little relation to the transactions to which they apply. Locating conduit transactions in both law and practice requires a grounding in this foundational disjunction.

Understanding the language of campaign finance law begins with understanding political contributions as transactions. Much more is involved than a transfer of money or other value. The candidate's purpose in soliciting contributions is to provide the material base for her quest for public office, to enhance her electoral prospects by having enough money to persuade enough voters to support her in order to ensure electoral victory.³⁵

Contributors' motives are more complex. Some contributors may want to enhance the democratic process represented by elections and to increase the likelihood of good government after the election. This kind of other-directed motive may be part of the motivational mix of most contributors. However, specific incentives may well be more important—the desire to ensure a particular policy outcome or the desire to secure a more general access to officeholders who occupy, or are expected to occupy, critical points in the policy process.

To the participants in the political contribution transaction, everything other than the basic transfer of value is a matter of tactics. Contributors will make either direct or indirect transfers. It does not matter to contributors whether or not the candidate controls the money transferred as long as the politician acknowledges a political debt to the contributor for the transfer. To a candidate, a transfer that he controls or one that is made for his benefit still becomes the basis of a political obligation to the contributor. A candidate does not make finely-drawn distinctions between persuading voters to support him by using money he controls and having others persuade voters to support him using money the candidate does not directly control.

35. Voters are not participants in political contribution transactions. The debts that politicians incur to those who vote for them are, it may be hypothesized, more diffuse and less compelling than the debts they incur to their contributors. This dynamic of asymmetrical obligations to contributors and voters is the basis for concern about the role of elections in representative government and the nature of the policy process that results from elections based on such asymmetrical obligations.

Indirect contributions trigger the same political obligations as direct contributions. Conduits facilitate indirect political contributions, whether they are made to the candidate subject to the candidate's control or whether they are made for the benefit of the candidate. Therefore, conduits are located in and, as discussed below, transform, the statutory categories of current election law.

The incoherence of statutory categories derives from the Supreme Court's holding in *Buckley v. Valeo* that contributions could be limited as to both source and amount but that similar limitations on expenditures are inconsistent with rights of political speech under the First Amendment.³⁶ The Court treated both contributions and expenditures as speech and rejected the lower court's treatment of both as conduct.³⁷ The Court found that the "Act's contribution and expenditure limitations impose direct quantity restrictions on political communication and association by persons, groups, candidates, and political parties"³⁸ The Court rejected the argument that the time, place and manner restrictions it had previously found acceptable under the First Amendment also limit the quantity of communication and association,³⁹ asserting, for example, that limits on the decibel level of a campaign sound truck did not limit the quantity of speech.⁴⁰

The Court nevertheless found contribution limitations constitutional while rejecting expenditure limitations. The Court held that contribution limitations "entail[] only a marginal restriction upon the contributor's

36. See *Buckley*, 424 U.S. at 58-59. Although the Act's contribution and expenditure limitations both implicate fundamental First Amendment interests, its expenditure ceilings impose significantly more severe restrictions on protected freedoms of political expression and association than do its limitations on financial contributions. The only remaining expenditure limitations are applied in the case of presidential and vice-presidential candidates who accept public funding. See 2 U.S.C. § 441a(b) (1986), construed in *Buckley*, 424 U.S. at 85-109. Certain expenditures by political parties are also limited. See 2 U.S.C. § 441a(d).

37. See *Buckley*, 424 U.S. at 16.

Some forms of communication made possible by the giving and spending of money involve speech alone, some involve conduct primarily, and some involve a combination of the two. Yet this Court has never suggested that the dependence of a communication on the expenditure of money operates itself to introduce a nonspeech element or to reduce the exacting scrutiny required by the First Amendment.

Id.

38. *Id.* at 18.

39. See *id.* at 17-19 (citing *Erznoznik v. City of Jacksonville*, 422 U.S. 205 (1975); *Adderly v. Florida*, 385 U.S. 39 (1966); *Cox v. Louisiana*, 379 U.S. 559 (1965); *Kovacs v. Cooper*, 336 U.S. 77 (1949)).

40. See *Buckley*, 424 U.S. at 18 n.17.

ability to engage in free communication."⁴¹ The Court found that rights of association, not speech, were invoked in the contribution limits.⁴² The Court identified this association right as the right to make large contributions and found the government's interest in preventing corruption or the appearance of corruption a sufficiently important government interest to justify restriction.⁴³

In contrast, the Court held that expenditure limitations directly restricted the "quantity and diversity" of speech.⁴⁴ In effect, the Court took the position that speech rights were more fundamental than associational rights and that the speech rights of candidates and those organized interests likely to make expenditures were more important in the constitutional scheme than were the speech rights of ordinary contributors. The Court did not consider the possibility that the quantity of speech and the diversity of speech move by different dynamics and in different directions. The Court simply did not entertain the possibility that

41. *Id.* at 20-21.

A contribution serves as a general expression of support for the candidate and his views, but does not communicate the underlying basis for the support. The quantity of communication by the contributor does not increase perceptibly with the size of his contribution, since the expression rests solely on the undifferentiated, symbolic act of contributing. At most, the size of the contribution provides a very rough index of the intensity of the contributor's support for the candidate. A limitation on the amount of money a person may give to a candidate or campaign organization thus involves little direct restraint on his political communication, for it permits the symbolic expression of support evidenced by a contribution but does not in any way infringe the contributor's freedom to discuss candidates and issues.

Id. at 21.

42. *See id.* at 24. "[T]he primary First Amendment problem raised by the Act's contribution limitations is their restriction of one aspect of the contributor's freedom of political association." *Id.* at 24-25.

43. *See id.* at 28.

44. *See id.* at 19.

A restriction on the amount of money a person or group can spend on political communication during a campaign necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of the audience reached. This is because virtually every means of communicating ideas in today's mass society requires the expenditure of money. The distribution of the humblest handbill or leaflet entails printing, paper, and circulation costs. Speeches and rallies generally necessitate hiring a hall and publicizing the event. The electorate's increasing dependence on television, radio, and other mass media for news and information has made these expensive modes of communication indispensable instruments of effective political speech.

Id.

increasing the quantity of speech might limit the diversity of the speech. To have done so would have brought the Court to the concentrated wealth concerns it had ignored.⁴⁵

The Court found that the main purpose of the expenditure limitations was to contain the “allegedly skyrocketing costs of political campaigns”⁴⁶ but held that this purpose is insufficient to sustain limitations on expenditures.⁴⁷ The Court rejected any connection between expenditure limitations and the government interest in preventing corruption—the rationale it had relied on in sustaining the contributions limitations.⁴⁸ The reasons for doing so vividly illustrate the conceptual incoherence of the Court’s contribution-expenditure distinction.

The Court based its rejection of expenditure limitations on a conceptual catch-22. It found that statute’s limitation on expenditures “relative to a clearly identifiable candidate”⁴⁹ was impermissibly vague unless it was construed as applying only to those expenditures expressly advocating the election or defeat of a clearly identified candidate for public office.⁵⁰ In the Court’s view, this reading of the expenditure limitation undermined the provision’s usefulness in preventing corruption or the appearance of corruption.⁵¹ The Court reasoned:

45. See *supra* Part I.C.

46. *Buckley*, 424 U.S. at 57 (noting that the Court of Appeals had emphasized the increase in campaign costs, while the appellants countered that campaign costs had risen less dramatically than had total expenditures for commercial advertising). For a debate on this comparison with contemporary numbers, see MAGLEBY & NELSON, *supra* note 11, at 27-47.

47. See *Buckley*, 424 U.S. at 57.

[T]he mere growth in the cost of federal election campaigns in and of itself provides no basis for governmental restrictions on the quantity of campaign spending and the resulting limitations on the scope of federal campaigns. The First Amendment denies government the power to determine that spending to promote one’s political views is wasteful, excessive, or unwise. In the free society ordained by our Constitution it is not the government, but the people—individually as citizens and candidates and collectively as associations and political committees—who must retain control over the quantity and range of debate on public issues in a political campaign.

Id.

48. See *id.* at 45-46.

49. *Id.* at 39-40 (construing I.R.C. § 608(e)(1) (1986)).

50. See *id.* at 44. The Court acknowledged that the distinction between issue advocacy and express advocacy was not clear, stating that “the distinction between discussion of issues and candidates and advocacy of election or defeat may often dissolve in practical application. Candidates, especially incumbents, are intimately tied to public issues involving legislative proposals and governmental actions.” *Id.* at 42.

51. See *id.* at 45.

The exacting interpretation of the statutory language necessary to avoid unconstitutional vagueness thus undermines the limitation's effectiveness as a loophole-closing provision by facilitating circumvention by those seeking to exert improper influence upon a candidate or officeholder. It would naively underestimate the ingenuity and resourcefulness of persons and groups desiring to buy influence to believe that they would have much difficulty devising expenditures that skirted the restriction on express advocacy of election or defeat but nevertheless benefited the candidate's campaign. Yet no substantial societal interest would be served by a loophole-closing provision designed to check corruption that permitted unscrupulous persons and organizations to expend unlimited sums of money in order to obtain improper influence over candidates for elective office.⁵²

This analysis of the dangers of corruption through independent expenditures threatened to undermine the distinction the Court sought to maintain between contributions and expenditures. The Court sought to bolster the distinction in two ways. First, it asserted that independent expenditures do not pose a significant danger of corruption or the appearance of corruption.⁵³ This argument rested solely on the Court's highly circumscribed concept of corruption as a direct and explicit quid pro quo.⁵⁴ Second, the Court argued that all expenditures are independent unless they are coordinated with or controlled by the candidate. Merely benefitting a candidate does not undermine the independent quality of the expenditure and does not create the possibility of corruption in the same way as a contribution does.⁵⁵ The only purpose of a limitation on independent expenditures would be to level the political playing field—a purpose the Court rejected.⁵⁶ The Court noted that an expenditure made by another person but controlled by a candidate will be treated as a contribution to the candidate.⁵⁷

The Court is remarkably reticent about control by or coordination with the candidate sufficient to transform an independent expenditure into a contribution. It concludes, in a footnote, that the Act's purposes and the legislative history was to treat "all expenditures placed in cooperation with or with the consent of a candidate, his agents, or an authorized committee

52. *Id.*

53. *See id.* at 45-47.

54. *See id.*; *see also supra* Part I.C.

55. *See Buckley*, 424 U.S. at 46-47.

56. *See id.*

57. *See id.* at 46.

of the candidate as contributions."⁵⁸ Remarkably, the Court concluded that independent expenditures were likely to be of only limited benefit to candidates and thus posed little danger of corruption.⁵⁹

The Court found that contribution limitations was the primary defense against corruption.⁶⁰ Yet, the Court's reasoning becomes completely circular when it looks to the possibility of independent expenditures to sustain the constitutionality of the contribution limitations. The quantity of political speech, which the Court treats as the constitutional touchstone of the analysis, is unlimited by the contribution limitations only because contributors are free to make independent expenditures as well as contributions. Independent expenditures were considered the speech of the person making the expenditure. Control by the candidate or coordination with the candidate meant that the speech was no longer that of the person supplying the money but instead became the speech of the person receiving and controlling the money. By extension, the Court held that a candidate could spend unlimited amounts of his own money because a candidate could not bribe himself.⁶¹

Three of the dissents rejected the Court's distinction between contributions and expenditures. Justice Blackmun asserted that it is impossible to make a principled distinction between expenditures and contributions.⁶² Justice Burger⁶³ and Justice White⁶⁴ delineate in their dissents the twin attacks on the distinction from those, like Justice Burger,

58. *Id.* at 47 n.53.

59. *See id.* at 47.

Unlike contributions, such independent expenditures may well provide little assistance to the candidate's campaign and indeed may prove counterproductive. The absence of prearrangement and coordination of an expenditure with the candidate or his agent not only undermines the value of the expenditure to the candidate, but also alleviates the danger that expenditures will be given as a quid pro quo for improper commitments from the candidate.

Id.

60. *See id.*

61. *See id.*; but *see id.* at 289-90 (Marshall, J., dissenting) (finding a compelling state interest in levelling the political playing field as between wealthy candidates and candidates without personal wealth, an enterprise he found compelled by the Court's sustaining limitations on contributions).

62. *See id.* at 290 (Blackmun, J., dissenting) ("I am not persuaded that the Court makes, or indeed is able to make, a principled constitutional distinction between the contribution limitations, on the one hand, and the expenditure limitations, on the other, that are involved here.").

63. *See id.* at 235-57 (Burger, C. J., dissenting).

64. *See id.* at 257-90 (White, J., concurring in part and dissenting in part).

who would also abolish the limitations on contributions, and those, like Justice White, who would also impose limitations on expenditures.

Buckley misdescribes a political contribution transaction in ways that are so patently apparent that the misdescription has become the basis of the current sense that campaign finance practices are illegitimate. The Court would have us believe that an expenditure made to advocate the election or defeat of a candidate consistent with the express advocacy standard is not a contribution to the beneficiary candidate's campaign. By making treatment as a contribution turn on control or coordination and by ignoring transfers for the benefit of a candidate, the *Buckley* Court ensured that this case would become the basis of abuse and cynicism.

The Court had justified its contribution-expenditure distinction by treating contributions as implicating associational rights and expenditures as implicating speech rights. Yet, the Court also found that contributions were forms of constitutionally protected political speech. In effect, *Buckley* ranks the speech of large contributors (who are more likely to have the sophistication to make their contributions in the form of expenditures) as entitled to a greater level of Constitutional protection than that of small contributors who are likely to make conventional contributions. In consequence, *Buckley* exacerbates precisely the kind of corruption it proclaims as the rationale for upholding the limitations on contributions. Its subsequent holding prohibiting corporations from making direct or indirect independent expenditures is a tacit acknowledgement of its error.⁶⁵

As a result of the contribution-expenditure distinction, the essence of campaign finance planning is to treat as many transfers of value as possible as expenditures, not as contributions. A transfer directly to the candidate is a contribution. A transfer for the benefit of a candidate may be either a contribution or an independent expenditure, depending on the degree of control the candidate or her campaign committee exercises over the money. "Soft money" contributions to political parties are not limited at all because they are treated as neither contributions nor expenditures under the Federal Election Campaign Act ("FECA"). The terms themselves have taken on the quality of a jurisprudential fantasia akin to Alice's conversations with the Mad Hatter.⁶⁶ The words have become abstracted

65. See *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652 (1990).

66. In this analogy, the Court is the White Rabbit and candidates and those with enough money to purchase access view the scene with the inscrutable satisfaction of the Cheshire Cat. The voters, it is hoped, have the resilience of Alice.

from their common meanings and from any possible empirical connection to the transactions of modern politics.⁶⁷

B. *Corporate Money in Campaign Finance: The Statutory Regime*

Corporations may transfer value to candidates in more ways than are initially apparent, but some barriers remain. With regard to corporations, the primary barriers are the prohibitions on direct contributions to candidates and independent expenditures which expressly advocate the election or defeat of a particular candidate. While corporations are able to make unlimited soft money contributions to political parties, the limitations posed by current election law create incentives for including conduits in any political fund-raising apparatus.

1. Limiting Hard Money Contributions

A corporation may not contribute any amount that is used by a candidate or a candidate's committee for direct political expenditures.⁶⁸ This prohibition on so called "hard money" extends to "any corporation whatever" and covers "a contribution or expenditure in connection with any election," including actions by political conventions or caucuses held to select candidates.⁶⁹ The FECA further provides that it is unlawful for any corporate officer or director to "consent" to any prohibited contribution or expenditure.⁷⁰ It is also unlawful "for any candidate, political committee, or other person knowingly to accept or receive any

67. Ongoing reporting of the transactions that both parties engaged in to finance the 1996 campaign may compel a new look at the transactional realities of campaign finance. Whether such a new exposure to fact results in realigning the statutory categories of the FECA remains highly problematic. See Ruth Marcus & Charles R. Babcock, *The System Cracks Under the Weight of Cash*, WASH. POST, Feb. 9, 1997, at A1 (reporting that the 1996 campaign cost \$2.7 billion).

68. See 2 U.S.C. § 441b(a), (b)(2) (1994).

69. *Id.* § 441b(a).

It is unlawful for any . . . corporation whatever, or any labor organization, to make a contribution or expenditure in connection with any election at which presidential and vice presidential electors or a Senator or Representative in, or a Delegate or Resident Commissioner to, Congress are to be voted for, or in connection with any primary election or political convention or caucus held to select candidates for any of the foregoing offices.

Id.

70. See *id.*

contribution prohibited by this section."⁷¹ Prohibitions on contributions by government contractors are stated separately.⁷²

A "contribution or expenditure" includes "any direct or indirect payment, distribution, loan, advance, deposit, or gift of money, or any services, or anything of value (except a loan of money by a national or State bank made in accordance with the applicable banking laws and regulations and in the ordinary course of business) to any candidate, campaign committee, or political party or organization, in connection with any election to any of the offices referred to in this section"⁷³ A corporation's communication "to its stockholders and executive and administrative personnel and their families" is not a prohibited contribution or expenditure.⁷⁴

The prohibition on political contributions by corporations pre-dates the FECA.⁷⁵ The Supreme Court upheld these restrictions on corporate political contributions in a series of cases dealing with the political activities of labor organizations.⁷⁶ The prohibition on corporate political activity was grounded on all three rationales set forth above, but the effects of concentrated wealth were given significant attention.⁷⁷

The first departure from this position came in *First National Bank v. Bellotti*, which involved corporate contributions to an organization that attempted to defeat a referendum issue in Massachusetts.⁷⁸ In this case, the Court relied on *Buckley* in finding that the prevention of corruption or the appearance of corruption was the most important consideration regarding limitations on political speech.⁷⁹ Finding that referendum issues did not pose the same danger of corruption that candidate elections did, the

71. *Id.*

72. *See id.* § 441c(a).

73. *Id.* § 441b(b)(2) (underscoring the importance of being able to argue plausibly that an intermediary is acting independently). *See infra* Part IV for an analysis of conduits.

74. *See* 2 U.S.C. § 441b(b)(2) (providing the same exception for a labor organization's communication with members and their families).

75. The current provisions of § 441b were first enacted in 1907 in the Federal Corrupt Practices Act, 34 Stat. 864.

76. *See* *Pipefitters v. United States*, 407 U.S. 385 (1972); *United States v. Automobile Workers*, 352 U.S. 567 (1957); *United States v. C.I.O.*, 335 U.S. 106 (1948).

77. *See supra* Part I.C (discussing the rationale for limiting corporate political contributions).

78. 435 U.S. 765 (1978).

79. *See id.* at 789-92.

Court held that corporations could contribute to the referendum fund.⁸⁰ The Court rejected as paternalistic the idea that corporations would enjoy a disproportionate voice if permitted to make political contributions⁸¹ and held that disclosure would prevent any limited problems of corruption that might arise.⁸² The Court rejected arguments that the corporate form itself sustained or required special limitations on political contributions. Nevertheless, the Court limited its holding to the facts of the case, which did not involve contributions to the campaign of a candidate for public office.

Justice White, joined by Justices Brennan and Marshall, dissented on grounds that corporate speech should not be equated to individual speech.⁸³ Justice White found that corporate speech does not raise any issue with respect to the self-expression of the speaker and is thus entitled to a lesser level of First Amendment protection.⁸⁴ The dissent also found that limitations on corporate speech posed lesser limits on the public's right to hear.⁸⁵ The dissent also raised issues of concentrated wealth⁸⁶ and the use of corporate assets to propagate the political views of managers.⁸⁷

While the statutory prohibition on corporate hard money contributions seems absolute, *Bellotti* suggests that the Supreme Court may be prepared to extend First Amendment protections to corporate political contributions. In addition, current campaign finance practices may mean that the statutory prohibition has little continuing force in light of the planning possibilities presented by the absence of limitations on corporate soft money contributions to political parties, the expanded opportunities opened to political parties to make independent expenditures, and the possibilities presented by including conduits in fund-raising structures.

2. Independent Expenditures by Corporations

Federal election law imposes stricter limitations on contributions to candidates than it imposes on expenditures made by others for the benefit of candidates. As discussed above, this result arises from the *Buckley*

80. *See id.* at 789-95.

81. *See id.* at 789-92.

82. *See id.* at 792 n.32; *see also infra* Part II.B.5 (discussing disclosure requirements in candidate elections); Part VI (discussing the implications of relying on disclosure).

83. *See Bellotti*, 435 U.S. at 803 (White, J., dissenting).

84. *See id.* at 806-07.

85. *See id.* at 807.

86. *See id.* at 809-12.

87. *See id.* at 818.

Court's contribution-expenditure distinction based on control by rather than benefit to the candidate.⁸⁸

Despite this distinction, corporations may not make independent expenditures directly or indirectly through a trade association in which they are members.⁸⁹ In *Austin*,⁹⁰ the Court held that a trade association could not use treasury funds⁹¹ to place a newspaper ad urging support for a particular candidate in an upcoming election for state office.⁹² The trade association was organized as a corporation and its members were taxable corporate entities. The Court distinguished this organization from that in *Massachusetts Citizens for Life* on grounds that the chamber of commerce served multiple purposes, while *Massachusetts Citizens for Life* was organized for the sole purpose of opposing abortion. Consequently, members who wished to leave the chamber of commerce in *Austin* would face a greater burden than members who might wish to leave *Massachusetts Citizens for Life*.

The restrictive effect of *Austin* depends on the scope of the activity subsumed under the definition of an independent expenditure. Federal election law is by no means clear, consistent, or precise in delineating what constitutes an independent expenditure. The FECA defines an independent expenditure as:

an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate which is made without cooperation or consultation with any candidate, or any authorized committee or agent of such candidate, and which is not made in

88. Though the Court did not discuss corporations, neither did it expressly exclude them. See generally *Buckley v. Valeo*, 424 U.S. 1 (1976) (per curiam).

89. Trade associations are exempt from entity-level tax. See I.R.C. § 501(c)(6) (1986). Members of trade associations are typically for-profit, taxable corporations, but some have individual members as well. Dues may be deductible if they are considered ordinary and necessary business expenses within the meaning of I.R.C. § 162, but no amount of dues used for political activities may be deducted. For an analysis of trade associations, see HILL & KIRSCHTEN, *supra* note 4, at ch. 7.

90. 494 U.S. 652 (1990) (illustrating the dysfunctional quality of the contribution-expenditure distinction since it prohibits an expenditure without fully analyzing it as a contribution).

91. See *id.* at 668-89. The organization involved operated a well-funded PAC but had reached its limit on contributions to the candidate in question. See *id.*; see also *id.* at 676 n.7 (Brennan, J., concurring) (discussing the economic strength of the affiliated PAC).

92. See *id.* at 655 n.1 (involving a state election laws comparable to federal election laws).

concert with, or at the request or suggestion of, any candidate, or any authorized committee or agent of such candidate.⁹³

This definition of an independent expenditure is not fully consistent with the definitions in the provisions imposing limitations. The dissonance in statutory language occurs in the provisions specifying that certain expenditures will be treated as contributions. The issue in both cases is the nature and extent of the coordination between the contributor and the candidate. This statutory dissonance would have been avoided and there would have been uniform treatment had the statute simply cross-referenced the definition of an independent expenditure. Having not pursued this approach to statutory drafting, the FECA has created uncertainty about the applicability of the definition of an independent expenditure and about the latitude for shared efforts between ostensibly independent sources of funds making their own expenditures and the candidate.

The first, and more generally applicable, of these provisions classifies certain expenditures as contributions in language that follows the language of the general definition of an independent expenditure. Thus, "expenditures made by any person in cooperation, consultation, or concert, with, or at the request or suggestion of, a candidate, his authorized political committees, or their agents, shall be considered to be a contribution to such candidate."⁹⁴

A second and distinct provision applies to expenditures by political parties.⁹⁵ In this case, special limitations apply to "*expenditures in connection with*" candidates for federal office.⁹⁶ It is far from clear that parties are subject to the same standard of coordination when determining whether their expenditures are independent expenditures or contributions to a candidate's campaign. This is an important question in its own terms. It becomes even more important because parties may receive soft money contributions from corporations.

Political parties' latitude in using funds for the benefit of candidates without having the amounts treated as contributions subject to limitation broadened when the Supreme Court held that the Colorado Republican Party had made independent expenditures, and not contributions, in a series of advertisements attacking a Democratic candidate for the United States Senate at a time when the Republican Party had not yet chosen its

93. 2 U.S.C. § 431(17) (1986).

94. *Id.* § 441a(a)(7)(B)(i).

95. *See id.* § 441a(d). *See also* Colorado Republican Fed. Campaign Comm. v. Federal Election Comm'n, 116 S. Ct. 2309 (1996).

96. *Colorado Republican*, 116 S. Ct. at 2314.

candidate in that race.⁹⁷ In this case of first impression, the absence of a Republican candidate was not the issue. Rather, the case turned on the question of coordination, and the distinction between an indirect expenditure by a political party and an indirect expenditure by some individual or entity other than a political party. The Supreme Court's decision in *Colorado Republican* represents the conceptual cul de sac of *Buckley*. Faced with this problem, the plurality chose to remand for evidentiary finding on coordination. Justices Rehnquist, Thomas and Scalia found the expenditure limitations on political party expenditures facially unconstitutional. In due course, the Court will again face the question unless the District Court finds no evidence of coordination. The Court discussed this distinction in terms of which type of independent expenditure posed the greater risk of corruption in the narrow sense in which that term was used in *Buckley*. Because these issues had not been considered below, the Court remanded the case for a factual determination with respect to coordination.⁹⁸

One example of a controversy surrounding such independent expenditures is whether President Clinton violated election law in early 1996 by playing a role in shaping Democratic National Committee television advertisements supporting his re-election.⁹⁹ Similar controversies arose over funds spent by various groups, as well as by the Republican National Committee, to support the Dole campaign after it reached its spending limit for the primary elections in March 1996.¹⁰⁰ The Dole campaign could not claim its federal support for the general election until Dole had been officially nominated at the party convention in August 1996.

3. Soft Money

A corporation may use corporate treasury funds to make direct contributions to political parties for use in party-building activities. These

97. See *id.* at 2310.

98. It remains to be seen how broadly the Court intends this opinion to be read. The issue arises with respect to the political advertising efforts of interest groups ranging from the AFL-CIO on behalf of Democratic Party candidates to Christian Coalition activities on behalf of Republican candidates.

99. See BOB WOODWARD, *THE CHOICE* 235-39, 436-37 (1996).

100. See Jane Fritsch, *Dole's Aides Are Counting Ways To Keep Campaign Cash Flowing*, N.Y. TIMES, Mar. 9, 1996, at A1; Ruth Marcus, *A Vote-for-Dole Ad By Another Name?*, WASH. POST, June 1, 1996, at A1; Katharine Q. Seelye, *Until Convention, Dole Faces A Budget Squeeze of His Own*, N.Y. TIMES, Apr. 21, 1996, at A1; Gerald F. Seib & John Harwood, *GOP Chairman Moves To Drum Up Cash, Set Themes for November*, WALL ST. J., Apr. 19, 1996, at A1.

so-called soft money contributions are not subject to any limitation. The FECA reaches this result by limiting a "contribution" subject to limitation as "any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office."¹⁰¹ If the transfer of value is not made for the purpose of influencing an election, it is not a contribution. Thus, a transfer of value to a political party is not a contribution if it is used for party-building rather than to support identifiable candidates directly. The planning challenge is to define party-building broadly.¹⁰² If the party simply deposits the money in the candidate's campaign checking account, it is a contribution of "hard money" subject to limitation.¹⁰³ If the party uses the corporation's money for voter education or registration or to enhance the organizational capacity of the party, it is a soft money contribution not subject to limitation.

The distinction between hard money and soft money is thus important to both the corporate contributor and the party recipient. Because all the activities of American political parties are undertaken for the purpose of electing candidates, any distinction between electoral activity and party-building is tenuous and problematic.¹⁰⁴ Parties may fund voter registration with soft money, including corporate contributions of soft money, if they

101. 2 U.S.C. § 431(8)(A)(i) (1986). It is paradoxical that this definition of a contribution, which turns on whether the contribution influences an election and which thus seems initially more inclusive than the definitions of a contribution as money controlled by the candidate and not as money used for the benefit of a candidate, even in the absence of control by or coordination with the candidate.

102. For purposes of the FECA, a political party encompasses a variety of committees such as the congressional campaign committee and the senatorial campaign committee of each party as well as the party's national committee and the committee of each state party. These organizations, each with its own agenda and controlled by different political leaders with their own ambitions, operate both cooperatively and competitively. Nevertheless, the structural complexity provides opportunities for the creative movement of funds so that party structures become conduits themselves.

103. See 2 U.S.C. § 441a(a)(2) (1994).

104. Political scientists have long decried the programmatic indistinctness of American political parties. See, e.g., RICHARD HOFSTADTER, *THE IDEA OF A PARTY SYSTEM: THE RISE OF LEGITIMATE OPPOSITION IN THE UNITED STATES, 1780-1840* (1969); CHARLES EDWARD MERRIAM & HAROLD FOOTE GOSNELL, *THE AMERICAN PARTY SYSTEM: AN INTRODUCTION TO THE STUDY OF POLITICAL PARTIES IN THE UNITED STATES* (1929); AUSTIN RANNEY, *THE DOCTRINE OF RESPONSIBLE PARTY GOVERNMENT: ITS ORIGINS AND PRESENT STATE* (1962); E.E. SCHATTSCHEIDER, *PARTY GOVERNMENT* (1942); PETER W. SCHRAMM & BRADFORD P. WILSON, *AMERICAN POLITICAL PARTIES AND CONSTITUTIONAL POLITICS* (1993); WOODROW WILSON, *CONGRESSIONAL GOVERNMENT: A STUDY IN AMERICAN POLITICS* (1885). For an effort by leading political scientists to address the problems they perceived in American political parties, see QUINCY WRIGHT, *THE AMERICAN POLITICAL SCIENCE REVIEW* (1950 & Supp. 44 1950).

do not use registration drives selectively to enhance the electoral prospects of candidates of that party.¹⁰⁵

These distinctions are elusive. Consider, for example, a voter registration drive conducted at a popular supermarket chain with stores in all the neighborhoods of a metropolitan area. Is the voter registration drive a party-building activity that can properly be funded by soft money contributions only if the party conduct its efforts at every store in the chain? At most of the stores? Only in the areas where it has previously done well? Only in areas where it has previously done poorly?

These questions become even more acute when the activity is voter education and outreach. A national political party with an incumbent president or a majority in one or both houses of Congress will be hard pressed to devise voter education that does not at the same time enhance the electoral prospects of these incumbents and other candidates who associate themselves with the incumbents.

Even more problematic is the inclusion of voter turnout in party-building.¹⁰⁶ One interpretation would limit funding of voter turnout efforts with soft money to those efforts that are not designed to enhance the turnout of those likely to support the party conducting the voter turnout effort. This is unlikely. Identifying party supporters and getting them to the polls is the heart of voter turnout. Indeed, one could argue that simply getting any and all voters to go to the polls does not build the party, which requires precisely the kind of targeting that also enhances the electoral prospects of particular candidates affiliated with the party and running under its banner in the election.

While the Court has not addressed this issue directly, it has addressed it indirectly through a bootstrap argument based on *Bellotti* and *Buckley*. The argument is that the same danger of corruption or the appearance of corruption does not exist in the case of soft money contributions, including corporate contributions made to political parties for party-building, as it does in the case of hard money contributions made directly to candidates. These arguments are grounded in the concept of corruption as limited to cases of a precise quid pro quo.

Even by these attenuated standards of corruption, soft money became controversial during early 1996 when it was discovered the tobacco companies had made significant soft money contributions to the Republican National Committee ("RNC") and that the head of the RNC had, in an apparent quid pro quo, sought to limit state legislative action contrary to

105. Parties may engage in the same voter education and voter registration activities as I.R.C. § 501(c)(3) organizations.

106. See 2 U.S.C. § 431(8)(B)(xii).

the interests of the tobacco company contributors.¹⁰⁷ This apparent connection underscores the relationship between campaign contributions and lobbying access. The very relaxed soft money standard means that corporations may contribute directly to political parties and obtain the kind of support that direct contributions to political candidates might afford. Indeed, the RNC-tobacco company case suggests that soft money contributions may be even more cost-effective than contributions to individual candidates if the purpose of the contribution is to influence legislation and not necessarily to support the election of particular candidates.¹⁰⁸ In this process, electoral outcomes become marginal.

Federal election law does not provide any means for ensuring that soft money contributions are not used for the kind of indirect support for a candidate that other parts of the FECA seem designed to prevent. In practice, soft money contributions blur into independent expenditures by political parties. This arises because parties have been treated in the same manner as candidate committees in terms of making independent expenditures, while only parties may receive soft money. The ability to receive soft money should be carefully considered in permitting the parties the broad latitude they currently enjoy in making independent expenditures. In the absence of any realistic grasp of political money, the Supreme Court rests its political speech jurisprudence on certain unarticulated assumptions about the perfection of accounting in segregating types of political money.

107. See Glenn Frankel, *Tobacco Industry Switches Brands; Political Donations Shift to Republicans After Favoring Democrats*, WASH. POST, Mar. 15, 1996, at A1 (reporting that Haley Barbour, Chair of the RNC, contacted the Republican Speaker of the Arizona House of Representatives, Mark Killian, in a futile attempt to persuade him to support a bill that would have permitted the state to override tough local restrictions on cigarette smoking in public places but Killian instead killed the bill); see also Kris Mayes & Michael Murphy, *Tobacco Money Access Questioned; Donations Benefit Arizona's Politicians*, ARIZ. REPUBLIC, Oct. 23, 1996, at A1 (reporting that Barbour successfully persuaded Arizona Governor Fife Symington to withdraw the state's health-care program for the poor from litigation to win reimbursement from tobacco companies for the health-care costs incurred by the state in treating tobacco-linked diseases). Barbour met with Governor Symington the night before the Governor made his announcement. See *id.*; see also Adrienne Flynn, *Did Meeting Sway Governor? Symington, GOP Chief Deny Discussing Suit*, ARIZ. REPUBLIC, Oct. 23, 1996, at A2 (reporting that tobacco interests contributed \$1.7 million to the RNC and more than \$2.1 million to all Republicans during the 1996 election cycle).

108. The larger question, and one that is not explored in this paper, is why any interest, whether it be tobacco companies or cancer patients, should feel that they have to pay an access charge to have their positions heard in public legislative arena. In short, why should the metaphor of a marketplace of ideas be linked with the reality of a marketplace for access?

4. Corporate Political Action Committees

Although corporations may not make hard money contributions or independent expenditures with treasury funds, they may establish, administer, and solicit contributions to a separate segregated fund, commonly called a political action committee ("PAC").¹⁰⁹ The PAC may make contributions directly to candidates for public office.¹¹⁰ Corporations that contract with the government may also organize and operate PACs.¹¹¹ A corporation may not contribute corporate treasury funds to its PAC for such hard money contributions.¹¹² A PAC is to be funded with contributions from the corporation's "stockholders and their families and its executive or administrative personnel and their families."¹¹³ Through its ability to appoint the board of the PAC the corporation may control PAC operations, including making decisions about which candidates the PAC will support. One corporation may establish and operate more than one PAC, but its contributions to any candidate will be aggregated for purposes of the contribution limitations.¹¹⁴ Contributions to any one candidate are limited to \$5,000,¹¹⁵ indexed for inflation, per election.¹¹⁶

Corporate PACs are subject to the same registration, reporting, and disclosure requirements as are political committees.¹¹⁷ The name of the PAC must include the name of the connected organization.¹¹⁸

109. See, e.g., ANN B. MATASAR, CORPORATE PACS AND FEDERAL CAMPAIGN FINANCING LAWS: USE OR ABUSE OF POWER? (1986); LARRY J. SABATO, PAC POWER: INSIDE THE WORLD OF POLITICAL ACTION COMMITTEES (1984).

110. See 2 U.S.C. § 441b (b)(2)(C) (1994) (providing for "the establishment, administration, and solicitation of contributions to a separate segregated fund to be utilized for political purposes by a corporation, labor organization, membership organization, cooperative, or corporation without capital stock").

111. See *id.* § 441c(b).

112. A corporation may use corporate treasury funds for the administrative expenses of its PAC so that the entire amount collected for political contributions may be used for that purpose.

113. 2 U.S.C. § 441b(b)(4)(A)(i). "'Executive or administrative personnel' means individuals employed by a corporation who are paid on a salary, rather than hourly, basis and who have policy making, managerial, professional, or supervisory responsibilities." *Id.* § 441b(b)(4)(D)(7).

114. See *id.* § 441a(a)(5).

115. *Id.* § 441a(a)(2)(A).

116. The inflation adjustment is based on indexing to the consumer price index under § 441a(c).

117. See generally 2 U.S.C. §§ 433-434 (1986).

118. See *id.* § 432(e)(5).

Nevertheless, PAC contributions are not attributed to the connected organization.

Conduits are more desirable than PACs because they offer the same opportunity for control without any of the limitations applicable to PACs. A corporation may use its corporate treasury funds in funding the conduit. In addition, exempt organization conduits do not need to report their activities to the Federal Election Commission ("FEC") and are not required to disclose their contributors. In addition, corporate transfers to certain exempt conduits enjoy more favorable tax treatment than do political contributions or transfers to PACs.¹¹⁹

5. Reporting and Disclosure Requirements

Federal election law imposes substantial reporting and disclosure requirements on authorized committees, principal campaign committees, multi-candidate political committees, and individuals or groups that make contributions or independent expenditures.¹²⁰ The detail in which the FECA specifies the reporting requirements serves as a realistic portrait of the political money trail. To protect the integrity of the reporting requirements, the FECA prohibits making contributions in the name of another.¹²¹ In addition, it prohibits the anonymous publication and distribution of materials expressly advocating the election or defeat of a candidate or the anonymous solicitation of political contributions.¹²² One of the duties of the FEC is to ensure proper disclosure of these reports.¹²³

While the *Buckley* Court severely restricted the limitations imposed under the FECA, it upheld the disclosure requirements.¹²⁴ While recognizing that "compelled disclosure, in itself, can seriously infringe on privacy of association and beliefs guaranteed by the First Amendment,"¹²⁵ the Court found that three categories of governmental interests sustain the conclusion that "[t]he disclosure requirements, as a general matter, directly

119. See *infra* Part IV.

120. See generally 2 U.S.C. § 434.

121. See *id.* § 441f.

122. See *id.* § 441d. But see *infra* Part V.A. for the Supreme Court's decision in *McIntyre v. Ohio Elections Commission* 514 U.S. 334 (1995) (upholding the right to distribute anonymously materials urging support for one side of a referendum issue).

123. See *id.* § 437g. The FEC is widely reported as unable to perform its public disclosure duties, as well as its regulatory duties. During the 104th Congress, the House leadership called for disclosure as an alternative to regulation but at the same time limited staffing and funding for the public disclosure office of the FEC. See Benjamin Weiser & Bill McAllister, *The Little Agency That Can't*, WASH. POST, Feb. 12, 1997, at A1.

124. See *Buckley v. Valeo*, 424 U.S. 1, 60-84 (1976) (per curiam).

125. *Id.* at 64.

serve substantial governmental interests.”¹²⁶ First, disclosure provides information necessary to allow voters “to place each candidate in the political spectrum more precisely than is often possible solely on the basis of party labels and campaign speeches.”¹²⁷ Second, disclosure deters corruption and the appearance of corruption. Consistent with its view of corruption as a quid pro quo, the Court concluded that “[a] public armed with information about a candidate’s most generous supporters is better able to detect any post-election special favors that may be given in return.”¹²⁸ Third, the Court found that the record keeping, reporting and disclosure requirements were essential to enforcement of the contribution limitations which it had found constitutional.¹²⁹ In sum, the Court found a government interest “in deterring the ‘buying’ of elections and the undue influence of large contributors on officeholders.”¹³⁰ The Court is far more inclined to see dangers from concentrated wealth when the issue is disclosure rather than limitations on expenditures.

Despite its realistic view of the dangers of concentrated wealth, the Court nevertheless modified what was then § 434(e) of the FECA. As enacted and then in effect, this section required disclosure of contributions or expenditures made “for the purpose of . . . influencing” the nomination or election of candidates for public office.¹³¹ The Court held that the phrase “for the purpose of . . . influencing” was impermissibly vague, especially in light of the criminal penalties provided in the FECA.¹³² The problem arose with respect to reporting expenditures, not with respect to reporting contributions.¹³³ To resolve this issue, the Court restricted reporting of expenditures to those expenditures that involved express advocacy and not those that constituted issue advocacy.¹³⁴ The Court reasoned that requiring the disclosure of expenditures that expressly advocate the election of a particular candidate might have been impermissible if its only purpose was to prevent corruption or the

126. *Id.* at 66, 68.

127. *Id.* at 66-67. This view assumes, of course, that the universe of contributors is divided along lines defined by party affiliation and does not fit a reality in which the contributors with the greatest economic power simply give to each side in amounts sufficient to assure access whatever the electoral result.

128. *Id.* at 67.

129. *See id.*

130. *Id.* at 70.

131. *Id.* at 77. This provision as amended to conform with the holding in *Buckley* is now 2 U.S.C. § 434(c)(1) (1994).

132. *Buckley*, 424 U.S. at 76-82.

133. *See id.* at 80-81.

134. *See id.* at 80.

appearance of corruption, but the Court pointed to the government's informational interest in permitting voters to know who is supporting various candidates. The Court said of such independent expenditures, "[t]he corruption potential of these expenditures may be significantly different, but the informational interest can be as strong as it is in coordinated spending, for disclosure helps voters to define more of the candidate's constituencies."¹³⁵

Conduits defeat the disclosure requirements. A contribution made through a conduit may not be reported on grounds that the conduit is not engaged in a political activity.¹³⁶ If the conduit reports a contribution or independent expenditure, it masks the true source of the funds. Such masking permits a candidate to use a corporation's money but prevents the voters from knowing about the contribution and drawing from this information whatever conclusions they choose. Such masking defeats information about the dissonance between a candidate's message and her funding that the *Buckley* Court found to be one of the primary rationales for requiring reporting and disclosure of both contributions and independent expenditures.¹³⁷

III. TAX LAW PROHIBITIONS ON DEDUCTIBILITY OF POLITICAL CONTRIBUTIONS

Political contributions are not deductible for federal income tax purposes.¹³⁸ Understanding the purpose and the technical mechanisms of these provisions facilitates understanding of attempts to claim deductions for political contributions by recharacterizing them as business expenses or as charitable contributions.¹³⁹ In addition, understanding the underlying theory of political money that serves as the basis of the tax law treatment highlights the conceptual impoverishment of election law by *Buckley* and its progeny. As is explained below, tax law prevents deductions for soft money contributions and independent expenditures as well as for hard money contributions.

The central purpose of the tax provisions is to prevent recharacterization of political contributions as ordinary and necessary business expenses. Section 162 expressly denies a deduction for "any

135. *Id.* at 81.

136. See *infra* Part IV.B (analyzing the use of exempt organizations to recharacterize political activity as exempt activity).

137. See *Buckley*, 424 U.S. at 66-68.

138. See generally I.R.C. §§ 161-197 (1997) (enumerating itemized deductions for individuals and corporations). These sections list no deduction for political contributions.

139. See *infra* Part IV.B.

amount paid or incurred in connection with participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office."¹⁴⁰ This prohibition encompasses amounts spent in connection with such political activities rather than simply amounts that are controlled by a candidate for public office.¹⁴¹

In addition to such denial of a deduction for any direct political expenditure, the Code denies a deduction for three types of indirect political contributions—forgiveness of debts to candidates or political parties, payments not expressly treated as political contributions made to political parties, and dues or other payments to trade associations if the trade association makes political expenditures. Each of these prohibitions operates to prevent circumvention of the denial of deductions for direct political contributions. This denial of deductions prevents contributors from externalizing the cost of their political activities to other taxpayers.¹⁴²

Section 271 denies a deduction for bad debts or worthless securities "by reason of the worthlessness of any debt owed by a political party."¹⁴³ This provision is intended to prevent a corporation from providing services on credit or advancing funds to a political organization and then deducting the debt as worthless under § 166, as a bad debt, or under § 165(g), as a worthless security. The statute and the regulations thereunder distinguish such disguised contributions from debts incurred in the ordinary course of a corporation's trade or business.¹⁴⁴

Consistent with this purpose, a political party is defined broadly to include not only a political party¹⁴⁵ and its national, state, or local committee,¹⁴⁶ but also:

"a committee, association, or organization which accepts contributions or makes expenditures for the purpose of influencing or attempting to influence the election of presidential or vice-

140. I.R.C. § 162(e)(1)(B). This is essentially the same language used to express the prohibition on political activity in I.R.C. § 501(c)(3) (1986).

141. See I.R.C. § 162(e)(5)(C) (providing that "any amount paid or incurred for research for, or preparation, planning, or coordination of, any activity described in paragraph (1) shall be treated as paid or incurred in connection with such activity"). Paragraph (1) refers to § 162(e)(1), which sets forth the prohibition on deductions for expenses for lobbying or electoral political activity. See *id.* § 162(e)(1).

142. The same issue arises with respect to corporate charitable contributions and to the recharacterization of political contributions as charitable contributions. See generally *supra* note 2.

143. I.R.C. § 271(a) (1997).

144. See Treas. Reg. § 1.271-1(a) (1996).

145. See I.R.C. § 271(b)(1)(A).

146. See *id.* § 271(b)(1)(B).

presidential electors or of any individual whose name is presented for election to any Federal, State or local elective public office, whether or not such individual is elected.”¹⁴⁷

The regulations provide that an organization which serves to facilitate political activity by another organization or individual by serving as a conduit will be treated as a political committee for purposes of § 271.¹⁴⁸ While there is no guidance on point, the definition of a political committee would seem to encompass any organization that would be treated as a political organization for purposes of § 527 of the Code. It should also encompass all organizations that must register with the FEC as political committees. It is entirely possible that the definition of a political party for purposes of § 271 is more inclusive than is the definition of § 527 or of federal election law. For example, those organizations that do not meet the de minimis exceptions of the FECA would still be treated as political parties for purposes of § 271. In addition, contributions to organizations that do not satisfy the requirements for exemption under § 527 would not be deductible under § 271. However, any organization that is a § 527 political organization or that is subject to the requirements of federal election law would also be a political party for purposes of § 271.

An organization that engages in activities which are “truly nonpartisan in nature” will not be treated as a political party for purposes of § 271.¹⁴⁹ The regulations give an example of a committee or group that:

is organized merely to inform the electorate as to the identity and experience of all candidates involved, to present on a nonpreferential basis the issues or views of the parties or

147. *Id.* § 271(b)(1)(C).

148. *See* Treas. Reg. § 1.271-1(b)(1).

It is immaterial whether the contributions or expenditures are accepted or made directly or indirectly. Thus, for example, a committee or other group is considered to be a political party, if, although it does not expend any funds, it turns funds over to another organization which does expend funds for the purpose of attempting to influence the nomination of an individual for an elective public office.

Id.

149. *See id.*

An organization which engages in activities which are truly nonpartisan in nature will not be considered a political party merely because it conducts activities with respect to an election campaign if, under all the facts and circumstances, it is clear that its efforts are not directed to the election of the candidates of any particular party or parties or to the selection, nomination or election of any particular candidate.

Id.

candidates as described by the parties or candidates, or to provide a forum in which the candidates are freely invited on a nonpreferential basis to discuss or debate the issues.¹⁵⁰

Additional evidence of the intended scope of the § 271 denial of deductibility is found in the broad definitions of both contribution and expenditure for purposes of defining a political committee. A contribution "includes a gift, subscription, loan, advance, or deposit, of money, or anything of value, and includes a contract, promise, or agreement to make a contribution, whether or not legally enforceable."¹⁵¹ An expenditure "includes a payment, distribution, loan, advance, deposit, or gift, of money, or anything of value, and includes a contract, promise, or agreement to make an expenditure, whether or not legally enforceable."¹⁵²

Section 271 provides an exception for ordinary commercial transactions that are not disguised contributions.¹⁵³ This exception applies only to accrual-based taxpayers that accrue the receivable "on a bona fide sale of goods or services" in the ordinary course of their trade or business¹⁵⁴ and more than thirty percent of all receivables accrued in the ordinary course of their trade or business were accrued from political parties.¹⁵⁵ This exception is available only if "the taxpayer made substantial continuing efforts to collect on the debt."¹⁵⁶ This exception applies primarily to political consulting firms, advertising firms, and polling firms that provide services to political campaigns in the course of their ordinary trade or business and are not making disguised contributions to the campaigns with which they contract.

Section 276 forbids deductions for corporate expenditures cast in the light of advertising or other activity that might be construed as deductible under § 162 as an ordinary or necessary business expense or under § 170 as a charitable contribution.

150. *Id.* This example tracks the requirements applicable to exempt organizations that prepare voter guides or sponsor candidate debates.

151. I.R.C. § 271(b)(2). The same definition of a contribution applies for purposes of I.R.C. § 276; *see also* Treas. Reg. § 1.271-1(b)(2) (1996).

152. I.R.C. § 271(b)(3). The same definition of an expenditure applies for purposes of I.R.C. § 276. *See* Treas. Reg. § 1.271-1(b)(3) (1996).

153. *See* I.R.C. § 271(c).

154. *Id.* The accrual requirement means that the taxpayer will have taken the receivable into income for the taxable year under the all events test of Treas. Reg. § 1.451-1(a) and will thus not be able to use the bad debt or worthless security deduction to offset other income.

155. *See id.* § 271(c)(1).

156. *Id.* § 271(c)(2).

The first of these disallowed deductions relates to “advertising in a convention program of a political party, or in any other publication if any part of the proceeds of such publication directly or indirectly inure (or is intended to inure) to or for the use of a political party or a political candidate.”¹⁵⁷ For purposes of § 276, proceeds inure directly or indirectly to a political party or political candidate “(a) if the party or candidate may order the disposition of any part of such proceeds, regardless of what use is actually made thereof, or (b) if any part of such proceeds is utilized by any person for the benefit of the party or candidate.”¹⁵⁸ If an event is “sponsored by or identified with” a candidate or party, the proceeds of such event are presumed to inure to the benefit of the candidate or party.¹⁵⁹ Remote benefits are not treated as inuring to a candidate or party.¹⁶⁰

There are additional rules that apply in the case of inurement to a political candidate. Proceeds inure to a candidate if they “may be used directly or indirectly for the purpose of furthering his candidacy for selection, nomination, or election to any elective public office”¹⁶¹ and they “are not received by such candidate in the ordinary course of a trade or business (other than the trade or business of holding elected public

157. *Id.* § 276(a)(1). Such expenditures may be deductible if they are used solely for the convention and not for a campaign, if they would be otherwise deductible under IRC § 162, and if they are reasonable in amount. *See* Treas. Reg. § 1.276-1(b)(2) (1996). The same principles apply in the case of publications other than a convention program. *See id.* § 1.276-1(c).

158. Treas. Reg. § 1.276-1(f)(3)(i) (providing also that these same conditions apply in determining whether proceeds are intended to inure to a candidate or party).

159. *See id.*

160. *See id.*

[P]roceeds are not considered to directly or indirectly inure to the benefit of a political party or political candidate if the benefit derived is so remote as to be negligible or merely a coincidence of the relationship of a political candidate to a trade or business profiting from an expenditure of funds. For example, the proceeds of expenditures made by a taxpayer in the ordinary course of his trade or business for advertising in a publication, such as a newspaper or magazine, are not considered as inuring to the benefit of a political party or political candidate merely because the publication endorses a particular political candidate or candidates of a particular political party, the publisher independently contributes to the support of a political party or candidate out of his own personal funds, or the principal stockholder of the publishing firm is a candidate for public office.

Id.

161. I.R.C. § 276(b)(2)(A); *see also* Treas. Reg. § 1.276-1(f)(3)(iii).

office).”¹⁶² The inurement concept contrasts with *Buckley* in treating as contributions amounts that benefit a candidate as well as amounts a candidate controls.¹⁶³

Proceeds will be treated as inuring to a political party if the party “may order the disposition of any part of the proceeds of a publication or event.”¹⁶⁴ The party need not use such proceeds for direct candidate related activity. Any use of the funds by a political party, including such soft money activities as voter registration or research, sustains such disallowance of deductions.¹⁶⁵ As discussed more fully below, this provision disallowing deductions for such activities is currently routinely circumvented by conducting such activities through a § 501(c)(3) organization.¹⁶⁶

The second of these disallowed deductions under § 276 relates to “admission to any dinner or program, if any part of the proceeds of such dinner or program directly or indirectly inures (or is intended to inure) to or for the use of a political party or a political candidate.”¹⁶⁷ The regulations adopt a broad definition of a dinner or program.¹⁶⁸ The broad

162. I.R.C. § 276(b)(2)(B); *see also* Treas. Reg. § 1.276-1(f)(3)(iii) (providing “if the proceeds received by a candidate exceed substantially the fair market value of the goods furnished or services rendered by him, the proceeds are not received by the candidate in the ordinary course of his trade or business”); *Id.* § 1.276-1(f)(3)(iv) ex. 4.

163. One reason is that there is no reason to distinguish between contributions and expenditures for tax law purposes. Both contributions and expenditures might support claims for deduction and I.R.C. § 276 denies deductions for either. However, the distinction is important for understanding the treatment of conduits and the claims for deduction that arise from the recharacterization of politics as charity.

164. Treas. Reg. § 1.276-1(f)(3)(ii).

165. *See id.*

[S]uch proceeds inure to the use of the party regardless of what the proceeds are to be used for or that their use is restricted to a particular purpose unrelated to the election of specific candidates for public office. Accordingly, where a political party holds a dinner for the purpose of raising funds to be used in a voter registration drive, voter education program, or nonprofit political research program, partisan or nonpartisan, the proceeds are considered to directly or indirectly inure to or for the use of the political party.

Id.

166. *See infra* Part IV.B.3. Even the Republican National Committee has an affiliated § 501(c)(3) organization, the National Policy Forum, to make deductions available to its core contributors.

167. I.R.C. § 276(a)(2).

168. *See* Treas. Reg. § 1.276-1(d) (defining a dinner or program to include “a gala, dance, ball, theatrical or film presentation, cocktail, or other party, picnic, barbecue, sporting event, brunch, tea, supper, auction, bazaar, reading, speech, forum, lecture,

scope of this provision is also evident in the application of the broad concept of inurement discussed above.¹⁶⁹ Thus, proceeds of events occurring after an election or before the formal declaration of candidacy are treated as inuring to a political candidate.¹⁷⁰

The third of these disallowed deductions under § 276 relates to “admission to an inaugural ball, inaugural gala, inaugural parade, or inaugural concert, or to any similar event which is identified with a political party or political candidate.”¹⁷¹ In this case, nondeductibility does not rest on inurement but on being identified with a political party. Consistent with the purpose of § 276, inaugural events are defined broadly to include any type of event connected with an inauguration.¹⁷² The cost of admission is also defined broadly to include all amounts paid in connection with attendance.¹⁷³

fashion show, concert, opening, meeting, gathering, or any similar event”).

169. See I.R.C. § 276(a)(2) (referring to the definition of inurement in Treas. Reg. § 1.276-1(f)).

170. See *id.* § 1.276-1(f)(3)(iii).

[P]roceeds may so inure whether or not the expenditure sought to be deducted was paid or incurred before the commencement of political activities with respect to the selection, nomination, or election . . . has been made or has taken place. For example, proceeds of an event which may be used by an individual who, under the facts and circumstances at the time of the event, the persons making expenditures in connection therewith generally believe will in the reasonably foreseeable future run for a public office, and which may be used in furtherance of such individual's candidacy, generally will be deemed to inure (or to be intended to inure) to or for the use of a political candidate for the purpose of furthering such individual's candidacy. Or, as another example, proceeds of an event occurring after an election, which may be used by a candidate in that election to repay loans incurred in directly or indirectly furthering his candidacy, will be deemed to directly or indirectly inure (or to be intended to inure) to or for the use of a political candidate for the purpose of furthering his candidacy.

Id.

171. I.R.C. § 276(a)(3); see also Treas. Reg. § 1.276-1(e)(1) (stating that deductions are also denied for equivalent events for losing candidates).

172. See Treas. Reg. § 1.276-1(e)(1) (stating the broad definition of a dinner or program under Treas. Reg. § 1.276-1(d) applicable to an inaugural event).

173. See *id.* § 1.276-1(f)(4).

[T]he cost of admission to a dinner, program, or inaugural event includes all charges, whether direct or indirect, for attendance and participation at such function. Thus, for example, amounts spent to be eligible for door prizes, for the privilege of sitting at the head table, or for transportation furnished as part of such an event, or any separate charges for food or drink, are amounts paid for admission.

Id.

Tax law also denies a deduction for indirect political contributions made in the form of dues to trade associations.¹⁷⁴ Such dues may be deductible if they are connected with the corporation's business activity.¹⁷⁵ This provision neither affects nor limits the charitable contribution deduction of § 170 because it does not apply to contributions made to § 501(c)(3) organizations.¹⁷⁶ In this sense, the limitations imposed under § 162(a)(3) make a § 501(c)(3) conduit even more valuable to a political fund-raising structure.

IV. CORPORATE-CANDIDATE CONDUITS

Corporations made significant political contributions during the 1996 campaign.¹⁷⁷ The explosion of soft money in the 1996 election may appear to suggest that candidates and corporations have no further need for conduits as elements of campaign finance structures. Conduits, however, offer advantages to both the candidate and to the corporation that the various soft money arrangements do not. Candidates prefer to receive contributions directly rather than having a party intermediary eligible to receive corporate soft money determine the allocation of such amounts.¹⁷⁸ Donors, including corporate donors, prefer to choose the specific beneficiaries of their largesse.¹⁷⁹ Conduits provide a means of avoiding

174. See I.R.C. § 162(e)(1)(B) (denying a deduction for amounts paid or incurred in connection with "participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office"). IRC § 162(e)(3) applies this prohibition to dues paid to certain exempt organizations.

175. See Treas. Reg. § 1.162-15 (providing that such dues may be ordinary and necessary business expenses within the meaning of IRC § 162(a) if they "bear a direct relationship to the taxpayer's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation").

176. See HILL & KIRSCHTEN, *supra* note 4, ¶ 7.04[3][b][11].

177. See John E. Yang & Howard Kurtz, *Big Firms Lead Campaign Donations*, WASH. POST, Oct. 18, 1996, at A32.

178. One of the many questions about soft money is whether, or to what extent, it is in practice earmarked to particular candidates. Earmarking to a candidate is inconsistent with the permissible party-building purposes of soft money. See *supra* Part II.B.3. The opportunity for earmarking arises from the holding in *Buckley* that there has been no contribution unless the candidate does not simply benefit from the money but in fact controls it. See *supra* Part II.A.

179. See Leslie Wayne, *D'Amato Converted Donations To Help New York Candidates*, N.Y. TIMES, Feb. 18, 1997, at A1 (citing examples of the negative reactions of donors to the National Republican Senatorial Committee upon learning that Senator Alfonse D'Amato (R-NY) transferred funds contributed to aid Republican candidates for the United States Senate to George Pataki's campaign for Governor of New York). Senator D'Amato responded to reports of contributors' unhappiness over the transfer,

the remaining limitations of election law. In the case of certain exempt organization conduits, political contributions may even be tax deductible.

This section analyzes conduits in the context of the statutory mosaic of election law and tax law prohibitions and possibilities set forth above.¹⁸⁰ This section concludes with an analysis of the particular benefits offered by exempt organizations as corporate-candidate conduits.

A. *Defining and Identifying Conduits*

Both election law and tax law provide that indirect contributions are subject to the same limitations and restrictions as are direct contributions.¹⁸¹ The FECA provides that "all contributions made by a person, either directly or indirectly, on behalf of a particular candidate, including contributions which are in any way earmarked or otherwise directed through an intermediary or conduit to such candidate, shall be treated as contributions from such person to such candidate."¹⁸² The FECA requires that the conduit report "the original source and the intended recipient" to the FEC as well as to the intended recipient.¹⁸³

The issue is not to determine whether conduit transactions are permissible—they are not—but to identify conduits. The structural complexity of modern campaigns as well as of modern political parties¹⁸⁴ makes the task of identifying conduits particularly difficult.

Election law, despite its literal application to conduit arrangements, is hampered by the contribution-expenditure distinction imposed by the Court in *Buckley*.¹⁸⁵ Tax law operates with a more fully developed body of principles for analyzing transactions involving intermediary organizations based on the principle that legal consequences of particular arrangements

stating "It's not necessary to tell people where their checks went . . . There is nothing wrong with that. We don't have an obligation to tell people. Money is fungible." *Id.*

180. See *supra* Parts II, III.

181. See 2 U.S.C. § 441b (1994); I.R.C. §§ 271, 276 (1997); see also *supra* Parts II.B.1, III.

182. 2 U.S.C. § 441a (a)(8).

183. *Id.*

184. See Ira Chinoy, *In Trades Between Party Committees, Not All Dollars are Equal*, WASH. POST, Feb. 18, 1997, at A7 (stating that political parties are not unitary organizations but are themselves complex structures that transfer political funds among their components).

185. 424 U.S. 1 (1976). For a discussion of *Buckley*, see *supra* Part II.B.

and activities are based on their substance and not on their form,¹⁸⁶ and the corollary that persons may not do indirectly what they cannot do directly.¹⁸⁷

The principle that substance, not form, determines the legal consequences of structures and activities supports two broad types of inquiries relating to conduit transactions. The first inquiry is whether money that passes through an intermediary entity was earmarked by the original contributor for a particular recipient. Tracing value flows, which became famous during Watergate with Deepthroat's advice to "follow the money," is one approach to identifying conduits.¹⁸⁸ The second approach is to focus on the intermediary organization to determine whether it should be given legal significance as an independent person or whether it should be ignored in the interest of basing legal consequences on substance and not form.¹⁸⁹ An organization may, however, serve as a conduit, even if it would otherwise be treated as an independent organization that controls its daily operations, if it simply transfers funds in a particular transaction unrelated to its ordinary business activities.¹⁹⁰

Tracing looks at the origin and destination of funds. Intermediary transit points are ignored as matters of form rather than of substance. If funds are earmarked for a particular purpose by the contributor, then the intermediary organization's role is ignored and the contributor and the

186. See *Commissioner v. Court Holding Co.*, 324 U.S. 331, 332-33 (1945) (holding that profits from property sale are taxable to a corporation as income despite a corporation's declaration of a "liquidating dividend" followed by transfer of title); *Gregory v. Helvering*, 293 U.S. 465 (1935) (stating that without a business purpose, structure that conforms to technical requirements of the IRC will not be given effect, and the taxpayer will be deprived of the tax benefits following from the form); see also Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982).

187. This is the heart of the step transaction doctrine which, for tax purposes, ignores intermediary steps in a transaction if each of the steps is interdependent and if no one step would have been taken but for the knowledge that all of the other steps would be taken to reach a pre-determined end result. See e.g., *Helvering v. Elkhorn Coal Co.*, 95 F.2d 732 (4th Cir. 1938).

188. See JUDITH E. KINDELL & JOHN F. REILLY, *ELECTION YEAR ISSUES, IRS CONTINUING PROFESSIONAL EDUCATION TEXT* (1992). The IRS has announced in nonprecedential guidance that it will trace political contributions made through exempt organizations.

189. See *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436 (1943); see also HILL & KIRSCHTEN, *supra* note 4, ¶ 9.01 (discussing *Moline Properties*).

190. See *Estate of Kluener v. Commissioner*, 72 T.C.M. 1326 (1996); *Bank of America v. Commissioner*, 15 T.C. 544 (1950), *aff'd per curiam* 193 F.2d 178 (9th Cir. 1951).

recipient are treated as though they had dealt with each other directly.¹⁹¹ Analysis turns on whether the intermediary organization had the right to control the use of the funds.¹⁹²

Determining the independent purposes, and thus organizational existence, of the structures that appear to serve as conduits is consistent with determining whether the organization's own purposes are being served, or whether the organization is simply a means or a tool through which another organization achieves its purposes.¹⁹³

These two factors, earmarking of funds and control of an organization's operations, suggest a typology of organizations ranging from independent organizations to pure conduits. An independent organization defines its own purposes and activities and controls the use of any money it receives. A pure conduit has no purposes of its own and exercises no control over any money it receives.

Between these two extremes are two partial conduits, each of which raises somewhat different issues. The first partial conduit defines its own purposes but does not control part of the money it receives. Such a partial conduit functions as a conduit with respect to particular transactions, and as an independent organization with respect to other transactions.¹⁹⁴ Its conduit operations are identified through tracing funds.

The other type of partial conduit raises or controls its own funds but uses them for the purposes and at the direction of another organization. In this case, tracing funds does not reveal the conduit nature of its operation with respect to any specific transaction. Here, the conduit nature of the organization rests on the absence of an independent purpose within the meaning of *Moline Properties*.¹⁹⁵ Political conduits of this type are commonly established by core supporters and current or former staff

191. For a recent example, see the conduit financing regulations of Treas. Reg. § 1.881-3 (1996).

192. This analysis applies, for example, in determining whether a contribution to a United States organization qualifies for a charitable contribution deduction when the purpose of the United States organization is to support the activities of a foreign organization. A contribution made directly to a foreign organization does not qualify for a charitable contribution deduction under I.R.C. § 170. In this area, form may be given greater deference than it is in certain other areas of tax law. Rev. Rul. 63-252, 1963-2 C.B. 101, amplified Rev. Rul. 66-79 1966-1 C.B. 48.

193. See, e.g., *Moline Properties*, 319 U.S. at 436; *National Carbide Corp. v. Commissioner*, 336 U.S. 422 (1949).

194. Aspects of this relationship are found in grants made from one exempt organization to one or more other exempt organizations. For a discussion of planning techniques in this area, see GREGORY L. COLVIN, *FISCAL SPONSORSHIP: 6 WAYS TO DO IT RIGHT* (1993).

195. *Moline Properties*, 319 U.S. at 436.

members of the candidate. The organization appears to have an independent board of directors, but the activities of the apparently independent board are so closely coordinated with the candidate's political agenda that the candidate exercises operational control over the organization, and the organization functions as a mere agent of the candidate.¹⁹⁶

While this typology serves the analytical purpose of highlighting elements of a conduit relationship, in practice, types of conduits are rarely so clearly delineated. Elements of the ideal typical conduits appear, to varying degree, in most political conduits. Political conduits work because *Buckley* held that only contributions could be limited, and that only the amount in fact controlled by candidates constituted contributions, in contrast to independent expenditures. Conduits help obscure the control exercised by candidates and the pattern of coordination with candidates even when the candidate exercises control over the operations of the conduit. Thus, by using one or more conduits, a candidate can transform contributions into independent expenditures and, at the same time, defeat disclosure by obscuring the identity of the true contributors. The ability of candidates to operate multiple committees also contributes to this result and makes tracing funds more problematic. One of the current unanswered questions is whether or to what extent corporate soft money contributions are moved through various conduits to fund purported independent expenditures that are in substance contributions subject to limitation and disclosure.

B. *Exempt Organizations as Corporate-Candidate Conduits:
Legal Bases and Special Benefits*

At first glance, exempt organizations are unlikely conduits. I.R.C. § 501(c)(3) absolutely prohibits support for, or opposition to, any candidate for public office.¹⁹⁷ No other forms of exempt organizations set forth in § 501(c) treat electoral politics as an exempt purpose. Indeed, § 527 sets forth distinct grounds for not taxing the income of political organizations,¹⁹⁸ and requires that § 501(c) organizations that become involved in those activities are treated as political within the meaning of

196. See *National Carbide Corp.*, 336 U.S. at 422 (setting forth this agency rationale for disregarding an entity); see also HILL & KIRSCHTEN, *supra* note 4, ¶ 9.01.

197. See I.R.C. § 501(c)(3) (1986) (providing that an organization qualifies for exemption only if it "does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office").

198. See *id.* § 527.

§ 527 also comply with these rules.¹⁹⁹ Yet, exempt organizations can be important components in the complex structures that characterize contemporary political campaigns. Paradoxically, this development in campaign finance arises in part because of the tax law prohibitions and limitations on political activity.

Exempt organizations offer three potential benefits as corporate-candidate conduits: the absence of an entity-level tax; the opportunity to recharacterize political activities as exempt activities; and, in the case of § 501(c)(3) organizations, a potential tax deduction for political contributions. Each of these is discussed below.

1. Absence of an Entity-Level Tax

The absence of an entity-level tax is a fundamental benefit in making any type of an exempt organization a more attractive conduit than other taxable entities or individuals. If the essence of a pure conduit is that earmarked money simply flows through it, then imposing a tax on the transfer from the contributor to the conduit reduces the economic efficiency of the transaction. The tax becomes a cost of doing political business. If, however, tax can be legally avoided, the pure conduit functions as intended by both the contributor and the recipient candidate. Any of the organizations described in § 501(c) will provide this benefit since all of these organizations are exempt from the entity-level tax.²⁰⁰ Thus, even multi-conduit arrangements impose no tax cost if each of the organizations is exempt from tax.

If tax were the sole consideration, however, then a political committee described in § 527 would be equally attractive because it, too, is free of entity-level tax. Indeed, a § 527 political committee might be even more attractive since this tax benefit applies expressly to political contributions and political expenditures. However, a § 501(c) exempt organization conduit offers the additional benefit of permitting the recharacterization of political activities as exempt activities.

2. Recharacterizing Political Activities as Exempt Activities: Overview

Several types of exempt organizations can serve as corporate-candidate conduits. In each case, the benefit is that the presence of an exempt conduit can be used to argue that political activities are in fact exempt

199. *See id*; *see also* Cerny & Hill, *supra* note 10.

200. *See* I.R.C. § 501. The exception is the taxation of unrelated business income, which does not encompass the conduit transactions of campaign finance. *See id.* § 501(b). The unrelated business income tax is set forth in I.R.C. §§ 510-514. For an analysis of the unrelated business income tax, *see* HILL & KIRSCHTEN, *supra* note 4, at 10-13.

activities. The effect of this recharacterization is that the reporting and disclosure requirements of federal election law, as well as the limitations on the source and amount of contributions, simply do not apply. Corporations can make what are in substance unlimited contributions to the campaigns of selected candidates and, by the same token, candidates can demand virtually unlimited contributions from contributors otherwise protected by the limits imposed under election law. Through the use of exempt conduits, election law is not simply crippled, it is rendered inapplicable.

This recharacterization is less complete when organizations other than § 501(c)(3) organizations are involved. In these cases, the organization has the option of making the argument that it, not the corporate contributor, is engaged in political activity, thereby recharacterizing only the parties to the political contribution transaction. Even these organizations, however, generally advance arguments not only that they are acting on their own behalf but also that their activities are exempt activities and not political activities. This dual recharacterization is necessary to protect the candidate from the intended effect of federal election law. If an organization simply argues that it and not the true contributor is engaged in electoral politics, then it must register with the FEC and disclose its contributions or independent expenditures. The amount of the contribution is limited. In presidential elections, the amount is counted against the candidate's expenditure limitation. For federal income tax purposes, the organization must report its political expenditure income to the IRS even though it is taxed only on any amount of political income that is used to earn investment income.²⁰¹ If, however, an exempt organization argues that the activity is not political activity but exempt activity, then it has taken the transaction entirely out of the scope of election law.

Other than § 501(c)(3) organizations, which are discussed below, the most common exempt conduits are § 501(c)(4) social welfare organizations and § 501(c)(6) trade associations. Social welfare organizations generally engage in civic betterment activities. They are sometimes treated as being able to engage in any activity that a § 501(c)(3) organization may engage in, but without the same political prohibition or the same limitation on lobbying. Organizations that have lost their § 501(c)(3) status due to political activity cannot simply apply for exemption under § 501(c)(4).²⁰²

Political activities cannot be the primary activity of a § 501(c)(4) organization.²⁰³ The same type of activities will be treated as political

201. See I.R.C. § 527; see also Cerny & Hill, *supra* note 10 (noting that political income is reported on Form 1120-POL).

202. See I.R.C. § 504.

203. See Rev. Rul. 81-95, 1981-1 C.B. 332.

activities for both § 501(c)(3) and § 501(c)(4) organizations.²⁰⁴ Certain organizations that have been very active in issue advocacy are organized under § 501(c)(4).²⁰⁵ Prominent examples include the National Rifle Association and the Sierra Club.²⁰⁶ The Sierra Club developed innovative televised voter guides that pushed the boundaries of both tax law and election law by contrasting the environmental records of named candidates but stopping short of urging that viewers vote for the candidate with the approved record.²⁰⁷ Perhaps the best known of these groups is the Christian Coalition, which has applied for exemption from tax as a § 501(c)(4) organization but has not yet received a determination from the IRS. While its application for exemption is pending, the Christian Coalition is protected from disclosing its contributors. In July 1996, the FEC filed suit against the Christian Coalition for allegedly operating in coordination with the Republican Party.²⁰⁸

A prominent recent example of the use of a § 501(c)(4) organization was the Better America Foundation ("BAF"), which was created by Senator Robert Dole.²⁰⁹ Typical of corporate-candidate conduits, BAF was established by long time staffers of Senator Dole, not by the Senator directly.²¹⁰ This arrangement gives the candidate the reality of control without the risk that direct control would turn contributions to the conduit into political contributions within the meaning of the FECA and *Buckley*.²¹¹ BAF's articles of incorporation stated that it was organized "[t]o promote and advocate values and principles espoused by the Republican party and to urge consideration of such principles for a better

204. *See id.*

205. *See* I.R.C. § 501(c)(4). Many of these organizations are complex structures that include an affiliated organization that can receive deductible charitable contributions. *See id.* § 501(c)(3).

206. *See, e.g.,* Janet Hook, *Special Interests Rewriting Political Script*, L.A. TIMES, Oct. 24, 1996, at A21; Ruth Marcus, *Outside Groups Pushing Election Laws into Irrelevance*, WASH. POST, Aug. 8, 1996, at A9.

207. *See* David S. Broder, et al., *Voter Guides on the Small Screen*, WASH. POST, July 21, 1996, at A22.

208. *See* Ruth Marcus, *FEC Files Suit Over Christian Coalition Role; Work with Republicans in Campaign Alleged*, WASH. POST, July 31, 1996, at A1.

209. *See* Timothy J. Burger & Glenn R. Simpson, *Dole's New Secret Weapon*, ROLL CALL, Nov. 7, 1994, at A1.

210. *See id.* The executive director was Senator Dole's deputy chief of staff and the president was the executive director of his PAC, Campaign America. *See id.* at A21. Dole held the position of "honorary Chairman." *Id.*

211. *See supra* Part II.B.1.

America.”²¹² BAF touted its benefits as a conduit for political money, telling potential contributors that there were no limits on the amounts an individual or corporation may contribute and that there was no requirement for public disclosure of contributors.²¹³ In 1994, BAF raised \$4 million from corporations and wealthy individuals and spent \$1.2 million on a television advertisement featuring Senator Dole.²¹⁴ The thirty second spot began to run on CNN on October 31, 1994, within a week of the 1994 mid-term elections.²¹⁵ Against a backdrop of patriotic images, a narrator stated: “[t]hat’s why the Better America Foundation was formed—to help leaders like Bob Dole and Newt Gingrich fight for a balanced budget, less spending and lower taxes. A plan for a better America.”²¹⁶ The final line of the ad urged viewers to “call, and help turn Congress around.”²¹⁷ BAF was so successful that it became publicly controversial, thereby imposing political costs on Senator Dole’s presidential aspirations. In response to this adverse publicity, Senator Dole returned the contributions to the contributors and dissolved the organization.²¹⁸

Section 501(c)(6) organizations include chambers of commerce and trade associations which promote the interests of a line of business rather than the particular interests of the individual members.²¹⁹ There is no precedential guidance on the treatment of political activities for tax purposes.²²⁰

212. CHARLES LEWIS, *THE CENTER FOR PUBLIC INTEGRITY, THE BUYING OF THE PRESIDENT* 115 (1996).

213. *See id.* at 115-16.

214. *See* Jake Thompson, *Ads Seek Support for GOP, Ideas*, KAN. CITY STAR, Nov. 8, 1994, at A1 (reporting that the 30-second advertisement cost over one million dollars). For a list of contributors to BAF see LEWIS, *supra* note 212, at 116-17.

215. *See* Thompson, *supra* note 214.

216. *Id.*

217. *Id.*

218. *See* R.H. Melton, *Dole’s Tax-Exempt Group Plans to Refund Millions; List Shows Backers of Closing Foundation*, WASH. POST, June 21, 1995, at A1 (describing the contributors as “a virtual Who’s Who of corporate America”); *see also* James Kuhnhehn, *Dole Group Offered Donors a ‘Loophole’; Better America’s Contributor’s Got Senator’s Help on Bills*, KAN. CITY STAR, June 22, 1995, at A1.

219. *See* HILL & KIRSCHTEN, *supra* note 4, at ch. 7 (analyzing I.R.C. § 501(c)(6) organizations).

220. *See* Gen. Couns. Mem. 34,233 (Dec. 30, 1969). The Service, in nonprecedential guidance from almost thirty years ago, contrasted legislative lobbying, which might be related to the members’ common business interests, with political activities, which would not be related to members’ common business interests since the organization had to support or reject all of the positions taken by a candidate and not just those positions related to the members’ common business interests. *See id.*

Austin v. Michigan Chamber of Commerce, which involved a § 501(c)(6) chamber of commerce, could be read in support of the proposition that courts will apply election law by looking through an intermediary organized as a corporation to the members organized as corporations.²²¹ This might in practice apply primarily to § 501(c)(6) organizations since they are more likely to have members who pay dues (in contrast to supporters who make contributions but exercise no role in organizational governance). It is not clear that the Court in *Austin* intended the case to be read this broadly or that a future court might do so even with substantially similar facts of a trade association organized as a corporation and having corporate members.

The San Diego Convention and Visitors Bureau, a § 501(c)(6) organization, found itself in the middle of a controversy during the 1996 Republican National Convention when it initially agreed to serve as a conduit for a corporate contributor, the Amway Corporation, which agreed to contribute \$1.3 million to buy air time for gavel-to-gavel coverage of the convention on Pat Robertson's Family Channel on cable television.²²² The San Diego Convention and Visitors Bureau claimed that it was merely promoting tourism to San Diego by accepting money for and then paying for the cable coverage of the Republican Convention.²²³ The organization was unwilling to extend this rationale when it was asked to serve as a conduit to pay for air time for an additional program produced directly by the Republican Party.²²⁴

3. Deduction and Recharacterization: Section 501(c)(3) Organizations as Conduits

Paradoxically, the most likely conduit, and the one offering the greatest benefits, is a § 501(c)(3) organization that is absolutely prohibited from supporting or opposing candidates for public office. Because §

221. See *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652, 659-60 (1990). It is unclear whether the Court was looking through the trade association to its members, which were for-profit, taxable corporations. See *id.* Cf. *Federal Election Comm'n v. Massachusetts Citizens for Life*, 479 U.S. 238 (1986) (providing an example of the Court treating as one of the organization's three distinguishing features the absence of corporate or union members and finding that the organization was not serving as a conduit).

222. See Ruth Marcus, *Amway Says it was Unnamed Donor to Help Broadcast GOP Convention; Democrats to File Complaint Alleging Illegal Corporate Contribution*, WASH. POST, July 26, 1996, at A8; Ruth Marcus, *RNC Asked, Amway Gave; Firm's Chief Says Barbour Sought San Diego TV Funds*, WASH. POST, July 27, 1996, at A12.

223. See Gerry Braun, *The Republican Convention; ConVis is Out as Conduit for GOP TV Funds*, SAN DIEGO UNION-TRIB., Aug. 9, 1996, at B1.

224. See *id.*

501(c)(3) contains the absolute prohibition, § 501(c)(3) organizations are not subject to the tax reporting requirements imposed on other § 501(c) organizations by § 527 and they are not required to register with and report to the FEC.

Charitable conduits are based on recharacterizing political activity as exempt educational activity. The relationship between educational and political activity is widely misunderstood. The key to understanding the relationship between educational activity and political activity is to understand that an activity can be simultaneously educational and political.²²⁵ Determining that an activity qualifies as education within the meaning of § 501(c)(3) does not mean that the activity is not also a prohibited political activity. Simultaneous characterization of an activity as both educational and political follows logically from the different criteria used to determine whether an activity is educational or political.

For purposes of § 501(c)(3), an activity is educational if it conveys sufficient information to permit the listener to make her own determination.²²⁶ Thus, an organization that takes controversial positions on contested public issues may qualify for exemption as an educational organization if it presents information that facilitates the listeners' own learning processes.

The determination of whether an activity constitutes impermissible political activity is based on the intent or purposes of those engaged in the activity, not on an analysis of any inherent qualities of the activity. Intent is deciphered from the statements of the participants or from an analysis of the manner in which the activity is conducted.²²⁷

The distinction between the methodology test and the purpose test is fundamental to understanding the role of § 501(c)(3) organizations as corporate-candidate conduits. If essentialist criteria were used to determine whether an activity is impermissible political activity within the meaning of § 501(c)(3), all political activity could claim to be educational. Most political advertisements convey information. If this alone precluded

225. See HILL & KIRSCHTEN, *supra* note 4, ¶ 2.03[4][b][ii].

226. See Rev. Proc. 86-43, 1986-2 C.B. 729 (setting forth a four-part methodology test to determine whether an activity is educational). This methodology test was developed in response to an appellate court determination that the "full and fair exposition" test of Treas. Reg. § 1.501(c)(3)-1(d)(3) was unconstitutionally vague. See *Big Mama Rag, Inc. v. Commissioner*, 631 F.2d 1030 (D.C. Cir. 1980); see also *Nationalist Movement v. Commissioner*, 102 T.C. 4785, 4797 (1992) (upholding the IRS' methodology test). For an analysis of the basis of determining what activities constitute exempt educational activities, see HILL & KIRSCHTEN, *supra* note 4, ¶ 2.03[4][b].

227. See I.R.C. § 501(c)(3) (1986); see also HILL & KIRSCHTEN, *supra* note 4, ¶ 2.03(4)(d) (discussing the analyses considered when determining whether activities such as voter registration drives, voter guides, or candidate fora are permissible educational activities or impermissible political activities under I.R.C. § 501(c)(3)).

characterization of the advertisement as political, all politics would be education and all political contributions would be deductible charitable contributions.

Consider the following example. If a candidate hired an actor to read the Federalist Papers in their entirety during prime television viewing hours on all the major television networks and all the cable outlets simultaneously, the activity might be educational, but it might also be political. An argument can be made that hearing the Federalist Papers read would be an educational experience. But that is neither the end nor the core of the inquiry. The core of the inquiry is whether the activity was undertaken for the purpose of affecting the election or defeat of one or more candidates for public office. The determination of whether this is a political activity would rest on the candidate's purpose in presenting the Federalist Papers. Even if the candidate stated that she had done this only to educate the viewers, it would be necessary to consider whether and in what manner the candidate identified herself with the program. Did she herself participate in reading the Federalist Papers to the viewers? When was the next election? Had the campaign involved a dispute over the Federalist Papers so that reading them would be understood in the context of the campaign debate?

Or, consider Ross Perot, who was a declared candidate for President of the United States on the Reform Party ticket. Perot campaigned primarily through a series of paid television appearances of approximately thirty minutes each, during which he presented significant amounts of information assisted by numerous charts and graphs. These appearances are not vulnerable to the charge leveled against the thirty second "spot" advertisements, the staple of most campaigns, that they convey no information. Does this distinction mean that Perot was engaged in education and that other candidates were engaged in politics? Answering in the affirmative would require that essentialist criteria were the only grounds for analysis and characterization.

Another contemporary example centers on the now famous Newt Gingrich lectures on *Renewing American Civilization*.²²⁸ While a member of the House of Representatives, but before becoming Speaker of the House, Gingrich offered a series of lectures on *Renewing American Civilization*, first at Kennesaw State College and then at Reinhardt College.²²⁹ The course, as offered at the host college, was team-taught by Gingrich and a local faculty member, each of whom gave half of the lectures. Those lectures presented by Gingrich, but not those offered by the local faculty member, were offered for credit at numerous colleges

228. See Frances R. Hill, *Newt Gingrich and Oliver Twist: Charitable Contributions and Campaign Finance*, 66 TAX NOTES 237, 11 EXEMPT ORGS. TAX REV. 43 (1995);

229. See *id.* at 245.

around the country through a satellite distribution via National Empowerment TV, which supports conservative political causes.

The course, particularly the dissemination of the Gingrich lectures, was funded through contributions directed to the Abraham Lincoln Opportunity Fund, a dormant § 501(c)(3) organization revived for this purpose by Gingrich loyalists. Contributions were solicited by GOPAC or Gingrich employees from persons, individual or corporate, who had previously contributed to Gingrich or GOPAC. Persons who contributed to the Abraham Lincoln Opportunity Fund were given memberships in GOPAC.

Representative Gingrich has consistently responded to charges that the course was a political activity with essentialist arguments that the course was a purely educational activity. Pointing to his having earned a doctorate in American history and his prior career as a faculty member, Gingrich argued that the course was purely educational and that it could not be treated as political if, on essentialist grounds, it is educational.

The House of Representatives voted to reprimand Gingrich and to levy a \$300,000 payment to the House because it determined that "Mr. Gingrich engaged in conduct that did not reflect creditably on the House of Representatives."²³⁰ The House left the question of Gingrich's violation of tax law to the Internal Revenue Service.

Gingrich is not the only member of Congress to appreciate the potential benefits of adding a § 501(c)(3) organization to his fund-raising apparatus. The bipartisan enthusiasm for charitable conduits rests ultimately on the argument that educational activities cannot also be political activities. By having a charity organized by loyalists but not by the candidate himself, the *Buckley* control criterion for contributions is satisfied and the charities' activities elude reporting to the FEC. If the conduit loses its exempt status, the candidate's loyalists simply organize another organization, apply for exemption, and conduct business as usual.

4. Complex Conduits

Candidates who are more circumspect than Gingrich organize a complex conduit built on two or more exempt organizations.²³¹ In this case, the corporate contributor transfers money to an IRC § 501(c)(3) organization that claims to be engaged in educational activities. This

230. See U.S. House of Representatives, *Statement of the Investigative Subcommittee on Behalf of the House Committee on Standards of Official Conduct*, December 21, 1996, available in LEXIS 96 TNT 249-25, ¶ 52 (Dec. 24, 1996) (documenting Gingrich's admission of violations).

231. See HILL & KIRSCHTEN, *supra* note 4, ¶ 9.09 (analyzing complex structures of exempt organizations).

organization retains some of the money and uses the rest for a contribution to an IRC § 501(c)(4) organization. Section 501(c)(6) trade associations use the same structure so their contributors can claim a charitable contribution deduction for their contributions to a § 501(c)(3) organization affiliated with the trade association. The § 501(c)(4) or § 501(c)(6) organization can either contribute directly to a candidate or it can create an IRC § 527(f)(3) separate segregated fund that contributes directly to a candidate.

This structure is based on respect for the separate identity of each component organization in a complex structure of affiliated organizations.²³² It was mentioned in passing in Justice Blackmun's concurrence in *Taxation with Representation*, a case that dealt with lobbying, not prohibited political activity, by a § 501(c)(3) organization.²³³ Justice Blackmun, however, took the position that the money contributed to the § 501(c)(3) organization could not be used for lobbying.²³⁴ Barriers to moving deductible contributions out of the § 501(c)(3) organization and into the § 501(c)(4) organization or the § 501(c)(6) organization may limit the effectiveness of complex structures. One method commonly used is for the § 501(c)(4) or § 501(c)(6) organization to provide space, office equipment, and other services to the § 501(c)(3) organization at prices that provide a surplus that can be used for hard money contributions to a candidate.²³⁵ Another method of transferring funds is to assert that the affiliated organization is not engaging in politics but in activities that the § 501(c)(3) organization could itself undertake. This strategy requires that the organizations develop some rationale for making the transfer.

Senator Jesse Helms operated a paradigmatic complex conduit called the Coalition for Freedom.²³⁶ Once the IRS revoked the Coalition's exempt status, Senator Helms announced that he had severed all ties with the organization.²³⁷ Like all conduits, the Coalition for Freedom was disposable and replaceable.

232. See *supra* Part IV.A.

233. See *Regan v. Taxation with Representation*, 461 U.S. 540, 551-54 (1983) (Blackmun, J., concurring).

234. See *id.* at 552-53.

235. See I.R.C. § 482 (1986) (addressing these questions of cost).

236. See Paul Taylor, *Helms Modernizes GOP Political Machine for the Electronic Age*, WASH. POST, Oct. 15, 1982, at A2.

237. See Toni Locy, *Helms Breaks with Coalition Called a Cash Conduit by IRS*, WASH. POST, Sept. 6, 1994, at A8.

5. Reverse and Lateral Conduits

The standard conduit transaction involves a transfer to one or more conduits with a candidate committee or political party as the final destination. Yet, conduits, particularly exempt conduits, offer benefits through reverse or lateral conduit transactions as well. A reverse conduit arrangement involves a transfer from a candidate committee or a political party to an exempt organization. A lateral conduit arrangement is a transfer from one exempt organization to another.

Reverse conduit arrangements serve to permit political parties and other political committees to evade the contribution limitations. Lateral conduit arrangements may also serve this purpose if the transferor is an exempt organization that is also a political organization and has reached its contribution limitation for a particular election.

Both reverse and lateral conduit arrangements serve to mask the identity of the supporter of a policy position. A political party may transfer funds to an exempt organization that shares its views on an issue so that the issue appears to have public support outside the party, thereby enhancing the public perception of the issue as legitimate in its own terms and not simply a partisan position. Similarly, an exempt organization may feel that its position on one controversial issue may limit its effectiveness in promoting another controversial idea. It may thus transfer funds to another organization that can, presumably, more effectively promote a policy or a candidate identified with a policy. Recent elections illustrate both of these transactions.

The Republican Party²³⁸ completed at least three reverse conduit transactions. One involved a transfer of \$175,000 from the National Republican Senatorial Committee to an antiabortion group, the National Right to Life Committee, in the closing days of the 1994 election.²³⁹ Senator Phil Gramm, then Chair of the National Republican Senatorial Committee, initially said "I made a decision . . . to provide some money to help activate pro-life voters in some key states where they would be pivotal to the election."²⁴⁰ The same day he revised his explanation to state that he had transferred the money because the anti-abortion group's "message conformed to the Republican message."²⁴¹ The organization in question claimed that it used the funds for "our ongoing educational, legislative citizen awareness activities" and denied any involvement in

238. Neither major party is one cohesive organization. Both have numerous committees that raise and distribute funds.

239. See Ruth Marcus, *GOP Donation Aided Right to Life Group; Money Was Not Earmarked, Sen. Gramm Explains*, WASH. POST, Feb. 12, 1995, at A27.

240. *Id.*

241. *Id.*

election campaigns.²⁴² The organization explained that its PAC's expenditure of \$107,000 on behalf of Republican Senate candidates was a coincidence.²⁴³

The National Republican Senatorial Committee has been accused of transferring soft money from corporate contributors to exempt organizations in Georgia which then used the money to support the Republic candidate, Paul Coverdell, who eventually won the runoff election.²⁴⁴ In this case, too, the transfer was allegedly used by the organizations for voter mobilization efforts that were at the margins of the permissible.

A third example of a reverse conduit arrangement arose in the 1996 presidential election when the Republican National Committee transferred \$4.6 million to Americans for Tax Reform; a group that is severely critical of the federal income tax and of the Internal Revenue Service, in the month before the 1996 election.²⁴⁵ In this case, the recipient organization reinforced the Republican Party's anti-tax, anti-government message, including the specific tax proposals of Bob Dole, the Republican candidate for President. Again, the organization stated that it was simply pursuing the issue agenda it had always pursued and that it was not engaging in impermissible intervention in a political campaign.²⁴⁶

Reverse conduits may offer a means of using soft money to affect the outcome of a specific election. An exempt organization will be able to engage in voter mobilization efforts and to argue that they have not engaged in political activities. This may explain a contribution of \$117,500 from the Democratic National Committee to the National Coalition on Black Voter Participation, which aimed to increase electoral participation by African American voters.²⁴⁷

Because the definition of party-building which can be funded by soft money, including unlimited corporate contributions, is imprecise,²⁴⁸ and because the boundaries of the permissible voter education activities is also imprecise, this kind of reverse conduit arrangement offers, under current

242. *Id.*

243. *See id.*

244. *See id.*

245. *See* Charles R. Babcock, *Anti-Tax Group Got Big Boost From RNC as Election Nears*, WASH. POST, Dec. 10, 1996, at A4.

246. *See id.* *See also supra* Part IV.B.3 (discussing tax reform groups operating as § 501(c)(3) organizations that cannot support or oppose candidates for public office).

247. *See* Michael Isikoff, *The White House Shell Game; How the Clinton Campaign's Frantic Fund Raising May Have Crossed the Line*, NEWSWEEK, Feb. 10, 1997, at 34.

248. *See supra* Part II.B.3 for a discussion on soft money and party-building.

law, the potential to direct soft money, including corporate contributions, to specific campaigns. This possibility will continue as long as the Supreme Court precludes inquiry into whether politicians benefit from expenditures and limit inquiry to whether they control funds.²⁴⁹

Another example of a reverse conduit arises at the end of a political career when a politician retires or is retired. Long-time incumbents may have retained, quite legally, excess campaign funds since the ability to raise political money increases as the seriousness of challenges in the home district declines. This phenomenon supports the interpretation of campaign contributions as access fees for legislative influence on a particular issue more than a general commitment to the election of a particular candidate. At the end of a political career, the politician may not retain the political funds unless she pays tax on this amount. However, the politician may donate such sums to an IRC § 501(c)(3) organization. This public charity may be one that the politician herself has created and which will employ her after her public career has ended. Provided that the new charity functions in accordance with IRC § 501(c)(3), the former politician may draw a reasonable salary, based in part on the politician's prior salary. This is, of course, an ambiguous situation. It may result in significant public benefits to a charitable class. It may result most directly in supporting the politician's continued ability to speak on public issues, perhaps with an eye to returning to elective office.

Lateral conduits involve transfers from one exempt organization to another exempt organization. These cases are only beginning to come to light in the wake of the 1996 campaign. While the direct conduit relationship within a complex conduit is to place money in a § 501(c)(3) for the purpose of offering political contributors a charitable contribution deduction,²⁵⁰ lateral conduit arrangements are more likely to be undertaken between organizations that have no formal affiliation. In these lateral conduit relationships, a § 501(c)(3) organization may well be the recipient organization. The purpose of a lateral conduit arrangement is to reinforce a campaign message by having it issue from a group with the presumption of integrity and political even-handedness that follows from exempt status.²⁵¹

249. See *supra* Part II.A for a discussion of these issues in the Supreme Court's jurisprudence regarding political money.

250. See *supra* Part IV.B.4 for a discussion of complex conduits.

251. See *infra* Part V.D. for a discussion of the danger of erosion of public confidence in precisely these traits of exempt organizations.

V. WHY CONDUITS MATTER

Understanding why and how conduits are used is a prelude to thinking about why and how conduits matter—apart from any impact that particular conduits may have on the outcome of particular elections. The rationales discussed above for concern about corporate contributions provide one set of reasons that conduits matter since conduits permit political contributors, including corporate contributors, to evade the statutory terms of their political contributions. In addition to these concerns about corruption and the appearance of corruption, the effect of concentrated wealth, and protection against compelled contributions from shareholders and employees, this article suggests that the role of conduits in campaign finance raises broader systemic issues. Each of these concerns involves contested propositions, but each also raises aspects of the ongoing effort to understand the core values of American democracy. These four concerns are set forth here not as settled propositions but as areas for discussion. This article identifies the following four areas in which conduits matter: (1) shaping the nature and quality of public discourse; (2) externalizing the costs of political contributions; (3) undermining tax equity; and (4) undermining public confidence in exempt organizations. Each of these is discussed below.

A. *Conduits and Public Discourse*

Conduits mask, or are intended to mask, the identity of one party or both parties to a political contribution transaction. Such masking raises questions about the quality of political discourse. This is inconsistent with the reporting and disclosure requirements of election law.²⁵² The Supreme Court has based its jurisprudence of political money on the right of persons to speak and the right of the public to hear.²⁵³ It has been less certain that the public has a right to know who is speaking. If a campaign contribution is protected political speech, then the use of conduits can be brought within the existing jurisprudence only if the identity of the speaker is irrelevant to the right of the listener. This approach to political speech would in fact mean that speakers have greater rights than listeners to structure the terms of public discourse. Because listening is passive, with the only defense under this approach being a refusal to listen, the quality of political discourse is diminished for the listener to the advantage of the speaker-contributor. Political speech jurisprudence that discourages listening or that is consistent only with passive listening is not jurisprudence that values political speech as deliberative democracy.

252. See *supra* Part II.B.5.

253. See *supra* Part II.A.

Under this approach political speech becomes a competitive zero-sum right in which a speaker's right is a listener's loss of a right. Such jurisprudence of political speech is destructive of the idea of political speech as the bedrock of citizen sovereignty and the means by which citizens constitute their government.

Inquiry into the identity of the speaker is readily distinguishable from a constitutionally impermissible inquiry into the content of the speech. Those who hear political speech do not simply have a passive right to be targets of speech taken at face value, but have an active right to make judgment about that speech, based on full information as to its source and the manner in which it was developed. Information about the source of speech may well, for many listeners, be an important factor in making such judgments. The speaker's active right cannot be premised on according the listener only a passive right. Political speech rights can be politically constitutive only if they are interactive, only if speakers and listeners both have active rights. Constitutionally protected political speech is not asymmetric and listeners are not passive, captive targets of speech about which they cannot inquire.

The Supreme Court's 1995 decision in *McIntyre v. Ohio Elections Commission* replicated this debate without resolving it.²⁵⁴ This case involved an Ohio statute that prohibited the distribution of campaign literature that does not identify the person or organization distributing it.²⁵⁵ Mrs. McIntyre, with the help of her son and a friend, printed handbills on her home computer calling for the defeat of a referendum on tax increases to support education. The handbills were addressed to "concerned parents and tax payers."²⁵⁶ In upholding Mrs. McIntyre's right to circulate her handbill without identifying herself as the author, the Court rejected the public's right to know who is speaking to them. Citing John Stuart Mill, the Court held that "anonymous pamphleteering" protected unpopular persons from having their speech rejected.²⁵⁷ The Court found that this interest outweighed any interest listeners may have in knowing who is

254. 514 U.S. 334 (1995).

255. *See id.* at 338 n.3.

256. *Id.* at 337.

257. *See id.* at 357.

Under our Constitution, anonymous pamphleteering is not a pernicious, fraudulent practice, but an honorable tradition of advocacy and dissent. Anonymity is a shield from the tyranny of the majority. . . . It thus exemplifies the purpose behind the Bill of Rights, and of the First Amendment in particular: to protect unpopular individuals from retaliation—and their ideas from suppression—at the hand of an intolerant society.

Id.

speaking.²⁵⁸ Justice Scalia, joined by Chief Justice Rehnquist, filed a vigorous dissent.²⁵⁹ The dissent distinguished anonymous publication in general from "anonymous electioneering."²⁶⁰ Permitting anonymous electioneering "facilitates wrong by eliminating accountability."²⁶¹ While recognizing that some situations that pose a danger of reprisals might require exceptions to a general prohibition on anonymous electioneering,²⁶² the dissent concluded that no such danger existed in this case or was likely to occur in most cases in contemporary America.²⁶³ The dissent also noted that the disclosure requirements upheld in *Buckley* were more intrusive than were those in the Ohio statute requiring identification of the speaker.²⁶⁴

Questions of the scope of *McIntyre* were presented in the two concurring opinions. Justice Ginsburg suggested that other cases might be decided differently.²⁶⁵ As she observed without elaboration, "[w]e do not thereby hold that the State may not in other, larger circumstances, require the speaker to disclose its interest by disclosing its identity."²⁶⁶ Justice Thomas, in a rare deviation from the positions of Justice Scalia, concurred in the result but would have found the Ohio statute facially unconstitutional.²⁶⁷

Whatever the subsequent interpretation of *McIntyre*, the anonymous pamphleteering in the context of a referendum might be distinguishable from the pseudonymous speech represented by conduits, whether in referenda or in elections for public office.²⁶⁸ Pseudonymous speech represents an attempt not simply to mask the identity of the speaker, but to recharacterize the speaker. In the case of a corporate-candidate conduit, the conduit's status as an exempt organization becomes part of the message and is an integral part of the recharacterization. Use of an exempt organization is an attempt to assert the legitimacy of the message by

258. *See id.* at 347-48.

259. *See id.* at 371 (Scalia, J., dissenting).

260. *Id.* at 372-73.

261. *Id.* at 385.

262. *See id.*

263. *See id.* at 380.

264. *See id.* at 383.

265. *See id.* at 358 (Ginsburg, J., concurring).

266. *Id.*

267. *See id.* (Thomas, J., concurring).

268. *See generally* *Austin v. Michigan Chamber of Commerce* 494 U.S. 652 (1989); *First Nat'l Bank of Boston v. Bellotti*, 435 U.S. 765 (1978) (exemplifying the distinction between referenda and elections).

presenting it as the view of supposedly neutral third parties acting in the public interest.

This is the issue raised in Philip Morris's creation of an exempt conduit to release a study of campaign contributions by the trial lawyers with whom the tobacco companies are locked in a battle over the health costs of smoking.²⁶⁹ During the 1996 campaign, Philip Morris directed State Affairs, Inc., a lobbying and public relations firm doing approximately half of its business with the tobacco giant, to establish a § 501(c)(4) organization. Working with Philip Morris's law firm, Covington and Burling of Washington, D.C., State Affairs created "Contributions Watch." Because Contributions Watch was intended to apply to exemption as an organization described in IRC § 501(c)(4), contributions would not be deductible but neither would it be required to disclose its contributors. By having State Affairs create the exempt organization, Philip Morris completely masked its role. Shortly after its creation, Contributions Watch issued a detailed study of the campaign contributions of the trial lawyers. The trial lawyers spent heavily on legislative lobbying to defeat tort reform legislation that would have limited recoveries against tobacco companies, among others.²⁷⁰ Trial lawyers have also been significant contributors to state and federal candidates.²⁷¹ When it released this study to the public, Contributions Watch presented itself as an independent organization, not as an organization fully funded by Philip Morris. When the press made public the connection between Contributions Watch and Philip Morris, State Affairs admitted that it would have been better to reveal from the beginning Philip Morris's role in the organization's creation.²⁷²

This kind of recharacterization of the identity of speakers contributes to a corrosive cynicism about public discourse that undermines the constitutive role of such discourse in political life. It undermines both the listeners' right to hear and the role of free speech in preserving and shaping a democratic system.

269. See Ruth Marcus, *Tobacco Lobby Created Campaign 'Watchdog'; Nonprofit Group Tied to Philip Morris Monitored Trial Lawyer Donations*, WASH. POST, Sept. 30, 1996, at A1.

270. See Douglas Frantz, *Trial Lawyers, Their Money and Their Influence Have Become Issues in the Campaign*, N.Y. TIMES, Oct. 13, 1996, at 18.

271. See *id.*

272. See Glenn R. Simpson, *Philip Morris Backs Study of Lawyers' Campaign Outlays*, WALL ST. J., Oct. 1, 1996, at B6 (quoting a State Affairs, Inc. statement as saying that "more specific disclosure of this funding would have been the better, and the right, course").

B. *Externalizing the Cost of Political Activities*

Federal election law is based on attributing contributions and expenditures to identifiable persons.²⁷³ Tax law is based on financing political activities with after-tax money.²⁷⁴ Taken together, election law and tax law evidence the intent that the costs of political activities be borne by those who initiate them and that such costs not be spread via tax deductions to other taxpayers.

Permitting the recharacterization of political contributions as deductible charitable contributions amounts to a taxpayer subsidy of the political activity. For this reason, Deputy Assistant Secretary of the Treasury in the Bush Administration, Michael Graetz, called upon Newt Gingrich to reimburse the Treasury, with interest, for the improper deductions claimed by his political contributors.²⁷⁵ Graetz based his reasoning on the effect on the deficit, pointing out that such deductions increase the government's need to borrow.²⁷⁶

Externalizing costs of political campaigns to taxpayers raises another issue as well. In effect, permitting questionable charitable contribution deductions is equivalent to compelling shareholders or employees to contribute to particular candidates²⁷⁷ or to using union dues to support candidates who the rank and file do not wish to support,²⁷⁸ both of which are prohibited by current law.²⁷⁹ Use of exempt conduits creates a captive taxpayer problem.

If politicians are permitted to compel contributions by using exempt conduits, constitutionally protected speech means that listeners are required to subsidize messages they do not wish to hear and would not choose to send. Opponents of public funding of campaigns argue in part that citizens should not be forced to support candidates with whom they disagree. Direct public funding, whatever the merits of the overall approach, at least would fund all viable candidates. Indirect public funding through exempt

273. See *supra* Part II.

274. See *supra* Part III.

275. See Michael J. Graetz, *What Gingrich Owes Us*, N.Y. TIMES, Jan. 8, 1997, at A15.

276. See *id.*

277. See, e.g., Ruth Marcus & Charles R. Babcock, *The Business of 'Bundling'*, WASH. POST, Apr. 25, 1996, at A1 (noting that compelled contributions by employees are "bundled" to increase their impact and their identification with the employer).

278. See *supra* Part I.C for a discussion of the captive member problem.

279. See *supra* Part II.B.4 (noting that both corporations and unions are prohibited from using treasury funds to fund the political contributions made by their affiliated PACs).

conduits is highly selective and perversely rewards those candidates most willing to skirt the law.²⁸⁰

C. Tax Fairness and Exempt Conduits

The compelled political contributions described above are a type of tax expenditure.²⁸¹ There is, however, one important difference highlighted by the moral hazard problem raised above. While the classic tax expenditure is an alternative to a permissible federal government program, the political tax expenditure at issue here arises from recharacterizing a political contribution as a charitable contribution and thereby claiming a deduction that is otherwise expressly prohibited.²⁸²

What political tax expenditures do have in common with traditional tax expenditures is the shifting of a specific cost to taxpayers. Such cost shifting can be economically regressive and can violate the tax fairness norms of horizontal and vertical equity. It is reasonable to assume that small contributions by ordinary citizens are less likely to be made through conduits than are very large contributions. Horizontal equity means that similarly situated taxpayers are treated similarly. Vertical equity means that those with more income pay more tax. These fairness norms have been central to the debate over tax expenditures.²⁸³ There should be no less attention to the distributional consequences of the captive taxpayer problem.

Political tax expenditures should be controversial because of their implications for tax equity. If other government programs are subject to public debate on this score,²⁸⁴ the tax subsidy arising from recharacterizing political contributions as charitable contributions should be made part of the debate.

280. See Kenneth Arrow, *The Economics of Moral Hazard: Further Comment*, 3 AM. ECON. REV. 537, 537-38 (1968) (supporting the inference that this is a classic moral hazard problem).

281. For articles discussing the foundational analyses of tax expenditures, see Stanley S. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352 (1970); Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970).

282. See *supra* Part III, Part IV.B.3.

283. See, e.g., Michael J. Graetz, *Assessing the Distributional Effects of Income Tax Revision: Some Lessons from Incidence Analysis*, 4 J. LEGAL STUD. 351 (1975).

284. See, e.g., *id.* (illustrating that the current debate over tax subsidies to corporations, often termed corporate welfare, defines the context for including a debate over permitting deductions for political contributions recharacterized as charitable contributions).

D. *Effect on Exempt Organizations*

Exempt organizations should have a keen interest in the role played in electoral politics by corporate-candidate conduits. In addition to the risk of political cynicism, the increasingly visible role of corporate-candidate conduits risks fueling cynicism about exempt organizations in general. At a time when many are calling upon exempt organizations to address issues previously addressed by government, such cynicism threatens to undermine the ability of exempt organizations to fulfil their historic mission.

Exempt organizations have built a reputation for serving the public interest directly and openly. While exempt organizations may well take controversial positions in defense of the environment or in defense of business interests, they have historically done so openly. Consequently, those persons who wish to support their work could do so and those who did not could refuse to do so. Exempt organizations maximized choice by focusing on a clear goal, whether funding research into a particular disease or protecting children or animals or the homeless or funding a ballet troupe or a symphony. The specificity of organizational mission permitted contributors to tailor their support consistent with their own preferences.

Political preferences may track with some activities of exempt organizations but not with others. It is not at all clear that the supporters of the Cleveland Symphony share political views, much less a preference for any one political candidate in any electoral contest. While members of the Sierra Club may tend to support Democrats, it is far from clear that positions on the environment define the voting choice of all or even most of the Sierra Club's members.

To the extent that particular exempt organizations take positions on particular electoral contests, they may gain the advantage of intensifying the support of some members and even of attracting some new members, but they also risk alienating current and potential members and supporters. For exempt organizations with their own agendas of exempt activity, these risks should be taken seriously.²⁸⁵

There is no comparable risk for pure conduits, however, because they do not have an agenda of exempt activities apart from the political agendas of their sponsors and creators. Such organizations are routinely abandoned once they have served their intended purpose in a particular election cycle. Such burned-out charities are the equivalent of the burned-out tax shelters of the 1970s. A conduit has no need to appeal to broad support and, indeed, would find such support potentially intrusive. Similarly, a conduit is unconcerned about the loss of its exempt status because it has no further use of that status.

285. See *supra* Part I.C for a discussion of the captive member problem.

Exempt organizations with active programs of exempt activities have an interest in preventing organizations from trafficking in exempt status. In effect, corporate-candidate conduits are free-riders on the public respect, support, and trust of exempt organizations in general. To the extent that the exempt sector sits passively by as that goodwill is undermined by the actions of the free-riders they are complicit in creating the undesirable consequences that may well follow.

VI. CONDUITS AND APPROACHES TO CAMPAIGN FINANCE REFORM

Current discussions of campaign finance reform turn on two types of proposals—regulation and disclosure. Neither of these approaches can succeed if it does not address the role of conduits.

Regulatory proposals represent efforts to strengthen the current FECA. They limit the amount of contributions, the identity of contributors, and permissible uses of political contributions. In the case of presidential candidates who receive federal matching funds, there are also limitations on campaign expenditures. The soft money and independent expenditures in the 1996 election have led to renewed calls for reform and the development of new proposals for doing so.²⁸⁶

Opponents of the regulatory approach argue either that it is unworkable or unconstitutional or both.²⁸⁷ They propose instead to eliminate the current regulatory provisions of the FECA and to replace them with disclosure. The nature of the proposed disclosure has not been specified.

The kind of disclosure which might enable citizen-voters to monitor campaign finance would necessarily be intrusive. It would involve the kind of government role that its proponents generally condemn. The problem is that electoral decisions are made at one set time, on election day, and therefore disclosure must be made before election day if it is to serve its intended purpose. Campaign finance disclosure thus operates in a very different context than does disclosure in securities markets. Trading decisions are made daily, or hourly, and can be undone, albeit at some cost. Citizens cannot recast their votes the day after election day. The difference in the timing and nature of decisions means that securities market analogies are not useful in analyzing electoral system disclosure.

286. The McCain-Feingold Bill is currently the most prominent regulatory proposal. It includes strong disclosure provisions. *See, e.g.*, 142 CONG. REC. S6761, S6762-63 (daily ed. June 25, 1996) (statement of Sen. McConnell); 143 CONG. REC. S2221, S2253 (daily ed. Mar. 13, 1997) (statement of Sen. McConnell).

287. Senator Mitch McConnell (R-Ky.) is the most outspoken proponent of this approach. *See, e.g.*, 142 CONG. REC. at S6762-63; 143 CONG. REC. at S2253.

Conduits defeat disclosure in the absence of regulation and defeat regulation in the absence of disclosure. Because exempt conduits both mask the identity of the true contributor and recharacterize the activity itself, they present a direct challenge to the integrity of the electoral system and thus to the foundational idea that, in our representative democracy, citizens are sovereign.

