Fair Political Practices Commission
MEMORANDUM

To: Chair Ravel, Commissioners Eskovitz, Garrett, Montgomery and Rotunda

From: Zackery P. Morazzini, General Counsel
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Subject: A More Accurate Rule for Reporting the Source of Funding for Expenditures by Multi-Purpose Groups

Date: November 23, 2011

Introduction

Among the interest groups that regularly make expenditures to influence California election campaigns are "multi-purpose groups" organized under Section 501(c) of the Internal Revenue Code. Many of these groups contribute relatively small sums to political campaigns, but many others are influential organizations that raise and spend very large sums to influence state elections. These entities differ from "political organizations" governed by IRC Section 527 because federal tax law limits campaign spending by non-profits organized under Section 501(c). The Act, however, permits any "person" to make expenditures in state or local elections.[1] Spending restrictions on non-profit groups are based on federal, not California law.

501(c) groups present a special challenge to the Act's campaign disclosure rules. Their expenditures are typically made from a general treasury collected from donors who may or may not know that their funds would be used to influence California elections. The Act's definition of "contribution" applies to payments made for a political purpose; "contributors" underwriting an expenditure from the general treasury of a non-profit organization are those persons who knew, or should have known, that their payment could be used to influence a California election.[2]

Current law is effective at stating *when* a multi-purpose group must disclose contributors that funded a campaign expenditure, but there is room for improvement in specifying *which* donors must be disclosed as having given money towards the expenditure, when not all donors need be named to account for the money spent. Such a step was urged this past January in a set of recommendations presented to the Commission by the Chairman's Task Force on the Political Reform Act. Moreover, it has lately become respectable in some quarters to openly urge the use of multi-purpose groups as a vehicle to conceal the identities of campaign contributors, and there is evidence that some groups have been formed or used for the purpose of evading campaign disclosure laws nationwide. A rule stating more precisely who must be disclosed as contributors, once disclosure is required, will reduce opportunities to circumvent our existing disclosure laws.

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[1] The term "person" is broadly defined at Section 82047 to include an "individual," certain specific entities, and finally "any other organization or group of persons acting in concert."

[2] "Contribution" is defined at Section 82015 and Regulation 18215. For simplicity's sake, the text discussion centers on multi-purpose groups organized under IRC Section 501(c). But the proposed reporting rules also apply to federal or out-of-state political committees that make expenditures to influence California elections.

Current Law

Broadly speaking, with important exceptions, Section 82015 defines "contribution" as a payment made for a political purpose. When a person makes a payment to a California candidate or political committee, without receiving full consideration in return, the payment can be called a "contribution," and the person making the payment can properly be classified as a "contributor." The problem is more complex when the payment is made to a "multi-purpose group." Payments to such groups which are *not* made or used for political purposes in California are not reportable "contributions." On the other hand, some payments to such groups *are* "contributions" subject to the Act's reporting rules – for example, payments responding to a group's solicitation of funding for an ad urging a particular vote on a California candidate or ballot measure.

Like all entities, multi-purpose groups must report any expenditure of $1,000 or more made to influence a California state or local election contest, *as well as* the source of all funds used to make that expenditure.[3] Staff proposes that the Commission adopt a more explicit rule specifying which persons should be identified as sources of funding used by a multi-purpose group to make an expenditure that is reportable under the Act.

The Act's definition of "contribution" at Section 82015 has long been read to include persons who give money to multi-purpose groups for use in California elections under the so-called "one bite of the apple" rule at Regulation 18215 (b)(1), which provides in full:

> "(b) The term 'contribution' includes:
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> (1) Any payment made to a person or organization other than a candidate or committee, when, at the time of making the payment, the donor knows or has reason to know that the payment, or funds with which the payment will be commingled, will be used to make contributions or expenditures. If the donor knows or has reason to know that only part of the payment will be used to make contributions or expenditures, the payment shall be apportioned on a reasonable basis in order to determine the amount of the contribution. There shall be a presumption that the donor does not have reason to know that all or part of the payment will be used to make expenditures or contributions, unless the person or organization has made expenditures or contributions of at least one thousand dollars ($1,000) in the aggregate during the calendar year in which the payment occurs, or any of the immediately preceding four calendar years."

The first sentence of this thirty-year old regulation states that the term "contribution"

[3] A multi-purpose group that spends $1,000 or more to influence a California election, or which receives the same amount for the purpose of making such an expenditure, becomes *ipso facto* a committee under Section 82013.

includes a payment to an organization which the donor knows, or has reason to know, will be used to make an expenditure.[4] The second allows for apportionment of certain payments, while the final sentence states a presumption limiting the duration of the donor's "reason to know" that a payment will be used to make a contribution or expenditure.[5]

Multi-purpose groups making occasional expenditures in California elections are not required, like a typical committee, to report *all* funds received and spent. They are required only to report their expenditures on California elections, and the source of the money so spent. Regulation 18215(b)(1) does not provide an explicit rule *prioritizing* the persons whose payments should be reported by a multi-purpose group when campaign expenditures from the group's general treasury amount to less than all funds in the treasury.

To illustrate how the "one bite of the apple" rule works, and the reporting options theoretically available, suppose that a multi-purpose group has $105,000 in its treasury, and has never made an expenditure on a California election. Suppose now that a candidate of interest to the group is on an upcoming ballot. The group backs the candidate with a contribution of $5,000. The candidate's committee will identify the group on its campaign report as a contributor of $5,000. The group may or may not have acted earlier to publicize its contribution. On the day the contribution was made, the group took its first "bite" of the apple, and all persons are then on notice that any subsequent payments to the group may be used to fund a campaign expenditure.

Now suppose that after the group made its initial contribution, it receives an additional $10,000. The polls grow tighter and the group then opts to make another contribution, soliciting funds for that purpose from its donor base, which sends in an additional $10,000. At this point, the group has $120,000 in its general treasury, $100,000 from persons who gave *before* the group had made its first campaign expenditure, $10,000 from persons "on notice" because they gave *after* the first contribution, and $10,000 from persons who gave in response to a solicitation for funds to make a second contribution. The group then makes a contribution of $25,000.

The group must now report the source of the funds used to make its contributions. The group's first contribution ($5,000) was made without actual or constructive notice to its donor base. The second contribution was made when the general treasury held $10,000 given by persons on notice that their funds might go towards a campaign expenditure, another $10,000 from persons clearly aware that a second contribution was planned, and $100,000 from a time before any donor was aware that the group might begin making campaign expenditures.

When (as here) less than all treasury funds are used to make campaign expenditures, a multi-purpose group serves the purposes of the Act by reporting as sources for its expenditures any payments "earmarked" for that purpose, or given in response to a request for assistance with the expenditure, or after the group's intent was widely publicized or, finally, when donors are

[4] "Expenditure" is defined at Regulation 18225.
[5] After a lengthy and determined challenge, this rule was upheld by the Ninth Circuit Court of Appeal in *California Pro-Life Council, Inc. v. Randolph*, 507 F.3d 1172 (9th Cir. 2007).

presumptively on notice their funds might be used for campaign speech. If there are not enough "contributions" in the treasury to account for the full amount of an expenditure, a group must report funds that are not properly classified as "contributions" at all, that is, payments from persons not at least presumptively on notice of the group's intent.

The Task Force Recommendation

At its January, 2011 meeting, the Commission received the final report of the Chairman's Task Force on the Political Reform Act, which included a recommendation for an improved reporting rule for multi-purpose groups, which reads in full:

> E. Revise FPPC rules for campaign filings by multi-purpose organizations so that there is a single standard and clear transparency in reporting the donors to the organizations. We recommend that the Commission consider a last-in, first-out ("LIFO") formula for identifying a multi-purpose organization's donors.

The evident concern of the Task Force was that a group might conceal the name of a particular funding source by reporting other donors first. Recognizing the lengthy "look-back" period of Regulation 18225(b)(1), the Task Force suggested a last-in, first-out ("LIFO") formula for identifying a multi-purpose group's donors, on the theory that funds received near the time of an expenditure are more likely to have been given with knowledge of the upcoming expenditure. This supposition may often be correct, but a strict LIFO rule is not always an optimal solution, and it does not take into account any circumstantial or other distinctions among "contributors."

Proposed Regulations

Regulation 18215(b)(1) requires a *full* accounting of a group's expenditures; if a group makes an expenditure of $25,000, it must report sources of funding that add up to $25,000. In place of a strict "LIFO" formula, staff chose to prioritize identification of "contributors" without direct reference to the date of the payment, leaving to be reported last (if at all) contributors with purely constructive knowledge that their funds might be used to make a campaign expenditure. This approach furthers the purposes of the Act and minimizes a problem voiced by interested persons concerned that identification as campaign "contributors" could jeopardize the tax status of non-profit entities that gave funds to a multi-purpose group for other reasons.[6]

Regulation 18412

[6] The Act cannot be interpreted to exempt a non-profit corporation from classification as a campaign "contributor" simply because federal tax law in some cases penalizes expenditures of tax-free income on political campaigns. A non-profit's donation to a multi-purpose group can be governed by a grant agreement barring use of the funds for political purposes. A non-profit group is not precluded from explaining to federal authorities that its "contribution" was the consequence of a constructive knowledge standard inapplicable under the facts and circumstances.

As noted above, Regulation 18215 interprets and applies the definition of "contribution" given at Section 82015 (in Chapter Two of the Act, which provides definitions for critical terms). Proposed Regulation 18412 is not a definition, but a *reporting* rule governed by Chapter Four. This regulation thus precedes Regulation 18413, a special reporting rule mandated by the *ProLife* decision to provide a simplified reporting schedule for small multi-purpose groups required to report contributions under the "one bite of the apple" rule at Regulation 18215.

As discussed below, Staff also proposes amendments to Regulation 18413 to bring it into conformity with proposed Regulation 18412. Staff recommends no substantive amendment at all to Regulation 18215(b)(1), but recommends that the Commission take this opportunity to add topic headings to assist first-time users in navigating this important regulation.

The title of proposed Regulation 18412 is designed to attract attention from tax-exempt organizations, alerting them that California law may require that they identify funding sources for contributions or independent expenditures made in California election campaigns. Subsection (a) then identifies the organizations subject to these reporting rules, if and when an organization is required to report sources of its funding under Regulation 18215(b)(1). The organization would of course be expected to consult Regulation 18215 if not already aware of its existence.[7]

Subsection (b) treats donors whose payments must be reported *in full* as "contributions" to a multi-purpose group. Subsection (c) clarifies the reporting priority not expressly given in Regulation 18215(b); after identifying and reporting all persons who knew their payments would fund a contribution or an expenditure, the group would report as necessary donors presumed to have had "reason to know" that their payments would be so used. Finally, if funds provided by all "contributors" fall short of the amount actually spent to make a contribution or independent expenditure, the group will identify *itself* as the source of the full remaining balance.

The public is given a full account of the persons whose funds were actually used to underwrite the contribution or expenditure. "Contributors" are identified as such,[8] and if "contributions" from organizational donors are insufficient to make up the total amount spent, the group identifies itself as the source of the remaining balance. The last sentence states that a multi-purpose group "should not" include in its campaign report persons whose funds were clearly earmarked for non-campaign purposes. This proviso is conditional because there may be cases where a multi-purpose group actually does use funds earmarked by the donor for non-campaign purposes, and it is unclear that the purposes of the Act require exposing an over-reporting multi-purpose group to a charge that it has violated the Act in such a case.

The presumption of knowledge stated in the "one bite of the apple" rule is not altered by Regulation 18412. This regulation treats as reportable "contributors" all persons with actual or

[7] Staff is concerned that some out-of-state groups may not fully research California's definition of "contribution" if they are already familiar with the term in another jurisdiction. Thus the title and subdivision (a) will serve as a reminder that California law is different than the law in many other jurisdictions.

[8] The identification is in full accord with definitions of "contribution" at Section 82015 and Regulation 18215(b).

constructive knowledge that their funds may be used for an expenditure in a California election campaign. Only after the exhaustion of all funds from all persons classified as "contributors" may a multi-purpose group identify itself as the contributor of general treasury funds amassed before donors were on notice that their payments might be used for political purposes.

Regulation 18413

This relatively recent rule was adopted as an emergency regulation in December 2007, following the Ninth Circuit's final opinion in the *ProLife* case, which required a simplified reporting rule for relatively small multi-purpose groups organized under IRC Section 501(c)(4). The proposed amendments to Regulation 18413 are confined to subdivision (d)(2), the purpose being simply to require groups reporting under Regulation 18413 to identify and report their donors in the same manner prescribed by Regulation 18412. If the Commission adopts Regulation 18412, it should amend Regulation 18413 to ensure that multi-purpose groups filing under Regulation 18413 identify their donors as do all other multi-purpose groups.

Conclusion

To the extent possible given the diversity in organization, makeup, history, goals, and sophistication of multi-purpose organizations, which have concurrent duties of diligence in observing the requirements of federal tax law, staff's proposals are designed to make more clear how, and particularly *in what order*, these groups must report the sources of income used to fund their expenditures in California elections. Staff believes that its proposals strike the most sensible balance between requirements of disclosure laws and regulations in place for decades, and the rights of all persons to support multi-purpose organizations with minimal legal burden.