Fair Political Practices Commission
MEMORANDUM

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

From: Zackery P. Morazzini, General Counsel
Lawrence T. Woodlock, Senior Commission Counsel

Subject: A More Accurate Rule for Reporting the Source of Funding for Expenditures by Multi-Purpose Groups

Date: March 26, 2012

Introduction

Among the organizations that spend money 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 others are powerful entities that raise and spend very large sums to influence state and local elections. These groups differ from political committees governed by IRC Section 527 because federal tax law limits campaign spending by nonprofits organized under Section 501(c). The Political Reform Act, (the "Act") however, permits any "person" to make expenditures in state or local elections.[1]

501(c) groups present a special challenge to the Act's campaign disclosure rules. They typically spend from a general treasury raised from donors that may or may *not* know their funds may be used to influence California elections. Because the Act defines the term "contribution" as a payment made for a political purpose, "contributors" whose payments are used to fund expenditure from the general treasury of a nonprofit group must *also* be persons who knew, or had reason to know, that their payment could be used to influence a California election.[2] Current law is effective at stating the point at which a multi-purpose group must report its contributors, but there is room for improvement in specifying *which* donors may be treated as "contributors."

In recent years there has been a growing tendency to use multi-purpose groups as vehicles to conceal the identities of campaign contributors, and there is reason to believe that such groups

---

[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 discussion centers on multi-purpose groups organized under IRC Section 501(c). But the proposed rules also apply to federal or out-of-state political committees that spend money to influence California elections. An important distinction between nonprofits organized under IRC Section 501(c), as opposed to nonprofit political organizations formed under IRC Section 527, is that 527 groups are required by federal law to disclose their donors, but 501(c) organizations are not.

have been used for the purpose of evading campaign disclosure laws nationwide. [3]

Complaints detailing specific instances of campaigns in violation of the federal tax code have been submitted to the Internal Revenue Service, which historically has been slow to enforce federal laws in this area.[4] Multi-purpose groups are aware that they can skirt California's disclosure laws by exploiting broadly-worded provisions in existing Commission regulations. When this memorandum was in draft, for example, an out-of-state federal PAC asked staff to confirm its understanding that current California rules allow apportionment of payments among so many donors that a group can spread its expenditures over a donor base sufficiently large that *no* donor reaches the $100 disclosure threshold. This use of "old money" (funds which are not "contributions" as defined by the Act) has long been a device enabling multi-purpose groups to avoid disclosure of *any* contributor – a problem that the proposed rules are designed to end.

Regulation 18215(b)(1) directs multi-purpose groups spending money on California elections to apportion their reportable contributions from donors "on a reasonable basis." Under Section 81003 the term "reasonable" should be read in light of the Act's goal of full and accurate campaign reporting. Some of the opposition to the draft rules view as "reasonable" any apportionment method, including those that result in no disclosure of individual contributions. Such an interpretation does not further the purposes of the Act.

The proposed regulations limit the donors that may be disclosed as contributors, to include only (A) donors with knowledge their payments may be used to fund a California election campaign and (B) donors who made their payments *after* the group has made at least one campaign

---

[3] In February, the Washington Post observed that: "More than a third of the advertising tied to the presidential race has been funded by nonprofit groups that will never have to reveal their donors, suggesting that a significant portion of the 2012 elections will be wrapped in a vast cloak of secrecy." http://www.washingtonpost.com/politics/secret-money-is-funding-more-election-ads/2012/02/03/gIQAfTxEuQ_print.html

[4] For example, see a December 14, 2011 follow-up letter sent to the IRS alleging in detail improper activities by two large 501(c)(4) groups widely suspected of being *de facto* political committees. The letter is available at: http://democracy21.org/vertical/Sites/%7B3D66FAFE-2697-446F-BB39-85FBBBA57812%7D/uploads/IRS_LETTER_12_14_2011.pdf
See also: http://images.politico.com/global/2012/02/letter_to_irs.html The extent of such abuses of campaign disclosure laws is difficult to document with precision in the absence of federal investigations, but they are evidently real, and cast doubt on the integrity of our political processes. On March 7, 2012, the New York Times reported that the IRS appears to have begun to investigate violations of the tax code by political groups organized as 501(c) "social welfare organizations:" http://www.nytimes.com/2012/03/07/us/politics/irs-scrutiny-of-political-groups-stirs-harassment-claim.html?_r=1&pagewanted=1&ref=politics On March 12, 2012 the Senate Committee on Finance published another viewpoint from a group of U.S. Senators, available at: http://finance.senate.gov/newsroom/ranking/release/?id=b49bd610-6a0f-4ea5-bea2-8ce37e2e5e04 The debate illustrated here is no longer about *whether* non-profit groups spend money to influence election campaigns, but the extent to which they are permitted to do it under federal tax law.

expenditure, and are therefore presumed to "have reason to know" their money could be used to fund another campaign expenditure. Among the presumed contributors, a Last In-First Out, ("LIFO") allocation rule helps ensure that the donors first disclosed as contributors are those who had the most time to learn the group had begun to make campaign expenditures.

When all donors from classes (A) and (B) have been disclosed, the group then reports *itself* as the source of any additional funds used to make campaign expenditures. It may no longer disclose or treat donors with neither actual nor constructive knowledge as "contributors." The proposed rules advance the goal of fuller and more accurate disclosure by *limiting* the pool of potentially reportable "contributors" to those that the Act actually defines as "contributors."

An Overview of Current California 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 will be called a "contribution," and the person making the payment can properly be called a "contributor."

The problem is more complex when the payment is made to a "multi-purpose group." Like all "persons," 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 funds used to make that expenditure.[5] Payments to such groups that are neither given nor used for political purposes are not reportable "contributions." But some payments to multi-purpose groups *are* reportable "contributions" even when not expressly designated as such by the contributor.

The Act's definition of "contribution" at Section 82015 has long included payments by persons to multi-purpose groups for use in California elections, under the "one bite of the apple" rule at Regulation 18215(b)(1), which provides in full:

> "(b) The term 'contribution' includes:
>
> (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,

[5] 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.

> 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" includes a payment to an organization which the donor knows, *or has reason to know*, will be used to make an expenditure.[6] The second sentence permits apportionment *among contributors* "on a reasonable basis in order to determine the amount of a contribution." The final sentence states a presumption limiting the duration of a donor's "reason to know" that a payment will be used to make a contribution or expenditure.

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. On the day the contribution was made, the group took its first "bite" of the apple, and all persons donating money to the group thereafter have "reason to know" that any subsequent payments to the group may be used to fund a campaign expenditure in California.

Now suppose that after the group made its initial contribution, it receives an additional $10,000 in response to a solicitation for funds to be used for a contribution in California, and also receives funds in the normal course of a membership drive. The group then makes its second contribution. The group must now report the source of the funds used to make its contributions.

Under the proposed rule, the group will report the donors that specifically gave funds for political purposes ($10,000) in response to the solicitation. If those funds do not account for the full amount of the second contribution, the group will disclose donors (using LIFO) who made payments in response to the membership drive, *after* the group had made its contribution and they had reason to know how their funds might be used. These are the only classes of donors who can be classified as "contributors" to the group under the proposed regulations, because they knew or "had reason to know" that their payments would or could be used for a political purpose.

Under current rules, some groups disclose early donors not presumptively on notice, in place of others who *did* have notice of the groups' intent, or whose payments were actually "earmarked" for political purposes.[7] Sometimes "old money" donors (persons who had no reason

---

[6] "Expenditure" is defined at Regulation 18225.

[7] The practice of using persons who have not made payments defined as "contributions," *in lieu* of others who have made such payments is wrongly thought (from silence on a question not posed) to have been endorsed n the *Rherig* Advice Letter, No. A-07-126. When the question *was* openly asked and the practice rejected in the *Strout/Abegg* Advice Letter, No. A-11-218, members of the regulated community urged that *Strout/Abegg* be rescinded as inconsistent with prior "advice" permitting multi-purpose groups to disclose "old money" in place of

to know their donations might one day be used for a political purpose) are treated as "contributors," and their availability exploited by the group to reduce below $100 the amount "apportioned" to each "contributor," thereby evading disclosure of any and all contributors.

Regulation 18215(b)(1) contains no explicit rule *prioritizing* and limiting donors whose payments must be reported by a multi-purpose group. Regulation 18412 would fill this gap by requiring disclosure, first, of persons *actually* on notice that their money may be spent for political purposes followed, if the first class of donors did not give enough to account for the full expenditure, by persons *presumptively* on notice that their money could be so used. The latter would be disclosed through a "last in, first out" (LIFO) accounting method, to ensure that those most likely to have known of the group's campaign expenditures will be the first ones disclosed.

If these two classes of contributors do not account for the full amount of the group's expenditure, the group will identify itself – rather than donors who gave *before* the "first bite" – as the source of funds needed to account for the remaining balance of the group's expenditures. It is worth stressing that persons with neither actual nor presumptive knowledge that their money could be used to fund a campaign expenditure can *never* be said to have made a "contribution" as that term is defined by the Act. The treatment of such donors as "contributors" under current rules simply provides a device to skirt disclosure, which is not sanctioned by the Act.

The Proposed Regulations

Regulation 18215

As noted above, Regulation 18215 interprets and applies the definition of "contribution" given at Section 82015. Staff recommends no substantive amendment to Regulation 18215, but suggests that the Commission take this opportunity to add headings for subdivision (b)(1) to assist first-time or occasional users in navigating this important regulation.

Regulation 18412

Proposed Regulation 18412 is a reporting rule governed by Chapter Four. Regulation 18412 is therefore numbered to precede Regulation 18413, a special reporting rule that provides a simplified reporting schedule for a narrow class of small multi-purpose groups required to report contributions under the "one bite of the apple" rule at Regulation 18215.

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 in California election campaigns.[8] Subdivision (a) then

---

donors who knew or who had reason to know of a group's intent to make campaign expenditures.

[8] Out-of-state groups may not fully research California's definition of "contribution" if they are already familiar with the term elsewhere. The title warns that California law is different than the law in many other jurisdictions.

identifies the organizations subject to these reporting rules, if and when they must report sources of campaign spending.[9]

Subdivision (b) treats donors whose payments must be reported as "contributions" when received by a multi-purpose group. Subdivision (c)(1) states a reporting priority not expressly given in Regulation 18215(b)(1); *after* reporting all persons who knew their payments would fund a contribution or an expenditure, the group will report (using a LIFO method) donors with "reason to know" that their payments would be so used. Finally, if the funds from these classes of donors fall short of the amount spent to make a contribution or an independent expenditure, subdivision (c)(2) requires the group to identify itself as the source of the full remaining balance.

Some groups treat as "contributors" donors whose payments do not meet any definition of "contribution," reading between the lines of the *Rherig* Advice letter to support the practice.[10] The result is either disclosure of donors whose classification as "contributors" is insupportable under the Act, or disclosure of *no* contributors when averaging the expenditure across a larger donor pool reduces every donor's share to a sum below the $100 disclosure threshold.

Opposition to Regulation 18412 may largely be due to the fact that Subdivision (c)(2) prohibits the practice of strategically augmenting the ranks of "contributors," requiring instead that the group itself be disclosed as the source of any funds needed to account for the remaining balance of an expenditure not funded by persons whose payments are lawfully considered to be "contributions." Donors can no longer be treated as "contributors" if they neither knew, nor had reason to know, that their payments might be used to fund a group's expenditure.

Regulation 18412(c)(1) contains two modifications proposed at the December meeting. The first exempts from disclosure any expenditure by a multi-purpose group that is made from a bank account holding organizational income that is segregated from "donations" to the group.[11] The second was proposed at the last meeting to make clear that the presumption of Regulation 18215(b)(1) is rebuttable, and that a group need not report any donor that the organization can establish did *not* know or have reason to know that its funds might be used to make a contribution

---

[9] The Act cannot be interpreted to exempt a non-profit corporation from classification as a "contributor" to a campaign under California law simply because federal tax law restricts use of tax-free income to fund political campaigns. A non-profit's donations can be governed by a grant agreement barring use of its funds for political purposes, and non-profit groups are certainly not precluded from explaining to the IRS that their "contributions" were the consequence of a constructive knowledge standard inapplicable to it under the pertinent circumstances, if such a case can be made.

[10] Indeed, if the Commission were to conclude that the *Rherig* Advice Letter actually sanctions this practice, it would be well advised to rescind that letter.

[11] The "income" referenced here is income derived from stocks, bonds, property, or other investments, or from sales.

or expenditure.

The presumption of the "one bite of the apple" rule is narrowed by Regulation 18412, in a manner staff believes to be required by law, treating as "contributors" *only* persons who had actual knowledge or who had reason to know that their funds might be used to influence a California election campaign.

Subdivision (e) has been added since the December meeting, to articulate reporting rules of particular interest to multi-purpose groups. Subdivision (e)(1) notes that under existing law a multi-purpose group will incur the reporting obligations of a recipient committee under Section 82013(a) if within a calendar year it receives payments (treated under subdivision (b) of this regulation) totaling $1,000 or more. Subdivision (e)(2) adopts a suggestion in December that reduces the reporting burden on federal PACs that file monthly reports of contributors with the Federal Election Commission. Subdivision (e)(3) treats reporting obligations of groups that make expenditures from segregated "income" accounts, and subdivision (e)(4) responds to a timing question raised in December, explains how to proceed with a report when contributor employment information is unavailable, and reminds groups that they must provide contributors with a "major donor" notice when and as required by Section 84105.

Regulation 18413

This relatively recent rule was adopted as an emergency regulation in December 2007, following the Ninth Circuit's final opinion in *California Pro-Life Council, Inc. v. Randolph et al*, 507 F.3d 1172 (9th Cir. 2007), which required a simplified reporting rule for relatively small multi-purpose groups organized under IRC Section 501(c)(4) that make independent expenditures, but not contributions. 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 any multi-purpose group that files under Regulation 18413 will identify its contributors as do all other multi-purpose groups.

Objections Noted at the December Commission Meeting

The most sweeping challenge to the proposed regulations at the December meeting was an assertion that "the Pro-Life cases" did not sanction the presumption that is the irreducible core of the "one bite of the apple" rule at Section 82015(b)(1). Arguing the presumption cannot be lawful "without more," one speaker dwelled at length on the obvious – the rule presumes that a member of the Sierra Club "has reason to know" his or her funds may be used for campaign expenditures at any date after the Club makes its first independent expenditure in California.

It did not escape the Ninth Circuit that this is how the presumption (or any presumption) works, but upon satisfying itself that the presumption was both justified and rebuttable, the court found it lawful under the harshest level of constitutional scrutiny. Specifically, in *California*

Pro-Life Council, Inc. v. Randolph et al, 507 F.3d 1172 (9th Cir. 2007) the Ninth Circuit found that California has a "compelling" state interest in informing voters of the sources of funding used by multi-purpose groups for their political advertisements. It then tested the presumption under the second prong of "strict scrutiny," summarizing its reasoning as follows:

> Accordingly, we conclude that the presumption in *§18215(b)(1)* is narrowly tailored. To be narrowly tailored, a statute need not be the least restrictive means of furthering the government's interests, but the restriction may not burden substantially more speech than necessary to further the interests. (Citation and internal quotation marks omitted.). California has demonstrated why other alternatives fail to advance its compelling informational interest. Moreover, as interpreted by California, *§ 18215(b)(1)* does not burden substantially more speech than necessary and serves to advance the compelling informational interest. (507 F.3d at 1186.)

In 2010, the Ninth Circuit reconsidered this analysis *sua sponte*, and found it had erred in applying "strict scrutiny" in both "*ProLife*" cases (denominated *CPLC I* and *CPLC II*) in *Human Life of Washington, Inc. v. Brumsickle, et al.*, 624 F. 3d 990 (9th Cir. 2010), concluding an extended discussion as follows:

> Since *CPLC–II* was decided, the Supreme Court has made clear that exacting scrutiny, not strict scrutiny, is applicable to campaign finance disclosure requirements. *See Reed*, 130 S. Ct. at 1288; *Citizens United*, 130 S. Ct. at 914. In light of this intervening Supreme Court authority, it is clear that *CPLC–II* set the bar too high in applying strict scrutiny. (624 F.3d at 1013.)

Regulation 18215(b)(1) stands on an exceptionally sound footing. That footing will become stronger, not weaker, if the Commission approves a reporting rule requiring disclosure of contributors on actual notice *before* reporting presumptive contributors, and making it abundantly clear that no other donor may be treated as having made a "contribution." In so doing the Commission will reject an unwarranted interpretation of the *Rherig* Advice Letter, urged by members of the regulated community who would disregard the definition of "contribution" to secure the "flexibility" of looking to other sources of income when they wish to avoid identifying persons whose payments actually are "contributions."

Regulation 18412 will codify prior advice – and the understanding of the Ninth Circuit – in expressly stating that the presumption is rebuttable. But to say the presumption is "rebuttable" is not to say it is "optional." The Ninth Circuit understood that what is presumed here is that a donor to a multi-purpose group has "reason to know" once the group has made a contribution or expenditure that his or her money may be used to fund a similar expenditure. The presumption may not be rebutted by a group's mere belief or suspicion that its donor might not have actually known about the group's prior action; that would reduce the presumption to a reporting option.

Instead, the proposed rule requires that a group must have some affirmative evidence "clearly establishing" the donor did *not* intend the payment to be used by the group to make a campaign expenditure. Such evidence would typically be a writing indicating the donor's wish that the payment not be used to fund a political campaign. Staff is confident that multi-purpose groups have the means to obtain such evidence from donors who desire to limit the use of their funds to non-political purposes.

In December the Commission also heard testimony on "timing" difficulties inherent in reporting contributors identified by Regulation 18215(b)(1). The proposed regulations add no difficulties not present for the past 30 years, but staff believes subdivision (e)(4)(1) may be useful in expressly linking dates of receipt (of contributions) to the dates of expenditures funded by them. Otherwise, multi-purpose groups need to keep track of just one thing not routinely tracked by every reporting committee: the date of the expenditure that constitutes the "first bite."

The Commission was asked to exempt 501(c)(3) groups from the proposed regulations, on the ground that these non-profits are not permitted under federal law to spend tax-free funds for political purposes. To the extent they make no contributions or independent expenditures to influence election campaigns in California, these groups are not subject to the proposed rules. But there is reason to believe that some 501(c)(3) groups, whether directly or through controlled 501(c)(4) proxies, do engage in such spending, and California has a right to demand that they comply with California law, whether or not federal authorities are willing or able to prosecute them for offences under the tax code.

There were also calls in December for codification of specific circumstances that would identify those who have "reason to know" (or the opposite) under Regulation 18215(b)(1). But after much thought staff has concluded that the multiplication of "scenarios" defining such circumstances can only create new boundaries that add further ambiguities, a particular problem given the near-limitless diversity of multi-purpose groups in organization, makeup, history, donor populations, goals, and other characteristics. *All* donors to such groups have "reason to know" the use to which their gifts may be put after a group has begun to spend donor resources to influence election campaigns. The proposed regulation states that the presumption is rebuttable upon a showing of some fact or circumstance clearly indicating the donor actually lacked such knowledge or intent. Commission staff can provide advice to any group with questions on truly marginal evidence.

Conclusion

As far as possible given the variety of non-profit multi-purpose groups, all of which have duties of diligence in observing the requirements of both federal and state law, staff's proposals identify the persons these groups must report as "contributors" to the groups' campaign spending in California. Staff believes its proposals strike a sensible balance between the requirements of disclosure statutes and regulations in place for decades, and the right to support these non-profit groups with minimal burdens on their election-related spending.