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Politics, Disclosure, and State Law Solutions for 501(c)(4) Organizations

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POLITICS, DISCLOSURE, AND STATE LAW SOLUTIONS FOR
501(C)(4) ORGANIZATIONS

LINDA SUGIN*

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I. INTRODUCTION

In 2013, the Internal Revenue Service (IRS) suffered its worst scandal in a generation over its treatment of tea-party related organizations.¹ Some of the facts are undisputed: Following the Supreme Court's 2010 *Citizens United* decision,² people rushed to organize section 501(c)(4) organizations that would be active in politics.³ The IRS was overwhelmed by applications, and the regulatory standard provided little guidance.⁴ The agents, who were not lawyers, used a shorthand to identify organizations that might not meet the standard of being "operated exclusively for the promotion of social welfare."⁵ The Treasury watchdog found that "[t]he IRS used inappropriate criteria that identified for review Tea Party and other organizations applying for tax-exempt status based upon their names or policy positions."⁶ Instead of identifying possible ineligible organizations by their names (including "Patriots" and "9/12"), the IRS should have determined eligibility for exemption by analyzing whether the organizations satisfied the regulatory requirements concerning political activity.⁷ Since that time, the IRS has been paralyzed in this area, and the Federal Election Commission has been deadlocked.⁸

The post-*Citizens United* explosion of (c)(4) political activity—and the federal government's dysfunction—did not go unnoticed by the states.⁹ While the federal government was at an impasse, some states attempted to bridge the gap.¹⁰ Federal law determines tax exemption, but state law defines charitable and noncharitable nonprofit organiza-

1. For a comprehensive and excellent discussion of the incident and its aftermath, see Evelyn Brody & Marcus Owens, *Exile to Main Street: The I.R.S.'s Diminished Role in Overseeing Tax-Exempt Organizations*, 91 CHI.-KENT L. REV. 859 (2016).

2. *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

3. Sean Sullivan, *What is a 501(c)(4), Anyway?*, WASH. POST (May 13, 2013), <https://www.washingtonpost.com/news/the-fix/wp/2013/05/13/what-is-a-501c4-anyway/>.

4. Brad Plumer, *How is the IRS Supposed to Vet 501(c)(4) Groups, Anyway?*, WASH. POST (May 14, 2013), <https://www.washingtonpost.com/news/wonk/wp/2013/05/14/lets-back-up-how-is-the-irs-supposed-to-scrutinize-501c4s-anyway/>.

5. *See id.*; I.R.C. § 501(c)(4) (2014).

6. TREASURY INSPECTOR GEN. FOR TAX ADMIN., INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW (2013), <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf>.

7. *Id.* at 5.

8. *See* Eric Lichtblau, *F.E.C. Can't Curb 2016 Election Abuse, Commission Chief Says*, N.Y. TIMES (May 2, 2015), <http://www.nytimes.com/2015/05/03/us/politics/fec-cant-curb-2016-election-abuse-commission-chief-says.html>.

9. *See infra* Part III.

10. *See infra* Part III.

tions and regulates their governance.¹¹ If nonprofit organizations are operated to the detriment of the public interest, state attorneys general have the power to investigate and discipline them.¹² New York and California have both attempted to address the same concerns about secret money in politics that led to the IRS scandal and proposed regulations.¹³

This article asks whether the states can (and should) use state nonprofits law to solve the problem of dark money spent by nonprofit non-charitable organizations. Since the problem of (c)(4) politicking is not a revenue issue,¹⁴ the Internal Revenue Service is clearly not the ideal regulator. Dark money may be *solely* an election law problem, in which case it would be exclusively in the domain of the FEC and state election regulators, and not in the purview of state nonprofits law. However, if there are concerns about nonprofit organizations in politics that implicate the policies relating to nonprofits, there might be something beyond election law at issue that state nonprofit law might address.

There are three reasons why state charity regulators might intervene in this area: (1) to protect charities, (2) to protect voters, and (3) to protect donors to nonprofit organizations.¹⁵ If dark money is damaging the reputation and integrity of the nonprofit sector as a whole, states may legitimately regulate noncharitable nonprofits to *protect charities* from negative consequences.¹⁶ The general public seems to confuse 501(c)(3) with 501(c)(4) organizations, failing to appreciate their legal distinction.¹⁷ Consequently, states have an interest in pre-

11. See, e.g., *Applying for Exemption – Difference Between Nonprofit and Tax-Exempt Status*, INTERNAL REVENUE SERV., <https://www.irs.gov/Charities-&-Non-Profits/Applying-for-Exemption-Difference-Between-Nonprofit-and-Tax-Exempt-Status> (last visited Mar. 16, 2016).

12. See, e.g., CAL. GOV'T CODE §§ 12580-12599.8 (West 2016).

13. See *infra* Part III. Neither of the state rules has yet been tested in the courts for constitutionality. However, California has been litigating to compel confidential disclosure—to the AG only and not the public—of donors to organizations associated with the Koch brothers. *Americans for Prosperity Found. v. Harris*, No. 2:14-cv-9448-R-FFM, 2015 WL 769778, at *1 (C.D. Cal. Feb. 23, 2015), *vacated*, 809 F.3d 536 (9th Cir. 2015). The state recently prevailed in a preliminary injunction involving a (c)(3) organization. *Ctr. for Competitive Politics v. Harris*, 784 F.3d 1307 (9th Cir. 2015).

14. Roger Colinvaux, *Political Activity Limits and Tax Exemption: A Gordian's Knot*, 34 VA. TAX REV. 1, 3 (2014) (“Political activity is about speech, and taxation is about raising revenue. They do not seem directly connected.”).

15. See *infra* Sections IV, V.

16. See *infra* Sections IV.D, V.A.4.

17. See, e.g., Matt Bernius, *501(c)4 vs 501(c)3 vs 527*, OUTSIDE THE BELTWAY (May 16, 2013), <http://www.outsidethebeltway.com/501c4-vs-501c3-vs-527/>; cf. TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 6.

venting reputational damage to charitable organizations on account of bad behavior by noncharitable nonprofit organizations. In addition, states may be justified in regulating politicking nonprofits to protect the public itself, either *as donors* or *as voters*.¹⁸ Much of state nonprofit law is designed to protect donors,¹⁹ so if regulating political speech is designed to protect donors who might unwittingly support political activity, then state nonprofits regulators are in a familiar institutional role. Donor confusion is understandable since 501(c)(4) organizations are categorized as “social welfare” organizations; donors may reasonably expect that their donations support social welfare activities, rather than politicking.

The final state policy, protecting the public *as voters*, veers away from nonprofits law into clear election law territory. Nevertheless, state attorneys general have an interest in preventing the public from being misled.²⁰ State nonprofits law is already concerned with preventing fraud perpetrated by bogus charities and unscrupulous solicitors. If it is fraudulent to pretend to be someone else or to speak anonymously in a political communication, then nonprofit regulators might approach the problem as analogous to charitable solicitation. Both political campaign activity and charitable solicitations raise First Amendment issues. The Supreme Court has repeatedly struck down statutory limits on charitable solicitation under the First Amendment,²¹ but it has allowed states to prosecute charitable fundraisers for misleading potential donors.²²

This article proceeds as follows: The next Part provides a brief background to the current situation and explains why federal tax law is not the appropriate locus of regulation. After that, I describe the steps that California and New York have taken to reduce the influence of dark money in their elections. Both states were motivated by specific incidents involving out-of-state interests, and both states faced substantial pressures from constituencies opposed to regulation. Part IV considers possible state law policies for regulating dark money, and Part V considers the regulatory solutions that correspond to those pol-

18. See *infra* Sections IV.C, E, V.A.2-3.

19. Usually, the donors are to charities, since state law carefully regulates the use of charitable gifts by organizations receiving them.

20. See *infra* Section IV.C.

21. See *Riley v. Nat'l Fed'n of the Blind of N.C., Inc.*, 487 U.S. 781 (1988); *Sec'y of State of Md. v. Joseph H. Munson Co.*, 467 U.S. 947 (1984); *Vill. of Schaumburg v. Citizens for a Better Env't*, 444 U.S. 620 (1980).

22. See *Ill. ex rel. Madigan v. Telemarketing Assocs., Inc.*, 538 U.S. 600 (2003).

icies. Part VI steps back to assess the desirability of state nonprofit law regulation, considering the legal and practical problems with states undertaking this regulation. Although the states can achieve some important goals, the conclusion in Part VII expresses skepticism at the states' ability to solve the (c)(4) politicking mess.

II. DARK MONEY IN POLITICS IS NOT A FEDERAL TAX PROBLEM

A. Tax Exemption is Not the Issue

It is curious that federal tax law is the focus of attention for dark money in politics, given that there is no revenue at stake.²³ Openly political organizations (like Political Action Committees) are exempt from tax, as are social welfare organizations and other 501(c) non-charitable nonprofits.²⁴ The problem is not a tax problem because it does not involve policing what should be taxed and what shouldn't be taxed; the same questions about dark money in politics would arise regardless of an organization's tax status.²⁵ Nobody is suggesting that the IRS increase oversight in order to collect more tax, and the legal structure governing exempt organizations under the tax law may be too weak to support substantial regulation of political speech.

The dark money problem may have exploded recently, but section 501(c)(4) has been part of the income tax since 1913.²⁶ That section exempts civic leagues, employees' organizations, and social welfare organizations from tax. Tax exemption means that income earned by an organization is not subject to (corporate) tax.²⁷ But if an organization has no income, it receives no economic benefit from tax exemption, so 501(c)(4) is not financially significant for organizations without endowments. Deductibility of donor contributions is generally more valuable than an organization's own exemption from tax,²⁸ but

23. See Colinvaux, *supra* note 14.

24. I.R.C. §§ 501, 527 (2014).

25. See Donald B. Tobin, *Citizens United and Taxable Entities: Will Taxable Entities Be the New Stealth Dark Money Campaign Organizations?*, 49 VAL. U. L. REV. 583, 595 (2015) ("If Congress, the Treasury or the Service successfully reforms the current structure to ensure donor disclosure by tax-exempt groups, [independent groups] may simply reorganize as taxable entities and seek ways to limit their tax liability."); Colinvaux, *supra* note 14, at 5.

26. Daniel C. Kirby, Note, *The Legal Quagmire of IRC § 501(c)(4) Organizations and the Consequential Rise of Dark Money in Elections*, 90 CHI.-KENT L. REV. 223, 226 (2015).

27. DONALD B. TOBIN, FAQ'S ON 501(c)(4) SOCIAL WELFARE ORGANIZATIONS 2 (May 20, 2013), http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=2491&context=fac_pubs.

28. Section 501(c)(3) organizations are eligible to receive deductible contributions. That deduction is worth real money to donors—up to the amount of the contribution multiplied by the donor's marginal tax rate. See I.R.C. § 170 (2014).

since section 501(c)(4) organizations are not charities, they are not eligible to receive tax-deductible contributions.²⁹ Donors to a (c)(4) organization must use after-tax dollars to make gifts.³⁰

Unchanged since 1959, the regulations under section 501(c)(4) provide that an organization is eligible for exemption only “if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.”³¹ While not defining precisely what constitutes the promotion of welfare, the regulations explicitly carve out political campaign activity. They provide that “the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”³² The precise contours of what constitutes participation in a political campaign have never been drawn.³³

Before *Citizens United*, there was not much pressure on the (c)(4) definition because election law limitations made (c)(4) organizations an ineffective tool for politicking.³⁴ Electioneering activities were generally placed in another type of exempt organization—section 527 political organizations.³⁵ From a tax perspective, there is little difference between an organization covered by section 527 and one covered by section 501(c)(4)—they are both tax-exempt.³⁶ But there is an important practical and political difference because the identity of donors to (c)(4) organizations remains secret, while donors to 527 organizations are publicly disclosed.³⁷

The Tea Party scandal illuminated the problem that had been long ignored in the 501(c)(4) regulations. The standard was too vague, and low-level employees in the IRS had to exercise discretion in making the required determination.³⁸ A tighter definition for “social welfare”

29. See TOBIN, *supra* note 27, at 6.

30. See *id.*

31. Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (as amended in 1990).

32. *Id.* § 1.501(c)(4)-1(a)(2)(ii).

33. See Kirby, *supra* note 26, at 228.

34. See Colinvaux, *supra* note 14, at 23.

35. See *id.*

36. There are differences in the exemptions for 501(c)(4) orgs and 527 orgs, but the key point for our purposes is that they are both largely tax-exempt.

37. I.R.C. § 527(j) (2014).

38. See Fredreka Schouten & Gregory Korte, *IRS Apologizes for Targeting Conservative Groups*, USA TODAY (May 12, 2013), <http://www.usatoday.com/story/news/politics/2013/05/10/irs-apology-conservative-groups-2012-election/2149939/>.

would provide greater consistency and prevent partisan preference in application. So, in December 2013, the Treasury proposed regulations: “Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities.”³⁹ The regulations attempted to draw bright lines, replacing the facts and circumstances approach in place.⁴⁰ Compared to prior practice, they arguably enlarged the category of candidate-related political activities.⁴¹ If they had been implemented, 501(c)(4) organizations would be allowed to engage in candidate-related activities,⁴² but (like before) those activities would not constitute promotion of social welfare, so could not constitute an organization’s primary activity.⁴³

Like all tax regulations, the proposed regulations invited comments.⁴⁴ The IRS received over 160,000 of them—more than had ever been received on a notice of proposed rulemaking about anything!⁴⁵ Comments from all over the political spectrum criticized the rules on First Amendment grounds for effectively limiting the political speech in which (c)(4) organizations could engage.⁴⁶ In response to the barrage, the Treasury withdrew the regulations.⁴⁷ Though the government claims to be working on revising them, nobody expects new regulations any time soon (or possibly ever), and the IRS has announced that it will not issue new guidance prior to the 2016 presidential election.⁴⁸

39. Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

40. *Id.* at 71,536-37.

41. *Id.* at 71,538 (“The Treasury Department and the IRS recognize that the approach taken in these proposed regulations, while clearer, may be both more restrictive and more permissive than the current approach . . .”).

42. See Treasury, *IRS Will Issue Proposed Guidance for Tax-Exempt Social Welfare Organizations*, INTERNAL REVENUE SERV. (Nov. 26, 2013), <https://www.irs.gov/uac/Newsroom/Treasury-IRS-Will-Issue-Proposed-Guidance-for-Tax-Exempt-Social-Welfare-Organizations>.

43. John D. McKinnon et al., *IRS Moves to Restrict Nonprofits’ Politicking*, WALL ST. J. (Nov. 26, 2013), <http://www.wsj.com/articles/SB10001424052702304465604579222110598111076>.

44. Kirby, *supra* note 26, at 235.

45. *Id.*

46. *Liberals vs. the IRS*, WALL ST. J. (Feb 25, 2014), <http://www.wsj.com/articles/SB10001424052702303704304579382983945174994>; Carl Hulse, *Left and Right Object to I.R.S. Plan to Restrict Nonprofits’ Political Activity*, N.Y. TIMES (Feb. 12, 2014), <http://www.nytimes.com/2014/02/13/us/politics/both-sides-object-to-irs-plan-to-restrict-nonprofits-political-activity.html>.

47. *IRS Update on the Proposed New Regulation on 501(c)(4) Organizations*, INTERNAL REVENUE SERV. (May 22, 2014), [https://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501\(c\)\(4\)-Organizations](https://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations).

48. Eric Lichtblau, *I.R.S. Expected to Stand Aside as Nonprofits Increase Role in 2016 Race*, N.Y. TIMES (July 5, 2015), <http://www.nytimes.com/2015/07/06/us/politics/irs-expected-to-stand-aside-as-nonprofits-increase-role-in-2016-race.html>.

B. Federal Tax Law is Legally Weak

Even if the IRS manages to reissue regulations, the regulatory route is problematic because hanging restrictions on the privilege of exemption is a dubious strategy. As a matter of legal power, the states may be a first-best solution to the dark money problem if federal regulation depends on conditioning a tax-based subsidy to regulated organizations.⁴⁹ Federal power is generally more circumscribed than state power, and if the power to regulate the political activity of (c)(4) organizations derives from the tax subsidy in their exemption, the power is tenuous. The IRS is primarily responsible for regulating the borders of tax exemption, but the states can regulate more expansively because they do not need to seize on the thread of subsidy to justify their regulation. The states have broad authority to regulate to protect citizens and prevent fraud; they have plenary power to legislate in the public interest.

Unlike the regulation of charities, there is no justification for political restrictions on (c)(4) organizations connected to a deduction for contributions (since there is no deduction).⁵⁰ The federal government has done a reasonably effective job limiting the political influence of charitable organizations by linking limitations to eligibility under section 501(c)(3). Qualification for exemption as a charitable organization under section 501(c)(3) depends on an organization completely abstaining from political campaigns, and lobbying only if it does not constitute a substantial part of the charity's activities.⁵¹ The Supreme Court has upheld these restrictions in section 501(c)(3) despite their burden on political speech.⁵² It adopted the theory that the charitable deduction is a subsidy that can be conditioned as long as there are opportunities for unsubsidized speech by the same speakers.⁵³ In its most expansive embrace of tax expenditure analysis, the Court stated:

Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much

49. See Roger Colinvaux, *Regulation of Political Organizations and the Red Herring of Tax Exempt Status*, 59 NAT'L TAX J. 531, 532 (2006) ("The notion of a tax subsidy was important . . . in that the provision of a subsidy by Congress . . . justified the imposition of a restriction on a fundamental right—freedom of speech in the form of lobbying.").

50. See *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 543–44 (1983).

51. I.R.C. § 501(c)(3) (2014) ("No substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . and which 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.").

52. *Regan*, 461 U.S. at 550.

53. *Id.* at 543–44.

the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contributions. . . . In short, Congress chose not to subsidize lobbying as extensively as it chose to subsidize other activities that non-profit organizations undertake to promote the public welfare.⁵⁴

Although Justice Rehnquist described both exemption and deduction as subsidies, exemption is only a subsidy for a subset of organizations. While the deduction for contributions is always valuable, organizations with no endowment, no unrelated activities and no investment income enjoy little or no subsidy on account of their own exemption.⁵⁵ Only organizations entitled to receive deductible contributions clearly receive a subsidy compelling enough to justify restricting speech.

Noncharitable exempt organizations enjoy very minimal or no subsidy from the exemption,⁵⁶ so hanging First Amendment restrictions on that subsidy seems a burden mere exemption cannot support. The legal regime that governs nonprofit organizations should not be so precarious that a court's rejection of the subsidy approach leaves the field entirely unregulated.⁵⁷ For these reasons, state nonprofit regulation appears to be on firmer legal footing than federal tax regulation. The states are well within their traditional authority to regulate for the protection of voters, donors and charities. Can the states save the day?

54. *Id.* at 544.

55. See Daniel Halperin, *The Tax Exemption Under Section 501(c)(4) 1-2* (Urban Inst., Tax Policy and Charities Project Working Paper, 2014), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/413152-The-Tax-Exemption-Under-Section-c.PDF>.) ("For charities I determined that a significant subsidy exists only with respect to the exemption for income from unrelated investments and with respect to the treatment of income from related activities used for capital expenditures, such as buildings . . ."); Daniel Halperin, *Is Income Tax Exemption for Charities a Subsidy?*, 64 TAX L. REV. 283, 284-85 (2011) ("Income tax exemption, in most circumstances, will affect only the relative cost of setting aside funds for the future as compared to providing current benefits. It will not seriously concern those organizations that spend nearly all their funds on current activities.")

56. See Colinvaux, *supra* note 14, at 36.

57. See Marcus S. Owens, *Charity Oversight: An Alternative Approach*, COLUM. UNIV. ACAD. COMMONS (2013), <http://dx.doi.org/10.7916/D8154F1D> (detailing other limitations of IRS based oversight of tax-exempt organizations and suggesting a self-regulatory approach instead).

III. WHAT HAVE THE STATES DONE?: CALIFORNIA AND NEW YORK

A. California

In 2014, California adopted the most expansive disclosure requirements for nonprofits engaged in politicking.⁵⁸ Those rules require “multipurpose organizations”—a category that includes (c)(4) organizations—to disclose the organization’s donors in a mandatory state filing.⁵⁹ The state explained that “the disclosure of donors provides voters with vital information on who is funding campaigns, increases transparency to deter actual or perceived corruption, and is an important means of gathering information to detect possible violations.”⁶⁰ California’s legislation was enacted in response to an incident involving out-of-state money intended to influence two California ballot initiatives.⁶¹ The out-of-state group, Americans for Responsible Leadership (ARL), had received \$18 million from the Center to Protect Patient Rights, another nonprofit organization, and contributed \$11 million to a California PAC for the purpose of influencing the outcome of the referenda.⁶² California’s campaign finance regulator, the Fair Political Practices Commission, eventually imposed a \$1 million fine on ARL for campaign money laundering,⁶³ but California law in place at the time did not require that the chain of organizations disclose the ultimate funders.

The new rules apply to expenditures connected to candidates for office and to ballot measures, which are widely used in California. Under the revised law, donors to nonprofit organizations who contribute

58. S.B. 27, 2014 Leg., Reg. Sess. (Cal. 2014).

59. CAL. GOV’T CODE § 84222 (West 2014); CAL. CODE REGS. tit. 2, § 18422 (2014).

60. CAL. FAIR POLITICAL PRACTICES COMM’N, MULTIPURPOSE ORGANIZATIONS REPORTING POLITICAL SPENDING 1 (2014), <http://www.fppc.ca.gov/content/dam/fppc/NS-Documents/TAD/Campaign%20Documents/Multipurpose%20Organizations.pdf>.

61. California was prompted largely by an Arizona group’s \$11 million donation in 2013 to a California campaign committee, which used the money to oppose a tax-hike measure and support another ballot initiative that was intended to curb unions’ political fundraising. Kathleen Gerber, *Proposed Legislation Would Require Nonprofit Organizations Participating in California Political Campaigns to Disclose the Identity of Their Donors*, MONDAQ (Jan. 4, 2013), <http://www.mondaq.com/unitedstates/x/214542/Charities+Non-Prof->

[its/Proposed+Legislation+Would+Require+Nonprofit+Organizations+Participating+In+California+Political+Campaigns+To+Disclose+The+Identity+Of+Their+Donors](http://www.mondaq.com/unitedstates/x/214542/Charities+Non-Prof-its/Proposed+Legislation+Would+Require+Nonprofit+Organizations+Participating+In+California+Political+Campaigns+To+Disclose+The+Identity+Of+Their+Donors).

62. Patrick Ford, *Chapter 16: Combating Dark Money in California Politics*, 46 MCGEORGE L. REV. 335, 339–40 (2014).

63. Chris Megerian & Anthony York, *California Fines Groups \$16 Million for Funneling Money to Campaigns*, L.A. TIMES (Oct. 25, 2013), <http://articles.latimes.com/2013/oct/25/local/la-me-secret-money-20131025>.

for the purpose of political spending must be identified if they contribute \$100 or more to a political solicitation by an organization.⁶⁴ Donors who give to organizations without explicitly supporting political activities are also potentially subject to identification because social welfare organizations that spend some of their money on political expenditures must identify donors giving at least \$1000, even if those donors did not specifically donate for the purpose of political spending. California's new rules require that exempt organizations identify themselves as such, distinguishing their filings from those of political committees, and thereby allowing the state to separately track the role of nonprofits in political campaign activity.⁶⁵ Perhaps most importantly, California's new law attempts to follow the daisy chain of contributions from one exempt organization to another, and requires disclosure by each organization in the chain, frustrating donors' attempts to hide their identity by transferring funds through a convoluted web of nonprofits. Donations of \$50,000 from one organization to another trigger notification requirements that may lead to donor disclosure by a contributing organization.⁶⁶

Because the impetus for the amendments to California's law was a daisy chain of dark money through nonprofit organizations, the new rules are designed to require donor disclosure in that circumstance as a primary purpose.⁶⁷ The law expanded the scope of existing campaign finance law—which required donor disclosure in some circumstances—to explicitly include “multipurpose organizations” such as 501(c)(4) social welfare organizations.⁶⁸ Nonprofit organizations are

64. The California statute applies to what it calls “multipurpose organizations,” a category that includes more than just 501(c)(4) organizations, but (c)(4)s make up a large portion of the most active political players within that definition. See Gov'T § 84222(a) (“For purposes of this title, ‘multipurpose organization’ means an organization described in Sections 501(c)(3) to 501(c)(10), inclusive, of the Internal Revenue Code and that is exempt from taxation under Section 501(a) of the Internal Revenue Code, a federal or out-of-state political organization, a trade association, a professional association, a civic organization, a religious organization, a fraternal society, an educational institution, or any other association or group of persons acting in concert, that is operating for purposes other than making contributions or expenditures. ‘Multipurpose organization’ does not include a business entity, an individual, or a federal candidate’s authorized committee, as defined in Section 431 of Title 2 of the United States Code, that is registered and filing reports pursuant to the Federal Election Campaign Act of 1971.”).

65. See CAL. FAIR POLITICAL PRACTICES COMM’N, FORM 410: STATEMENT OF ORGANIZATION (2016), <http://www.fppc.ca.gov/content/dam/fppc/NS-Documents/TAD/Campaign%20Forms/410.pdf>; see also Gov'T § 84222(e)(1)(A) (“The statement of organization filed pursuant to Section 84101 shall indicate that the organization is filing pursuant to this section as a multipurpose organization and state the organization’s nonprofit tax exempt status, if any.”).

66. Gov'T § 84222(c)(5).

67. See CAL. FAIR POLITICAL PRACTICES COMM’N, *supra* note 60.

68. Gov'T § 84222(a).

now required to report their political expenditures and the sources of those funds, even though they are not required to report their other (i.e. non-political) expenditures or the sources of those funds.⁶⁹ Expenditures of \$50,000 in one year or \$100,000 over four years trigger the reporting requirements.⁷⁰ Organizations must use a last-in-first-out method to identify donors supporting political activities, so that the organization's most recent donors are deemed to have paid for politicking activities; only donors who contribute \$1000 or more must be identified.⁷¹ Donors who indicate that none of their contributions may be used for political purposes are exempt from disclosure.⁷²

The California law's sponsor stated that "[l]aundering campaign cash through nonprofits to hide one's true identity will no longer be possible in California after my bill is enacted."⁷³ To that end, the new law provides that ballot measure committees and state candidate independent expenditure committees that have raised \$1 million or more must provide top 10 contributor lists for posting online.⁷⁴ While the new law includes broad reporting and disclosure requirements, only this provision makes clear that the objective is *public* disclosure that is readily available to ordinary voters, rather than disclosure to the state authorities.

Section 1 of the senate bill set out the state's purposes in adopting the amendments, which map onto the state's interest in regulation. If these interests are compelling, then the statute will withstand a First Amendment challenge to the disclosure regime. The bill states that disclosure of donors "provides the electorate with information as to where campaign money comes from,"⁷⁵ "deters actual corruption and avoids the appearance of corruption by providing increased transparency of contributions and expenditures,"⁷⁶ and helps the state to gath-

69. Gov'T § 84222; CAL. CODE REGS. tit. 2, § 18422 (2014).

70. Gov'T § 84222(c)(5).

71. *Id.* § 84222(e)(2), (g).

72. *Id.* § 84222(e)(2).

73. Brian Joseph, *O.C. Senator Introduces Bill to Illuminate 'Dark Money'*, ORANGE COUNTY REG. (Dec. 4, 2012), <http://www.ocregister.com/taxdollars/strong-478977-http-href.html> (statement by Orange County state Senator Lou Correa).

74. Gov'T § 84223(a) ("A committee primarily formed to support or oppose a state ballot measure or state candidate that raises one million dollars (\$1,000,000) or more for an election shall maintain an accurate list of the committee's top 10 contributors, as specified by Commission regulations. A current list of the top 10 contributors shall be provided to the Commission for disclosure on the Commission's Internet Web site . . .").

75. S.B. 27, 2014 Leg., Reg. Sess. § 1(c)(1) (Cal. 2014).

76. *Id.* § 1(c)(2).

er “the information necessary to detect violations of the Political Reform Act of 1974.”⁷⁷

While these new rules have not yet been tested in court, California has been involved in litigation over the anonymity of donors under other regulations that require charitable organizations registered in California to disclose their major donors to the Attorney General. In a decision that might foreshadow litigation involving the new regulations for (c)(4) organizations involved in political activities, the Ninth Circuit held for the state in an action brought by an out-of-state 501(c)(3) educational organization attempting to avoid donor disclosure on free association grounds.⁷⁸ The court held: “no case has ever held or implied that a disclosure requirement in and of itself constitutes First Amendment injury.”⁷⁹ The regulation at issue in the (c)(3) case required disclosure to the Attorney General, and not to the public, but the court rejected the organization’s argument that federal non-disclosure of Schedule B to Form 990 prohibited California from demanding that information. There was no evidence in the case that donors to the organization would suffer negative repercussions from complying with the California regulation.

B. New York

In June 2013, New York adopted regulations requiring disclosure by noncharitable nonprofit organizations that participate in elections.⁸⁰ The regulations required reporting of the percentage of an organization’s expenditures devoted to political campaigns, and mandated public disclosure of contributors in connection with New York elections, to be posted on the Attorney General’s website. Like California, New York State became concerned about spending by out-of-state social welfare organizations in New York elections.⁸¹ “In New York, a 501(c)(4) called Common Sense Principles, based in Richmond, Virginia, sent a slew of mailers to many voters attacking three state senate

77. *Id.* § 1(c)(3).

78. *Ctr. for Competitive Politics v. Harris*, 784 F.3d 1307 (9th Cir. 2015).

79. *Id.* at 1316.

80. N.Y. COMP. CODES R. & REGS. tit. 13, § 91.6 (repealed 2014).

81. *See, e.g.*, Eliza Newlin Carney, *States Target Politically Active Nonprofits*, ROLL CALL (Jan. 3, 2013), http://www.rollcall.com/news/states_target_politically_active_nonprofits-220544-1.html; Nicholas Confessore, *Attorney General Seeks to Force Disclosure of More Political Donors*, N.Y. TIMES (Dec. 11, 2012), <http://www.nytimes.com/2012/12/12/nyregion/new-york-attorney-general-seeks-to-expose-more-political-donors.html>.

candidates.”⁸² In the summer of 2012, Attorney General Eric Schneiderman sent letters to politically active nonprofits including Crossroads GPS, American Action Network, and American Bridge 21st Century Foundation, requesting internal financial documents.⁸³ Shortly thereafter, he announced proposed regulations that would require exempt organizations registered in New York to disclose certain expenditures and identify donors.⁸⁴

The regulations explicitly excluded section 501(c)(3) organizations, and were targeted to non-501(c)(3) organizations registered with the Attorney General (i.e. noncharitable nonprofits).⁸⁵ They were designed to be a part of the regulation of nonprofits, rather than the regulation of campaign finance more generally, or the regulation of public integrity, which New York had previously addressed in other legislation.⁸⁶ The Attorney General’s reason for the regulations included (1) protecting prospective donors from misleading solicitations, (2) giving voters more information about who is behind ads, and (3) protecting the reputation of nonprofit organizations, including charities.⁸⁷

Adopted in June 2013,⁸⁸ the regulations required any tax exempt organization registered in New York to disclose the total dollar amount of election-related expenditures (including state, local, federal, and out of state elections) as well as what percentage those expenditures are of total expenditures made by the organization.⁸⁹ In addition, any organization spending more than \$10,000 on New York elections would be required to disclose the recipients of all expenditures greater than \$50

82. David Earley, Counsel, Democracy Program, Brennan Ctr. for Justice at N.Y. Univ. Sch. of Law, Testimony on New York Attorney General Eric Schneiderman’s Proposed Regulations Regarding Political Spending by Nonprofit Organizations (Jan. 15, 2013), <https://www.brennancenter.org/analysis/testimony-new-york-ags-proposed-regulations-political-spending-nonprofits>.

83. Carney, *supra* note 81.

84. Press Release, Eric T. Schneiderman, Attorney Gen., N.Y. State Office of the Attorney Gen., A.G. Schneiderman Announces New Disclosure Requirements For Nonprofits That Engage In Electioneering (Dec. 12, 2012); Contents of Annual Financial Reports Filed with the Attorney General by Certain Nonprofits, 34 N.Y. Reg. 29 (Dec. 26, 2012) (proposed rule making).

85. See tit. 13, § 91.6(a)(2) (definition of covered organization).

86. See Public Integrity Reform Act of 2011, ch. 399, 2011 N.Y. Sess. Laws 5679 (McKinney); Press Release, Andrew M. Cuomo, Governor of N.Y., Governor Cuomo Signs Ethics Reform Legislation (Aug. 15, 2011), <http://www.governor.ny.gov/press/08152011EthicsReformLegislation>. The lack of coordination between these rules is dizzying.

87. Press Release, Eric T. Schneiderman, Attorney Gen., N.Y. State Office of the Attorney Gen., A.G. Schneiderman Adopts New Disclosure Requirements For Nonprofits That Engage In Electioneering (June 5, 2013).

88. *Id.*

89. tit. 13, § 91.6(b)(1).

and also the name, address, and employer of donors giving \$1000 or more.⁹⁰ The New York rule provided that the information disclosed be made available on the Attorney General's website, with an exception from public disclosure on a showing of probability of harm.⁹¹ The non-profit regulations were soon preempted by campaign finance law developments.

New York's Governor Cuomo called for greater disclosure of contributions to and expenditures by all organizations, not just noncharitable nonprofits,⁹² so the nonprofits regulation was too narrow. Consequently, the state's Election Law was amended in June 2014 to require quick disclosure of contributions and expenditures made by a wide range of organizations, including noncharitable nonprofits.⁹³ The Attorney General immediately thereafter revoked the nonprofit rule as "largely redundant," somewhat "contradictory" and "burdensome" to organizations.⁹⁴ A new regulation on independent expenditures went into effect in January 2015 to implement the Election Law.⁹⁵ It requires registration by organizations making independent expenditures, defined (in part) by a set of factors.⁹⁶ Registrant organizations must now disclose contributions of \$1,000 or more and expenditures of \$5,000 or more to the Board of Elections.⁹⁷

90. *Id.* § 91.6(b)(2)-(c)(1).

91. *Id.* § 91.6(g)-(h).

92. Amy Hamilton, *New York Governor Proposes Tax-Free 'Hot Spots,' Tougher Disclosure Law*, TAXNOTES (Jan. 10, 2013), <http://www.taxnotes.com/state-tax-today/corporate-taxation/new-york-governor-proposes-tax-free-hot-spots-tougher-disclosure-law/2013/01/10/88896> ("[C]ontributions of more than \$500 to a political action committee, a lobbying 501(c)(3) organization or other 501(c) organization, or political party would be disclosed to the state within 48 hours, and within 24 hours near Election Day.").

93. N.Y. ELEC. LAW § 14-107 (McKinney 2015).

94. Eric T. Schneiderman, Attorney Gen., N.Y. State Office of the Attorney Gen., Certification on the Amendment to Part 91 of Title 13 of the Official Compilation of Codes, Rules and Regulations of the State of New York (July 31, 2014), http://www.charitiesnys.com/pdfs/91_6R_AG_Certification.pdf.

95. N.Y. COMP. CODES R. & REGS. tit. 9, § 6200.10 (2015).

96. *Id.* § 6200.10(b)(1)(i)(c)(2)(f) ("For purposes of determining whether or not a communication is advocating for or against a candidate or ballot proposal, the following factors shall be considered, but shall not be limited to: (A) Whether it identifies a particular candidate by name or other means such as party affiliation or distinctive features of a candidate's platform or biography; (B) Whether it expresses approval or disapproval for said candidate's positions or actions; (C) Whether it is part of an ongoing series by the group on the same issue and the series is not timed to an election; (D) Has the issue raised in the communication been raised as a distinguishing characteristic amongst the candidates; and (E) Whether its timing and the identification of the candidate are related to a non-electoral event (e.g., a vote on legislation or a position on legislation by an officeholder who is also a candidate). However, even if some of the above factors are found, the communication must still be considered in context before arriving at any conclusion.").

97. *Id.* § 6200.10(d).

Although the Attorney General's revocation notice for the non-profit regulation suggested that the new rule would achieve the same goals as the revoked rule, the two rules differ in important ways. Most essentially, the revoked rule was targeted to nonprofit organizations, and administered as part of the apparatus governing their activities in the state. The integrity of the nonprofit sector provided a clear backdrop to those rules, whereas the election law rules are more broadly applicable and connected to campaign finance regulation rather than nonprofit regulation. The content of the regulatory requirements also differ, and the nonprofit rules were arguably more rigorous. The Election Law's definition of reportable election-related activities covers a narrower range of advocacy than did the nonprofits regulation because it includes only communications that "refer to and advocate for or against" a candidate in a New York election, while the revoked rule included "election targeted issue advocacy" that clearly identified a candidate or political party.⁹⁸ The threshold for reporting spending is also substantially higher in the Election Law version than the nonprofit version (\$5,000 vs. \$50).

Most importantly, there is no provision in the Election Law regulations for public disclosure on the Attorney General's website. The state would have the reported information for enforcement purposes, but the general public would not be able to judge the content of a message by discovering which individuals or corporations paid for it. There is a public aspect to the required disclosure under the Election Law, but it is targeted to the political communications themselves, and fails to look behind an organization. The Election Law provision requires that communications include attributions so that the person who paid for a communication (such as a television ad) is identified.⁹⁹ That rule demands minimal real transparency because the identification of an organization with an opaque name reveals virtually no information about

98. N.Y. COMP. CODES R. & REGS. tit. 13, § 91.6(a)(7) (repealed 2014) ("Election targeted issue advocacy' (i) means any communication other than express election advocacy made within forty-five days before any primary election or ninety days before any general election that: (A) refers to one or more clearly identified candidates in that election; (B) depicts the name, image, likeness or voice of one or more clearly identified candidates in that election; or (C) refers to any clearly identified political party, constitutional amendment, proposition, referendum or other question submitted to the voters in that election.").

99. tit. 9, § 6200.10(g)(1) ("Whenever any person makes an Independent Expenditure that costs more than \$1,000 in the aggregate, such communication shall clearly state the name of the person who paid for or otherwise published or distributed the communication and state, with respect to communications regarding candidates, that the communication was not expressly authorized or requested by any candidate, or by any candidate's political committee or any of its agents (EL 14-107(2)).").

who is behind the communication. In fact, even the revoked New York rule could fail to provide meaningful information because a daisy chain of organizations can obscure the real backers. Neither iteration of New York's rule contains the look-through reporting obligations of the California rule.

IV. WHAT IS THE POLICY GOAL?

To evaluate state-law regulation, it is necessary to have a clear notion of the policy goals to be addressed. The inquiry here is two-fold: states must be compared to the federal government, and within state-law regulation, nonprofit law must be compared to state election law. The states might be a first-best solution for addressing the problems of dark money in politics if the regulatory policy goals are core state-law goals like preventing fraud and protecting charities or donors. But state solutions are still worth pursuing even if they are second-best alternatives if they can improve election integrity while the federal government is too dysfunctional to do anything in this area. This section explores possible state policy interests, and the next section maps regulatory solutions onto them.

A. Equalizing Political Power

At its most fundamental, the dark money problem is about unequal political power.¹⁰⁰ Money enables some individuals and corporations to have greater influence in the political process.¹⁰¹ Of course, this is a problem with "bright" money as well, and none of the regulations adopted by states attempt to remedy the inevitable imbalance of political power caused by economic inequality. Under current Supreme Court jurisprudence, equalizing political power cannot reasonably be the goal of state law regulation;¹⁰² *Citizens United* itself shows that any regulation to remedy that most central problem would face prodigious

100. DANIEL I. WEINER, BRENNAN CTR. FOR JUSTICE AT N.Y. UNIV. SCH. OF LAW, *CITIZENS UNITED FIVE YEARS LATER* 5-6 (2015), http://www.brennancenter.org/sites/default/files/analysis/Citizens_United_%20Five_Years_Late_r.pdf.

101. See *id.* at 5 ("In 2014, the top 100 individual donors spent nearly as much as the estimated 4.75 million small donors in federal elections.").

102. *McCutcheon v. Fed. Election Comm'n*, 134 S. Ct. 1434, 1450 (2014) (discussing the role of federal government and saying, "No matter how desirable it may seem, it is not an acceptable governmental objective to 'level the playing field,' or to 'level electoral opportunities,' or to 'equaliz[e] the financial resources of candidates.'").

constitutional hurdles.¹⁰³ If equalizing political power is the central regulatory goal, the states are doomed to fail. But a narrower definition of the policy objective, though more limited in its ambition, is also more amenable to regulatory solution.

B. Creating Frictions for Out-of-State Voices

Both California and New York were spurred to act on account of political activity by out-of-state organizations interfering with in-state elections.¹⁰⁴ Silencing out-of-state meddlers is a substantially narrower—and more parochial—goal than addressing inequality in political spending. Consequently, a narrow solution aimed at creating hurdles for out-of-state institutions to participate in state elections could be sufficient to address the objective. Unlike the broader goal of equalizing political power, state law solutions make sense when the goal is defined as states protecting themselves from unique injuries that other states do not share. A state might have a legitimate interest in protecting its own citizens from out-of-state dangers by ensuring that only groups and individuals with legitimate interests influence in-state elections.

However, defining the policy this way is also legally challenging. Like more ambitious power-equalizing proposals, the most robust solutions to the problem of outside interlopers—like silencing out-of-state voices altogether—would face substantial constitutional problems.¹⁰⁵ Neither New York nor California imposes heavier burdens on out-of-state organizations than it does on in-state organizations, and it would likely be unconstitutional if they did. Nevertheless, states could legitimately reduce, slow, or reveal in-state electioneering by out-of-state speakers by following the route that California and New York have both taken. Their new rules require registration, reporting, and disclosure for all organizations. Costs count, disclosure can be embarrassing, and some organizations might be less inclined to interfere in elections when their potential influence comes at a heavy cost of com-

103. *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310, 349–50 (2010) (rejecting the *Austin* anti-distortion rationale in favor of the *Buckley* rejection of the “premise that the Government has an interest in ‘equalizing the relative ability of individuals and groups to influence the outcome of elections.’”).

104. See *supra* notes 61, 81 and accompanying text.

105. See *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (dormant commerce clause prohibits discrimination against out-of-state entities).

pliance and transparency.¹⁰⁶ Because organizations reasonably object to the cost and inconvenience of reporting requirements, imposing those costs can themselves be a legitimate goal of the state.¹⁰⁷ Disclosure is reputationally costly, even if no financial costs are involved.¹⁰⁸ Creating frictions in the electoral process is a legitimate state-law tool that can help to separate institutions with substantial interests in a state's elections from those without.

C. Protecting Voters from Fraud

The states have an interest in protecting individuals who are the target of political communications from fraud.¹⁰⁹ Lack of transparency in political discourse caused by the use of opaque organizations to influence voters may rise to the level of defrauding the public if dark money enables deception. States have a legitimate interest in regulating communications that involve misstatements of fact and presentation of opinion as though it were fact. Misrepresentations about a speaker's actual interest may also be designed to mislead. Voters may erroneously believe that communications come from concerned citizens, when they are actually the voice of corporate interests, and their responses may be influenced by those beliefs.¹¹⁰

106. Cf. David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312, 1315 (2001) ("When the right kind of friction reinforces a narrow reform, end runs will be uncommon.").

107. See Dana Brakman Reiser, *There Ought to Be a Law: The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform*, 80 CHI.-KENT L. REV. 559, 611 (2005) ("[D]isclosure-based reforms should be carefully chosen and selectively applied. They can create serious costs for [the nonprofit] sector. But, to the extent these costs can be tolerated, disclosure-based reforms that will facilitate enforcement of nonprofit obligations, motivate nonprofit fiduciaries to more actively self-monitor, or both, can generate important and lasting accountability benefits.").

108. See Jared Milfred, *Shining Light on Dark Money in Campaign Finance*, YALE INST. FOR SOC. & POL'Y STUD., <http://isps.yale.edu/news/blog/2014/11/shining-light-on-dark-money-in-campaign-finance#.Vnq2ZPkrLIU> (last visited Mar. 16, 2016) ("After *Citizens United*, corporations gained the legal ability to spend unlimited sums, but with reputational risk. If disclosed, shareholders, customers and employees might each object to a corporation's political activity.").

109. *Burson v. Freeman*, 504 U.S. 191, 199 (1992) ("[A] State has a compelling interest in ensuring that an individual's right to vote is not undermined by fraud in the election process."). For example, many states have tried to regulate false campaign advertisements. Although this leads to potential First Amendment issues, it is possible that a narrowly tailored law could pass constitutional scrutiny and protect voters. See Staci Liefkring, Note, *First Amendment and the Right to Lie: Regulating Knowingly False Campaign Speech After United States v. Alvarez*, 97 MINN. L. REV. 1047, 1056–61, 1078 (2013).

110. See David Earley, *Donors and Charities Need Protection as Secret Political Spending Grows*, CHRON. OF PHILANTHROPY (Jan. 13, 2013), <https://philanthropy.com/article/DonorsCharities-Need/155615> ("The new regulations will make New York's elections transparent by informing voters about who is spending to influence their votes.").

While effectively ensuring election integrity probably requires a broad federal solution, states have long been in the business of prosecuting fraud, so they may be in a position to contribute useful enforcement. Whether an element of state or federal law, protecting voters from fraud is about political integrity,¹¹¹ so election law is the obvious place to situate it, not nonprofits law. But nonprofits law may be an attractive locus if nonprofit organizations are primarily the ones being regulated, or if their regulation is particularly important. Consequently, whether in their nonprofit-regulator role or broader fraud-prevention role, state attorneys general may be appropriate enforcers of a policy to protect voters from fraud.

States could use a variety of tools to address this policy goal. Increased regulation of organizations that engage in political communications may be appropriate. Protecting voters from fraud may require public disclosure of information about expenditures made by organizations, as well as the source of an organization's funds. States could increase transparency without silencing any voices, no matter where they come from, by requiring more information about political communications and organizations engaged in them. Even disclosure only to the state, and not the public, allows some oversight. That approach may be the least restrictive (from a First Amendment perspective), but it could potentially allow misleading communications to sway voters who are only partially informed.

Protecting voters from fraud may additionally require prosecutions of individuals and organizations that have engaged in specific fraudulent communications. States may even use individual prosecutions as an alternative to regulation, choosing to pursue organizations that engage in misleading communications, rather than instituting procedures or disclosures for the sector as a whole. Individual prosecutions are time-consuming and expensive, but they guarantee the greatest constitutional protection for political speech. Framing the problem simply as fraud—and solving it with traditional fraud prosecutions—avoids the most serious constitutional concerns raised by regulatory solutions. To withstand constitutional challenge, regulations to prevent fraudulent speech must be narrowly tailored and di-

111. See *Crawford v. Marion Cty. Election Bd.*, 553 U.S. 181, 197 (2008) (“[P]ublic confidence in the integrity of the electoral process has independent significance, because it encourages citizen participation in the democratic process.”).

rected precisely at that concern.¹¹² If too expansive, a regulatory regime is vulnerable to an overbreadth challenge. But relying solely on individual prosecutions is likely to be less effective than comprehensive regulation in solving the endemic problems of dark money in politics.

D. Protecting the Charitable Sector

The first three goals—equalizing political power, quieting out-of-state voices, and protecting voters from fraud—call for solutions that go beyond the traditional scope of state nonprofit law. To the contrary, protecting the charitable sector is a core state nonprofit-law function, and jurisdiction to regulate falls squarely on state charity regulators compared to election law regulators, whether federal or state.¹¹³ If the harm to be prevented by regulation primarily consists of damage to the charitable sector, then state nonprofit law may actually be the best place to try to solve the (c)(4) mess.

The states might treat protecting the charitable sector as an important policy goal because the charitable sector provides vital social goods, and public confidence is key to the sector's ability to raise funds and operate effectively.¹¹⁴ States should care about whether nonprofit organizations engage in misleading political activity because all nonprofit organizations are affected by the behavior of a few.¹¹⁵ The reputation of the sector depends on the impressions of the sector as whole—whether it operates with integrity, and whether it earns the public's trust.¹¹⁶ Individual bad actors can taint the whole sector's reputation. State attorneys general are justified in believing that the electioneering activities of social welfare organizations threaten to tarnish

112. First Amendment jurisprudence makes clear that a substantial state interest can curtail speech, but only if it is narrowly tailored. See *United States v. O'Brien*, 391 U.S. 367, 377 (1968) (“[W]e think it clear that a government regulation is sufficiently justified if it is within the constitutional power of the Government; if it furthers an important or substantial governmental interest; if the governmental interest is unrelated to the suppression of free expression; and if the incidental restriction on alleged First Amendment freedoms is no greater than is essential to the furtherance of that interest.”).

113. See, e.g., NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, MODEL PROTECTION OF CHARITABLE ASSETS ACT 2-4 (2011), <http://www.americanbar.org/content/dam/aba/events/taxation/taxiq-fall11-charitable-assets-act-paper.authcheckdam.pdf>.

114. *Id.* at 1.

115. See Earley, *supra* note 110 (“The regulations also guard the reputation of nonprofits that engage in little or no political spending. The explosion in political spending by a few 501(c)(4) organizations . . . may incidentally tarnish other organization's nonpartisan reputations.”).

116. See *id.*

the halo that all nonprofit organizations—particularly charities—rely upon for their very existence. This interest may be the most compelling reason to locate the regulation of dark money in the state law of nonprofit organizations.

Spillover damage to the entire sector is a legitimate state concern because the public generally fails to appreciate the distinction among different nonprofit organizations.¹¹⁷ Sections 501(c)(3) and (c)(4) are barely distinguishable to most people, and the confusion is compounded by the fact that many organizations have related (c)(3) and (c)(4) organizations under a single umbrella.¹¹⁸ The most important distinction between charities and 501(c)(4) organizations, the non-deductibility of contributions to (c)(4) organizations, is not always prominent or relevant to the public. Recipients of a message have no reason to distinguish (c)(3) from (c)(4) organizations, so they are unlikely to notice whether a nonprofit fits into a particular category. Even donors—whose contributions are only deductible if the organization is a (c)(3)—might not pay much attention; the tax distinction itself is irrelevant for the majority of taxpayers, who are non-itemizers.¹¹⁹

Even if people appreciated the distinction between (c)(3) and (c)(4) organizations, the states would still be justified in regulating to protect the value of the nonprofit signal. All nonprofit organizations have an imprimatur of legitimacy from their nonprofit and tax-exempt status.¹²⁰ Signaling legitimacy is precisely the point of organizing as a nonprofit,¹²¹ and the state has an interest in monitoring and protecting that signal for the benefit of donors and others who respond to it. People who organize (c)(4) organizations with the intention of influencing elections know that nonprofit status is an advantage to them, crucial to their success in soliciting donations and in disseminating a convincing message. Exemption is a valuable brand, and state attorneys general are in the best position to define and protect that brand because they

117. See *supra* note 17 and accompanying text.

118. See Laura Saunders, *Is Your Political Donation Deductible?*, WALL ST. J. (Sept. 28, 2012), <http://www.wsj.com/articles/SB10000872396390444549204578022201425205738> (giving the NRA and ACLU as examples of organizations that have an educational charity component which is deductible and an activist social welfare organization which is not deductible).

119. In 2010, only 30.1% of tax units itemized deductions, most of them high-income. See Benjamin H. Harris & Daniel Baneman, *Who Itemizes Deductions?*, TAX NOTES 345 (Jan. 17, 2011), <http://www.taxpolicycenter.org/UploadedPDF/1001486-Who-Itemizes-Deductions.pdf>.

120. See BURTON A. WEISBROD, *THE NONPROFIT ECONOMY* 60 (1988).

121. Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 *YALE L.J.* 835, 844–45, 47 (1980) (contract failure theory of exemption gives donors comfort that the money is being used for proper purposes).

are in charge of defining what it is. This policy goal justifies state nonprofit law regulation, but the design of such regulation is not immediately apparent. As discussed further in part V, regulation in pursuit of this policy could take the form of disclosure of political activities, regulation of allowable activities, and potentially also disclosure of an organization's donors.

E. Protecting Nonprofit Donors

The state also has a legitimate interest in ensuring that money donated for social welfare purposes actually go to such purposes. When a donor gives to a cause-related organization, he may be unaware that the organization spends funds on campaign intervention.¹²² Donors may be confused by the nonprofit label and duped into supporting political activities they did not intend to support.¹²³ Section 501(c)(4) organizations that actively engage in politics often have bland names and stated purposes that are admirable and/or vague.¹²⁴ They also often combine political activities with real social welfare purposes (or state that they do in order to be eligible for exemption).¹²⁵ The state policy to protect donors is independent of the state's interest in protecting voters because it is concerned with ensuring that donors who support political messages are aware that their contributions are used for such purposes.

Protecting nonprofit donors is a core function of state charity law, so state charity regulators have good reason to regulate in this area to protect donors to (c)(4) organizations. Like protecting the charitable sector, this policy goal provides a strong reason for addressing dark money in politics through state nonprofits regulation. Unlike the protection of voters however, the key mechanism for carrying out this goal requires disclosure—at an appropriate time—of an organization's activities and expenditures.

122. Earley, *supra* note 110 (“Donors to nonprofits may be unaware that the organizations can and sometimes do engage in political spending.”).

123. *Id.* (“Some donors may tolerate or even encourage such activity while others may recoil.”).

124. See Tara Malloy, *A New Transparency: How to Ensure Disclosure from “Mixed-Purpose” Groups After Citizens United*, 46 U.S.F. L. REV. 425, 426 (2011) (discussing “mixed purpose” 501(c) groups engaged in both issue advocacy and campaign-related advocacy).

125. *Id.*

V. MAPPING REGULATION ONTO GOALS

These different state goals require different regulatory solutions. If protecting the political process and voters is the goal, then regulation should require disclosure about individuals and corporations behind opaque organizations. On the other hand, protecting donors would require more disclosure about—or substantive limits on—the organization’s activities and spending, but would not primarily need to reveal information about other donors. Protecting charities is a less concrete goal, so the nature of public confusion and expectation would have to be understood better to design appropriate regulation; it is possible that nothing short of abolishing two distinct types of exempt organizations would really work to protect charities.

The regulations adopted by California and New York are good models for what states might have the power and the political will to do. States have a choice between election law and nonprofits law in addressing the dark money problem. Election law is the most obvious vehicle for state-law regulation because states have long required registration and reporting of expenditures on state elections, and the recent amendments build on an infrastructure already in place. Placement in election law suggests that both California and New York were focused on a political-integrity or voter-protection goal.

Even though California adopted campaign finance regulation as election law, its focus on multipurpose organizations indicates that the state was particularly interested in regulating politically active social welfare organizations.¹²⁶ Both states’ rules reveal concern for donors to covered organizations because they both require that organization registrants disclose information about their spending—the key item of concern to donors.¹²⁷ New York started squarely within the jurisdiction of nonprofit regulation,¹²⁸ and its first attempt to adopt rules applied only to non-charitable nonprofit organizations,¹²⁹ but its ultimate approach is less targeted to the (c)(4) problem.¹³⁰ The revoked New York rule required the most extensive information that might be relevant to donors by mandating a public statement about both the total amount and the percentage of election-related expenditures, as well as

126. See *supra* note 68 and accompanying text.

127. See *supra* note 69–70, 93 and accompanying text.

128. See *supra* note 80–86 and accompanying text.

129. See *supra* note 85 and accompanying text.

130. See *supra* notes 92–93 and accompanying text.

an itemized schedule of all expenditures connected to New York elections over \$50.¹³¹ Higher thresholds under the rules eventually adopted by both New York and California are less protective of a donor's interest in information about an organization's use of funds.¹³²

Disclosure regarding spending by organizations can be mapped most directly onto the policy goal of protecting donors, but such disclosure may also be relevant to protecting voters. Expenditure disclosure identifies certain organizations as political actors, and increases transparency about those organizations, which may contribute to greater political integrity. But expenditure disclosure alone is not sufficient to protect voters. The state's interest in protecting the political process and voters also demands identification of the individuals and corporations behind the dark money. California's new law was designed to address precisely this voter-protection goal,¹³³ but New York's rules continue to allow daisy chains of organizations to obscure the ultimate source of funds.

If the intended beneficiaries of increased regulation are only the public electorate, there is no particular reason to regulate through nonprofits law rather than election law. But if the state's policies extend to protecting the integrity of nonprofits by protecting donors and safeguarding charities, state nonprofits law is an important additional locus of regulation. This part now considers specific regulatory approaches, and considers how each approach fits the goals described in part IV.

A. Disclosure

1. Why Mandate Disclosure?

The solution reflected in the campaign finance laws of New York and California, and endorsed by other scholars,¹³⁴ is to require greater, more prompt disclosure by organizations that engage in politicking. Disclosure can make political communications more informative and less misleading, and disclosure—rather than substantive control—seems to be the hallmark of modern regulation. Disclosure prohibits

131. See *supra* notes 88–90 and accompanying text.

132. See *supra* note 70 and accompanying text (for California political expenditures of \$50,000 in one year or \$100,000 over four years); see also *supra* notes 96–97 and accompanying text (for New York independent expenditures of \$5,000 or more).

133. See *supra* note 66 and accompanying text.

134. Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 ELECTION L.J. 363, 403–04 (2011); Colinvau, *supra* note 14, at 47–49.

nothing, and assumes that people can process information and make better choices if they have more information. Underlying the appeal of disclosure regimes is an assumption that disclosure will produce informed decisions by the public, whether as voters, donors, or shareholders.

Even if disclosure fails to deliver on the promise of increasing autonomy for individuals, it may be a good choice for regulating political speech because the constitutional hurdles to more substantive regulation are too high. Legally, disclosure is less vulnerable to constitutional attack than other regulatory approaches. *Citizens United*, which precipitated this crisis in the first place by striking down substantive limits on independent spending, endorsed substantial disclosure requirements.¹³⁵ The Court explained, “[d]isclaimer and disclosure requirements may burden the ability to speak, but they ‘impose no ceiling on campaign-related activities,’ and ‘do not prevent anyone from speaking.’”¹³⁶ It held that disclosure requirements stem from a legitimate government interest in helping citizens make informed choices.¹³⁷ In a part of the opinion joined by eight justices, the Court noted the particular effectiveness that disclosure might have on current policy because “[w]ith the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters.”¹³⁸

Choosing disclosure as the form of regulation because it is constitutionally strong implies nothing about the subject of the disclosure, or even the target audience. A disclosure regime designed to protect voters might differ substantially from a disclosure regime designed to protect donors or charitable organizations. States could use their election or nonprofit law to require disclosure that would address these different policies.

2. Disclosure to Protect Voters

Protecting voters requires identifying the source of political communications by looking behind the organizations that produce those

135. *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310, 369 (2010) (“The Court has explained that disclosure is a less restrictive alternative to more comprehensive regulations of speech.”).

136. *Id.* at 366 (quoting *Buckley v. Valeo*, 424 U.S. 1, 64 (1976) and *McConnell v. Fed. Election Comm’n*, 540 U.S. 93, 201 (2003)).

137. *Id.* at 367.

138. *Id.* at 370.

communications. Donor disclosure to the public protects the electorate from the anonymity that nonprofit intermediaries make possible; voters can then investigate who is behind a particular communication and use that knowledge to judge its content. Disclosure of corporate donors would help make private financial interests more transparent, and disclosure of individuals allows consideration of both financial and non-financial motives and other private interests.

Following the model of section 527 organizations and federal election law disclosure requirements, states might mandate public disclosure of the names of donors to organizations that engage in politicking. New York's revoked rule was an example of this public-oriented disclosure.¹³⁹ It mandated that the Attorney General post the names of donors on its website, absent a showing of likelihood of harm from such disclosure.¹⁴⁰ Both New York¹⁴¹ and California¹⁴² have adopted this approach to some extent in their final rules. But there is no particular reason to have a donor-disclosure rule at the state level—states might adopt it only because the federal government has not. Federal legislation, such as extending the scope of section 527 itself, or modifying section 501(c) to require donor disclosure outside 501(c)(3) would be a more streamlined solution. But Congress will clearly not be mandating such disclosure any time soon.¹⁴³

If states were to disclose donors of politicking nonprofits, they would need to adopt standards for identifying such organizations. As detailed in Evelyn Brody and Marcus Owens' contribution to this symposium, the IRS' attempt to identify politicking nonprofits was a colossal failure,¹⁴⁴ so states might be reticent to repeat that attempt. States could avoid categorizing political organizations by requiring that *all* noncharitable nonprofits disclose their donors, regardless of the political activities of the organization. That approach would make it unnecessary to craft a definition of politicking, but it might sweep too broadly. If political activity has overwhelmed the traditional social welfare functions of noncharitable nonprofit organizations, then states might think the policy worthwhile. But it would be undesirable to

139. N.Y. COMP. CODES R. & REGS. tit. 13, § 91.6(g) (repealed 2014).

140. *Id.* § 91.6(g)–(h).

141. N.Y. COMP. CODES R. & REGS. tit. 9, § 6200.10(g)(1) (2015).

142. CAL. GOV'T CODE § 84223 (West 2014).

143. It just prohibited the IRS from adopting regulations to define politicking organizations. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, div. E, tit. I, § 127, 129 Stat. 2242, 2433 (2015).

144. See Brody & Owens, *supra* note 1.

adopt such a requirement if it would harm organizations involved in real social welfare activities. States would need to balance the advantage of dispensing with line-drawing against the overbroad reach of such a regulation.

Legally, such broad disclosure might encounter greater problems than more targeted disclosure connected to political spending. In 1958, the Supreme Court held that compelled disclosure of the names of members of a chapter of the NAACP violated the associational rights of those members.¹⁴⁵ The Court concluded that the state had no interest in obtaining the names.¹⁴⁶ States would likely need to show a correlation between noncharitable nonprofit status and misleading politicking activity in order to make the requisite case for a legitimate state interest in disclosure for all organizations. That interest would also need to outweigh any damage to donors and organizations through diminished financial support and membership.¹⁴⁷ Alternatively, states could require donor disclosure only for noncharitable nonprofits that engage in certain levels of political activity. Of course, that approach requires attempting the fraught business of categorizing organizations.

3. Disclosure to Protect Nonprofits Donors

If the policy goal behind disclosure is the protection of donors to social welfare organizations, the analysis must focus on disclosure of an organization's political activity, and on the terms of donor disclosure as well. Donors might be interested in donating to core social welfare programs (and not politicking) and might also be (legitimately) interested in remaining anonymous when they do. Disclosure about an organization's expenditures informs donors about what they are supporting. Disclosure of donor identity allows those who value anonymity to limit or target their contributions to avoid publicity. It also informs potential donors of the company they will keep.

Both New York and California require that covered organizations report their political expenditures (above a threshold) to the state.¹⁴⁸ Both states also require some donor disclosure. Under California's new rules, covered organizations must disclose "all donors who earmark

145. *NAACP v. Ala. ex rel. Patterson*, 357 U.S. 449, 462 (1958) ("We think that the production order, in the respects here drawn in question, must be regarded as entailing the likelihood of a substantial restraint upon the exercise by petitioner's members of their right to freedom of association.")

146. *Id.* at 464–65.

147. *Id.* at 459–60.

148. *See supra* notes 70, 96–97 and accompanying text.

their contributions for political purposes,”¹⁴⁹ and if an organization’s total political spending exceeds a threshold, the organization must reveal all donors who have made contributions greater than \$1000, in reverse chronological order until the amount spent is accounted for. For organizations “formed primarily to support or oppose a particular candidate or ballot measure” that raises more than \$1 million, California law requires that they disclose and maintain a list of their top ten donors on a public website.¹⁵⁰

Donors who are concerned about anonymity¹⁵¹ will take these new disclosure rules into account when deciding where and how to donate their money. These disclosure rules may create an incentive for donors to clearly distinguish which nonprofit organizations will be using their donations for political purposes and which will not, *before* making a donation.¹⁵² Insofar as donors may share in the widespread confusion that shrouds the distinction between charitable organizations and social welfare organizations, California’s new disclosure regime may create an incentive for donors to educate themselves about the particular organization’s status and political activity.

For donors who value their anonymity, these incentives operate in two ways that address (albeit in a limited way) broader concerns about dark money. First, these donors will be put on notice that certain politicking activities by the recipient organization may trigger mandatory disclosure of the donor’s identity to the public.¹⁵³ This notice

149. Ford, *supra* note 62, at 343.

150. *Id.* at 343–44.

151. One reason that donors may wish to remain anonymous is to avoid potential backlash or harassment because of their support for certain causes. Monica Youn, *Proposition 8 and the Mormon Church: A Case Study in Donor Disclosure*, 81 GEO. WASH. L. REV. 2108, 2126–28 (2013). The extent of this kind of potential backlash will of course vary depending on the nature of the election, but opponents warn that disclosure is, at its core, “about identifying political opponents in order to silence them.” Cleta Mitchell, *Donor Disclosure: Undermining the First Amendment*, 96 MINN. L. REV. 1755, 1762 (2012). On the other end of the spectrum, donors may wish to remain anonymous to prevent their identity from affecting the message or potency of the communication. See Thomas B. Edsall, Opinion, *Who Needs a Smoke-Filled Room?: Karl Rove, the Koch Brothers and the End of Political Transparency*, N.Y. TIMES (Sept. 9, 2014), <http://www.nytimes.com/2014/09/10/opinion/karl-rove-the-koch-brothers-and-the-end-of-political-transparency.html>. Edsall details his correspondence with various officials at Americans for Tax Reform, Crossroads GPS, Freedom Network, and Koch Industries, and cannot find a satisfactory answer to his question: “Why is there such a complex structure of organizations? Some exist only to transfer money. Many of the organizations provide grants to the same recipients. What is the purpose of this?” *Id.*

152. Donors who wish to donate to politically active nonprofits but who wish to remain anonymous may still donate under the \$1,000 threshold, or choose not to donate at all.

153. This notice is the first essential part of the so-called “chilling effect” of disclosure rules. Lloyd Hitoshi Mayer, *Disclosures About Disclosure*, 44 IND. L. REV. 255, 271 (2010). This point assumes that donors are aware of and take into account the potential social costs of contributing.

should cause them to inquire further into the political activities of the donee organization to determine whether those activities will trigger disclosure.¹⁵⁴ These careful donors will demand more transparency from donee organizations as to the ultimate use of their funds to be able to weigh the potential costs of disclosure against the potential benefit of contributing.

Second, those donors who know that the donee organization is engaged in substantial political activity have an incentive to make sure that their donation will not be used for those purposes in order to prevent disclosure of their identity to the public.¹⁵⁵ Thus, to the extent that donors are truly concerned about remaining anonymous, the California rules may also reduce the volume of donations to dark money organizations.

4. Disclosure to Shield Charities from Taint

The state's interest in protecting the charitable sector is a more inchoate goal than the others, and regulatory solutions are consequently less obvious. States might protect charities by creating a more clear delineation between charities and other nonprofit organizations. Disclosure can be part of that solution, to the extent that disclosure informs donors and voters that politicking nonprofits are different from charities.

Requiring donor disclosure when an organization engages in politicking gives donors incentives to seek transparency from recipient organizations. These incentives are good for the charitable sector be-

See Youn, *supra* note 151, at 2133 (arguing that while "relatively minor and innocuous responses" to contributors such as "social opprobrium and criticism . . . may not be sufficiently threatening to entitle an individual or group to the benefit of the harassment exemption, they still may loom large enough in an individual's consciousness to deter political participation under certain circumstances"); *cf.* *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310, 480–85 (2010) (Thomas, J., concurring in part and dissenting in part). Youn is careful to point out, however, that in terms of the whole electorate, "[a]s an empirical matter, it is questionable whether such deterrence effects are significant enough to result in decreased political participation." Youn, *supra* note 151, at 2133; *see also* Mayer, *supra*, at 273. It is also questionable whether this assumption holds true outside of a hotly contested social issue such as Proposition 8 and equal marriage. *Id.* at 274.

154. *See* DICK M. CARPENTER II, INST. FOR JUSTICE, DISCLOSURE COSTS: UNINTENDED CONSEQUENCES OF CAMPAIGN FINANCE REFORM 7–8 (2007),

http://www.ij.org/images/pdf_folder/other_pubs/DisclosureCosts.pdf (reporting survey finding that a majority of respondents "would think twice before donating money" "[i]f by contributing to a ballot issue campaign my name and address were released to the public by the state"). *But see* Mayer, *supra* note 153, at 278 (critiquing the Carpenter survey for not testing "whether the respondents would change their giving patterns [sic] in the face of such disclosures (as opposed to saying that they might)").

155. *See* CAL. GOV'T CODE § 84222(e)(2)(A)–(B) (West 2014).

cause they encourage donors to monitor the divide between charities and other organizations. To the extent that states are concerned that charitable organizations' "halo effect" undeservedly transfers to dark money social welfare organizations, disclosure regimes such as California's push donors to investigate whether that halo is deserved or not.

Disclosure through state nonprofit law—rather than election law—makes sense if the purpose of the disclosure requirement is to distinguish charities from other organizations—either for the benefit of donors to (c)(3) and (c)(4) organizations, or to protect the public reputation of charitable organizations. Current law is confusing and fails to send a clear message of which organizations fit into what category; 501(c)(3) and (c)(4) organizations resemble one another too closely.¹⁵⁶ If only charities have the privilege of anonymous donors, the law will foster less confusion between (c)(3)s and (c)(4)s, better protecting charities from the taint of politicking. In addition, it will make 501(c)(4) organizations better resemble 527 organizations, which might be a closer functional match now that (c)(4)s engage in so much political activity. An additional advantage of bringing (c)(4)s and 527s closer to one another is that such a move will likely relieve the pressure on the IRS to police that distinction.

B. Police Private Benefits in Noncharitable Nonprofits

Public disclosure of donors and/or political expenditures is a broad, but shallow, remedy for the ills of the political process. Most voters are unlikely to know how to access publicly disclosed information, and even fewer people will find it worthwhile to investigate and evaluate what has been disclosed. In addition, to be really meaningful, donor disclosure must look through shell organizations to reveal real corporations and/or individuals whose identity might give meaning to the substance of their communications. It is impossible to know what will happen if greater donor disclosure is required for nonprofit organizations—new avenues for anonymous politicking might open up, political activity might decline, or donors might accept the new regime and leave the politicking landscape largely unchanged.

An alternative to relying on the public to use disclosure to engage in monitoring via voting and giving, states could use their nonprofit

156. Often, the same organization will have both (c)(3) and (c)(4) branches. See Saunders, *supra* note 118.

laws to enforce the state-law nondistribution requirement for nonprofits more aggressively. The central defining characteristic of all nonprofits is that they lack owners and are prohibited from distributing their earnings to shareholder-like interests.¹⁵⁷ States police the nondistribution constraint by preventing founders, directors and other insiders from siphoning charitable funds for their personal benefit.¹⁵⁸ While the federal government has overlapping enforcement through the Internal Revenue Code's prohibition on inurement,¹⁵⁹ the states are engaged in protecting the charitable sector when they prevent the dissolution of charitable funds, while the IRS is protecting the tax base by monitoring the border between taxable and non-taxable organizations. The nondistribution constraint is generally financial, but could be extended to limit non-financial private benefits as well.¹⁶⁰ The regulations under section 501(c)(3) recognize non-financial private benefits and prohibit them,¹⁶¹ and the states could adopt the same approach. Disclosure to the state (and not the public) would be sufficient for the Attorney General to evaluate whether individuals are reaping excessive private benefits from a nonprofit organization.¹⁶²

A disadvantage in relying on this type of state enforcement is that it is slow and resource-intensive—similar to the approach that relies on individual fraud prosecutions for making misleading statements.

157. See JAMES J. FISHMAN ET AL., *NONPROFIT ORGANIZATIONS* (5th ed. 2015); MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION* 3 (paperback ed. 2008).

158. This is a common enforcement action brought by state charities bureaus. See, e.g., *Charities Bureau News and Alerts, Continued*, CHARITIESNYS.COM, http://www.charitiesnys.com/news_archives.jsp (last visited Mar. 16, 2016); CHARITIES BUREAU, OFFICE OF THE ATTORNEY GEN., PENNIES FOR CHARITY: WHERE YOUR MONEY GOES: TELEMARKETING BY PROFESSIONAL FUNDRAISERS 1 (Mar. 2015), http://www.charitiesnys.com/pdfs/2014_Pennies.pdf (discussing telemarketers making charitable solicitations and retaining large portions of the profits instead of passing them on to the charity).

159. I.R.C. § 501(c)(3) (2014) (“Corporations . . . organized and operated exclusively for . . . charitable . . . purposes . . . , no part of the net earnings which inures to the benefit of any private shareholder or individual . . .”).

160. See, e.g., N.Y. NOT-FOR-PROFIT CORP. LAW § 102(a)(5) (McKinney 2015) (providing that a nonprofit corporation must be formed “exclusively for a purpose or purposes, not for pecuniary profit or financial gain, for which a corporation may be formed under this chapter, and . . . no part of the assets, income or profit . . . is distributable to, or inures to the benefit of, its members, directors or officers except to the extent permitted under this statute.”).

161. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 2008).

162. California’s attorney general made this argument in the context of donor disclosure for a charitable organization. See *Ctr. for Competitive Politics v. Harris*, 784 F.3d 1307, 1311 (9th Cir. 2015) (“The Attorney General argues that there is a compelling law enforcement interest in the disclosure of the names of significant donors. She argues that such information is necessary to determine whether a charity is actually engaged in a charitable purpose, or is instead violating California law by engaging in self-dealing, improper loans, or other unfair business practices.”).

Charities officials—even in states with the most active regulators—can generally afford to choose only the most egregious cases for their scarce enforcement dollars. If the public—either as voters or donors—can monitor using information that organizations themselves must disclose, there can be substantial saving for the states. The question is whether public disclosure for public enforcement will be effective enough to be worth the regulatory trouble. It is too soon to tell how California and New York’s new rules will operate on the ground.

C. Redefine Nonprofit Organizations Under State Law

If the states turn to nonprofits law regulation, the approach could mirror potential federal regulation under section 501(c)(4) by defining some organizations as ineligible for nonprofits status. This alternative would have the states inheriting the project that the IRS failed to complete when it withdrew, and never reissued, the proposed regulations under section 501(c)(4).¹⁶³ New York’s current nonprofit corporation law, for example, has a very broad definition for noncharitable corporations:

“Non-charitable corporation” means any corporation formed under this chapter, other than a charitable corporation, including but not limited to one formed for any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, or animal husbandry, or for the purpose of operating a professional, commercial, industrial, trade or service association.¹⁶⁴

The states could revise the limitations on eligible nonprofit organizations to limit certain types of political activities. Current law in New York, for example, contains an express limitation only on profit-making activity.¹⁶⁵ Carving out certain primarily political organizations from the definition of nonprofit corporations could be a reasonable modification of current law.

Revising the definition of noncharitable nonprofit organizations is unlikely to be an attractive option, and would be no more popular than the IRS’ attempt to revise the definition of section 501(c)(4). While the states might not be as politically vulnerable on this issue as the IRS, the

163. See *supra* notes 47–48 and accompanying text.

164. NOT-FOR-PROFIT CORP. § 102(a)(9-a).

165. *Id.* § 204 (“Notwithstanding any other provision of this chapter or any other general law, a corporation of any kind to which this chapter applies shall conduct no activities for pecuniary profit or financial gain, whether or not in furtherance of its corporate purposes, except to the extent that such activity supports its other lawful activities then being conducted.”).

states are in no better position than the federal government to solve the underlying difficulty of distinguishing public-oriented educational activities from political activities—the definitional morass will plague both the federal government and the states equally.

More importantly, such a revision in the law might be ineffective in regulating dark money in politics. If political organizations are unable to be nonprofit corporations under state law, they might simply choose another form of organization. Tax exemption under federal law does not require incorporation as a nonprofit corporation under state law. It might be harder for organizations to raise money through donations if they are unable to wear the nonprofits mantle, but large and anonymous independent expenditures are likely to continue through other means, including non-corporate forms and for-profit corporations.¹⁶⁶

VI. CAN STATE NONPROFIT LAW REGULATION SUCCEED?

This section raises questions about using state nonprofit regulation to address the problem of dark money in politics. A state nonprofits law solution is vulnerable along two dimensions: nonprofit and state. If election law is superior, then nonprofits law is a bad choice, and if federal law is necessary, then any state law would be undesirable. If for-profits can do what nonprofits are doing, then regulating nonprofits alone would be ineffective. If state-law jurisdictional reach is too limited to regulate sufficiently, then any state regulation—whether nonprofits law or otherwise—would need to be coordinated across states to ensure sufficient regulatory coverage. But states might be able to experiment with different approaches as a step in the process toward achieving federal regulation. Finally, if disclosure is the only constitutional method of regulation, it may simply be too ineffective.

A. Do We Care About For-Profits?

One way to test whether the solution should be a nonprofits law solution is to consider whether the problem would be the same if for-profit organizations were the vehicle for dark money, rather than non-

166. Donald Tobin has discussed the possibility of using taxable entities as a loophole to avoid the disclosure requirements of 527, instead of other tax-exempt entities which can be challenged. Tobin, *supra* note 25; Donald B. Tobin, *Political Advocacy and Taxable Entities: Are They The Next "Loophole"?*, 6 FIRST AMEND. L. REV. 41 (2007). See also *infra* Section XVI.A.

profit organizations. If for-profit organizations are a good substitute for nonprofits, then regulating nonprofits alone would be a waste. This is not a completely academic inquiry, since some for-profit organizations have been used for political advocacy recently.¹⁶⁷ Whether for-profit organizations present the same problem as nonprofits depends on the definition of the problem.

Disparate power in the political process benefitting the rich would continue to be a concern even if electioneering activities were undertaken by for-profit organizations—those who can afford to buy influence are better off either way. Similarly, concern over the anonymity of who is behind a message would also continue to be a problem. Any legal structure that separates individuals in control from the activities of the organization makes it difficult to identify the person behind the message, which is possible in both for-profit and nonprofit organizations. It is easy to form a corporation with shareholders under state law, and there is no prohibition against corporations having an express purpose of making political expenditures. There is also no public disclosure of the identity of shareholders under state corporate law. While it is arguable that section 527 would require disclosure of for-profit “donors,” the IRS is unlikely to require that.¹⁶⁸ Consequently, dark money can continue to affect the political process even if nonprofits are not involved. To the extent these concerns need attention, nonprofits law has nothing to add. Election-law regulation will be necessary to include both for-profit and nonprofit organizations, as well as individuals.

However, there is an important distinction between for-profit and nonprofit organizations and their ability to engage in politicking that argues for nonprofits regulation: for-profit organizations do not attract donations. This is important in evaluating the policies described above. If the state’s goal is the protection of donors to nonprofit organizations,

167. See Thomas Catan, *Political Donors Chase Funding Alternative*, WALL ST. J. (Jan. 5, 2014), <http://www.wsj.com/articles/SB10001424052702304887104579302671398893050>; Randy Krehbiel, *T.W. Shannon Supporters Set Up For-Profit Corporations to Pay for Ads*, TULSA WORLD (Mar. 23, 2014), http://www.tulsaworld.com/news/government/t-w-shannon-supporters-set-up-for-profit-corporation-to/article_a52ecb95-0389-5223-96d7-b2a4ae87b145.html; Beth Reinhard & Janet Hook, *GOP Operative Plans ‘Guerrilla Campaign’ Against Donald Trump*, WALL ST. J. (Nov. 20, 2015), <http://www.wsj.com/articles/gop-operative-plans-guerrilla-campaign-against-donald-trump-1448050937>.

168. See Tobin, *supra* note 25, at 586 (“[I]n light of the Service’s reluctance to aggressively enforce existing provisions, it is questionable whether taxable entities will be subject to section 527’s disclosure provisions even if the organizations have as their primary purpose engaging in election advocacy.”).

or the protection of charities, then nonprofits law may be a good regulatory locus. Dark money in for-profit organizations is not a problem if the issue to be addressed is either (1) the confusion between (c)(3) and other exempt organizations, or (2) the purposeful misleading of donors so they give more to exempt organizations. Political spending by for-profit organizations and individuals may be troubling. Nevertheless, the state may legitimately decide to protect nonprofit donors and charities, and leave the larger dark-money problem for another day (or a constitutional amendment).

Nonprofits are a particularly appealing vehicle for combining social welfare activities and politicking because people are inclined to be generous to social welfare organizations. Donors may not understand that an organization engages in political spending, and may expect their donations to finance social welfare objectives. It is precisely because nonprofits have a tradition of successful fundraising that they are attractive as dark money vehicles. For-profit organizations would have a much harder time convincing individuals to support their profit-making purposes with "contributions." Consequently, the for-profit corporate form might be effective for people who plan to finance the entire expenditure themselves, but do not want to reveal their actual identity, but it would be less effective for people hoping to receive donor support.

For-profit public corporations are more similar to nonprofit organizations that solicit contributions because they both rely on the support of individuals who do not have an active role in controlling the organization. To the extent that nonprofit law is necessary to protect unwitting donors to social welfare organizations, corporate law could address the problem of unwitting shareholder support of political activities. Election law could require the disclosure of all politicking activities by both types of organizations. Alternatively, public companies could be required to disclose their political spending to their shareholders. There have been calls for the SEC to increase its oversight of corporate political activities, in order to protect corporate shareholders, but Congress recently prohibited the SEC from adopting such rules in the near term.¹⁶⁹ Disclosure might enable shareholders to better hold for-profit companies accountable for their political spending.

169. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, div. O, tit. VII, § 707, 129 Stat. 2242, 3029-30 (2015). See also Lucian A. Bebchuk & Robert J. Jackson, Jr., *Shining Light on Corporate Political Spending*, 101 GEO. L.J. 923 (2013).

B. Are States a Good Testing Ground for Federal Regulation?

The most significant drawback to state law regulation arises from the limited scope of that regulation. States can regulate people, organizations, and elections in their borders, but no state can adopt a national solution to the problem of dark money in politics. If a national solution is necessary, the federal government needs to overcome its current dysfunction. But state-law regulation may be the way to start moving towards a federal solution. If legal experimentation is desirable, state-law regulation could be the ideal way to try different approaches that could operate as models for eventual federal regulation. The federal government's paralysis has already encouraged novel public financing systems in some states, so experimentation is already in progress.¹⁷⁰

From a legal perspective, experimentation is desirable to test the constitutional limits of government regulation. A balance must be struck between protecting free speech on one hand, and preventing corruption, deception and abuse on the other. Different states might calibrate it differently, with some rules failing to pass constitutional muster and other rules failing to substantially mitigate the problems.

Diversity in approaches would be particularly useful in defining the activities subject to regulation. A definition for politicking activity is necessary for regulating it, but that definition has thus far been cripplingly controversial—the federal tax regulations imploded on that definition. Since there is so much riding on its precise contours, it may be too fraught for the federal government to attempt to impose one approach without testing different choices. It will likely take some trial and error to separate the category of politicking from the category of research and education. Some states could adopt bright lines,¹⁷¹ while others could experiment with a facts and circumstances definition sensitive to the organization's other activities, the context in which political communications take place, and the influence an organization has

170. Thomas B. Edsall, Opinion, *Is There a Silver Lining to Citizens United*, N.Y. TIMES (Oct. 28, 2015), <http://www.nytimes.com/2015/10/28/opinion/is-there-a-silver-lining-to-citizens-united.html>.

171. See *Endorsing the Bright Lines Project Approach*, BRIGHT LINES PROJECT, <http://www.brightlinesproject.org/endorse/> (last visited Mar. 16, 2016) (“[S]peech that refers to a candidate and reflects a view on that candidate would be considered political activity, but protects speech focused solely on issues, grass roots lobbying, nonpartisan voter guides, and other defensible forms of expression.”).

on a particular issue.¹⁷² Some states could draft broad definitions and allow more leeway for organizations to engage in such conduct without burden, while others could adopt more targeted requirements but mandate greater regulation. These are the questions that swirl around any federal regulations, but the IRS lacks the ability to try multiple approaches at once. Different states could adopt different definitions and create an experiment that reveals which definitions can withstand judicial scrutiny, and which definitions operate most effectively.

The difference between California and New York law could prove to be instructive concerning the importance of looking through organizations to identify their ultimate donors. The differences in the rules give a natural experiment about the effects of different expenditure thresholds and timing rules. Both states can monitor the effects their rules have on the prevalence of dark money in state politics. Effectiveness may also depend on how exceptions are designed. Different states might allow different levels of protected anonymity for small donors, or controversial causes, for example.

C. Is Disclosure Worth the Trouble?

While disclosure seems a more promising solution than substantive regulation because it is more likely to withstand judicial scrutiny, there are serious downsides to disclosure that should be weighed in evaluating it. Most crucially, disclosure is not designed to stop bad behavior, just to reveal information to voters, donors, and law enforcers. First Amendment doctrine implies that the state's goal cannot be the silencing of political speech, but there is little doubt that one of the policies behind regulation of dark money is to reduce the influence of anonymous speech in the political process. The power of that speech may depend in part on the anonymity of the speaker, but even with donor disclosure, political discourse is unlikely to become substantially more balanced without substantive regulation.

If the function of public donor disclosure is to inform voters, its success depends on voters knowing who the donors are and understanding the significance of their interest. There are few people whose views are widely understood to represent a particular perspective that has meaning to voters (the Koch brothers, George Soros). Knowing an

172. This was the approach of the withdrawn (c)(4) regulations. See Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1).

individual's address or employer—the information that donors provide under election law—does not reveal much about possible bias in their views. Few voters are likely to investigate donors sufficiently to use this information well.¹⁷³ Consequently, disclosure designed to inform voters depends on the media highlighting relevant information (and making it seem fun); the *New York Times* has an interactive feature on who is funding the 2016 presidential election.¹⁷⁴ But media players do not necessarily communicate the information fairly or accurately—they are not regulated by the state. Biased reporting about the disclosed information could further distort the political process.¹⁷⁵

If the policy goal is to protect donors to the organizations, similar concerns about effectiveness arise. Despite a wealth of public information about charities, charitable donors do not educate themselves particularly well.¹⁷⁶ More information about noncharitable nonprofits is unlikely to make donors significantly better informed. Vague references to efforts to improve the economy or protect women's health would be insufficient to better educate donors—those are the messages that donors currently receive when they contribute to (c)(4) organizations. To have any effect, states might have to mandate that people soliciting contributions to (c)(4) organizations explicitly tell donors about the campaign activities of the organization.¹⁷⁷

Where regulations require disclosure to the state, but not the public, law enforcement depends on state officials identifying irregularities in the disclosures to investigate and prosecute. That disclosure is not

173. Tara Malloy & Bradley A. Smith, *Transcript: A Debate on Campaign Finance Disclosure*, 38 VT. L. REV. 933, 940 (2014) (“[H]ow many of you actually go to the FEC website and look up who is giving money to your candidate so you can determine how to vote? Not very many. And this crowd [at the symposium] is going to be a lot more likely to do so than your typical audience.”); DAVID M. PRIMO, INST. FOR JUSTICE, FULL DISCLOSURE: HOW CAMPAIGN FINANCE DISCLOSURE LAWS FAIL TO INFORM VOTERS AND STIFLE PUBLIC DEBATE 8 (2011), http://www.ij.org/images/pdf_folder/other_pubs/fulldisclosure.pdf.

174. Nicholas Confessore et al., *The Families Funding the 2016 Presidential Election*, N.Y. TIMES (Oct. 10, 2015), <http://www.nytimes.com/interactive/2015/10/11/us/politics/2016-presidential-election-super-pac-donors.html?ref=politics>.

175. I am skeptical of media enforcement of legal standards. See Linda Sugin, *Strengthening Charity Law: Replacing Media Oversight with Advance Rulings for Nonprofit Fiduciaries*, 89 TUL. L. REV. 869 (2015).

176. For example, consumers need to be warned to research how a charity will handle private information and whether the charity is legitimate in the first place. See Ann Carrns, *Before Giving, Check Out Charities and Their Policies on Privacy*, N.Y. TIMES (Dec. 1, 2015), <http://www.nytimes.com/2015/12/02/your-money/before-giving-check-out-charities-and-their-policies-on-privacy.html>.

177. It is not clear that this would withstand constitutional scrutiny under the *Riley* line of cases. See *supra* note 21 and accompanying text.

designed to produce widespread public knowledge, so the effect it might have on voters or donors is likely to be small. With only a remote chance of enforcement and the public embarrassment that might accompany it, there may be little disincentive for individuals to curtail their expenditures.

If California wants to keep out-of-state money from influencing its ballot initiatives, its new regulations are unlikely to succeed in doing that. Out-of-state actors may now have less influence in ballot initiatives—if California voters discount their message knowing their identity. Some political messages might be less well-funded than they would otherwise be because individuals refuse to publicly support what they might support privately. It was embarrassing for the owners of the Gap when they were revealed to be major donors to campaigns to defeat a tax measure and weaken labor unions in California.¹⁷⁸ But that embarrassment will now simply be a factor to weigh against the benefits to be had from supporting the measure publicly. While some issues or candidates will not make the grade, many donors will simply bite the bullet—as they long have for contributions made directly to candidates, political action committees, and political parties.¹⁷⁹

Against the limited effectiveness of disclosure as a remedy, states must weigh the burden of compliance on organizations. Additional reporting requirements means diversion of resources towards record-keeping, rather than core organizational activities. This is a perennial issue in the regulation of charities.¹⁸⁰ If the goal of the regulation is to create friction by increasing the price of campaign activities, then this cost might be seen as an advantage: it could incentivize some nonprofit organizations to engage in fewer campaign activities, and devote a greater percentage of resources to other purposes. But organizations are still likely to spend considerable energy attempting to avoid reporting thresholds,¹⁸¹ and donors may change the timing and/or

178. Anthony York, *List Unmasks Secret Donors to California Initiative Campaigns*, L.A. TIMES (Oct. 24, 2013), <http://articles.latimes.com/2013/oct/24/local/la-me-pc-secret-donors-california-initiatives-20131024>.

179. These have always been reported, and now they are easy to access. See *Transaction Query by Individual Contributor*, FED. ELECTION COMM'N, <http://www.fec.gov/finance/disclosure/norindsea.shtml>, (last visited Mar. 16, 2016) (providing a search of contributions by individual name); see also OPENSECRETS.ORG, <https://www.opensecrets.org/> (last visited Mar. 16, 2016) (website tracking the influence of money on U.S. politics).

180. See Reiser, *supra* note 107.

181. For example, organizations are likely to manage their expenditures to remain shy of the \$50,000 California mark if they can.

amount of their unrestricted contributions in order to remain anonymous.

Another concern is that these rules might not be effective in providing information that constitutes meaningful disclosure, even if organizations fully comply with the letter of the rules. The problem of dark money arises on account of daisy chains of organizations siphoning funds to one another. It may be impossible to get to any meaningful information about donors, even if there is full disclosure pursuant to the law. California's rule makes an attempt to follow through the chain of organizations, but New York's rule does not, making it easy to "fully disclose" while remaining completely opaque.

Noncharitable nonprofit organizations active in campaign activities may be interested in creating an appearance of transparency, without actually achieving it, so state laws may actually be weak by design. Groups across the political spectrum make independent expenditures without full transparency, and they are engaged in a race to the bottom in which neither one can afford to drop out. Real reform requires a level of political compromise that may be impossible—rivals need to agree and cooperate to prevent both union and business, liberal and conservative groups from secret spending.

VII. CONCLUSION

Even if the states have a legitimate interest in addressing the problem of dark money, nonprofits regulation might not be an appropriate response. Of the regulatory goals described above, only the goals of protecting charities and protecting nonprofit donors justify a nonprofit-law solution. New York repealed its nonprofits rule in deference to its election law, which is more consistent with the goals of protecting voters and the political process.¹⁸² California's regulation of multi-purpose organizations was never run through its charities law.¹⁸³ The overlapping jurisdictions under state law are impossible to sort out—New York state's Public Integrity Reform Act was adopted in 2011 to deal with concerns about opacity in legislative lobbying,¹⁸⁴ but there is no evidence that the New York legislature coordinated that law with its election law, even though both affect (c)(4) organizations.

182. See *supra* notes 92–93 and accompanying text.

183. See *supra* Section III.A.

184. See *supra* note 86 and accompanying text.

Any disclosure regime is limited, at best. It would be limited if imposed by the FEC or the IRS, but it is particularly limited when imposed by state election law because the states can only regulate their own elections. Both New York and California explicitly limit their statutes to elections and initiatives in their respective states. If every state adopted some sort of regulation, there would still be the immense universe of federal elections outside the regulatory scheme.

The scope problem may ultimately be the strongest reason for regulating dark money through state nonprofits law, rather than state election law. Nonprofits regulation can be explicitly geared toward protecting charities and donors. If states regulate nonprofits within their jurisdiction as a mechanism for informing donors and protecting charitable organizations in the state, that regulation could be more expansive. Those purposes justify extending regulation beyond elections within the state to any electioneering activity of the organization. While that policy might not withstand a legal challenge, it is more readily justified than a blanket election law. A federal resolution will ultimately be necessary to solve the problem of dark money in politics, but the states may be helpful in preparing the federal government for that day. At the very least, state regulation might pave the way, politically, for the federal government to do something.