

May 21, 1999

Mr. David Jones
Exempt Organizations
Internal Revenue Service
1111 Constitution Ave., Room 6033
Washington, D.C. 20224

Attention: CP:E:EO:R

Re: Technical Advice Memorandum (“TAM”) 9847006 (Aug. 11, 1998)

Dear Mr. Jones:

This office represents the National Association of Business Political Action Committees, Inc. (“NABPAC”). This letter follows our recent telephonic discussion regarding the above-cited TAM. The purpose of this letter is to convey some of NABPAC’s concerns about this TAM and to discuss how it conflicts with longstanding policies underlying the Federal Election Campaign Act, as amended (“Act”) and Federal Election Commission (“FEC”) regulations.

About NABPAC

NABPAC is a professional trade association of approximately 130 political action committees (PACs) sponsored by corporations, trade associations, and membership organizations. NABPAC’s members are registered with the FEC and qualify as “political committees” under the Act and as “political organizations” under § 527 of the Internal Revenue Code (“IRC”). These members accounted for \$54 million of \$502 million raised by all PACs during the 1997-98 election cycle.

NABPAC itself is not a PAC and does not intervene in election campaigns for public office. It conducts research, holds conferences on politics and PAC management, and supports legislative and regulatory measures that promote political participation, communication, disclosure, and competition. Its headquarters and sole office is located in Arlington, Virginia, and its Web site is <www.nabpac.com>.

TAM 9847006

The recently published TAM concluded that the proceeds of a PAC raffle conducted by a for-profit corporation do not qualify as “exempt function income” and therefore were taxable. The TAM further concluded that the deposit and commingling of PAC raffle proceeds with other PAC income (i.e., political contributions) would make all proceeds taxable. Both of these conclusions have caused great concern among NABPAC members and the PAC community at large. According to an informal survey of NABPAC members, over 34% of respondents confirmed that they have used raffles as a fundraising device for their PAC. As of January 1, 1999, there were 3,798 PACs registered with the FEC (FEC Press Release, Feb. 12, 1999). If the NABPAC survey is an indicator of the prevalence of raffles among PACs, then well over 1,000 PACs registered with the FEC might use raffles.

One reason for the widespread use of raffles by PACs is that they are expressly sanctioned by the FEC. As will be explained, the FEC condones and regulates PAC raffles. Moreover, the Act requires PACs to operate in a way that ensures that PAC raffles explicitly raise funds for political purposes.

FEC Regulation of PACs

The Act generally prohibits corporations and unions from making contributions or expenditures in connection with elections for federal office. 2 U.S.C. § 441b(a). However, covered organizations may establish, administer, and solicit voluntary donations from certain individuals to be deposited in a “separate segregated fund.” Id. § 441b(b)(2)(c). These separate segregated funds are “political committees” which must register with the FEC. Id. §§ 431(4)(B) & 433(a).

1. Solicitation Rules

Corporations and trade associations that sponsor federally registered separate segregated funds (popularly known as PACs) may not solicit the general public for contributions. Rather, they may solicit contributions, including contributions through a raffle, only from a “restricted class” of individuals. 11 C.F.R. § 114.1(j). A business corporation may solicit only its executive or administrative personnel, as well as its stockholders.[1] Trade associations have additional restrictions on their ability to seek contributions. Specifically, a trade association may not seek contributions from all of its members or members’ employees. Rather, a trade association which is comprised of corporate members must seek prior written approval from the corporation in order to solicit the executive and administrative personnel of that corporate member. See 11 C.F.R. § 114.8. Without the prior approval, the trade association may not solicit the employees of the corporate member.[2] These solicitation rules apply to the sale of PAC raffle tickets. See AO 1989-18, Fed. Election Camp. Fin. Guide (CCH) ¶ 5968 (1989).

The Technical Advice Memorandum described a corporation having a corporate dinner unrelated to the PAC at which the raffle was being held. This seems inconsistent with FEC requirements. A federally registered separate segregated fund could hold such a raffle at a corporate dinner only if those in the room were members of the corporation’s or the trade association’s “restricted class” and, in the case of trade associations, prior approval had been given to solicit these individuals for a PAC contribution. In other words, a federally registered corporate or trade association separate segregated fund could not hold a PAC raffle for the public at large or even for the company or trade association at large. Federal election law requires a limited audience which ensures the political purpose of the event and raffle.

2. PAC Raffles and the One-Third Rule

Since 1977, the Federal Election Commission Regulations have specifically recognized raffles as an appropriate fundraising device. The FEC regulation states that:

A corporation, labor organization, membership organization, cooperative , or corporation without capitol stock may . . . utilize a raffle or other fundraising device which involves a prize, so long as State law permits and the prize is not disproportionately valuable. Dances, parties, and other types of entertainment may also be used as fundraising devices. When using a raffle or entertainment to raise funds, a reasonable practice to follow is for the separate segregated fund to reimburse the corporation or labor organization for costs which exceed one-third of the money contributed.

11 C.F.R. § 114.5(b)(2).

This regulation is known as the one-third rule. Corporations and trade associations may pay the

administrative expenses of their PACs including the costs of raffle prizes. Id. § 114.1(b). However, because a corporation may not "trade" money with PAC contributors, any raffle prize expenses in excess of one-third of the proceeds must be reimbursed by the PAC to the corporation. See Explanation and Justification for 1977 Amendments to the Federal Election Campaign Act of 1971, House Document No 95-44, January 12, 1977 at 107.[3] The FEC has opined numerous times on the application of the one-third rule to PAC raffles. AO 1982-36, Fed. Election Camp. Fin. Guide (CCH) ¶ 5680 (1982); AO 1986-13, Fed. Election Camp. Fin. Guide (CCH) ¶ 5854 (1986); AO 1989-18, Fed. Election Camp. Fin. Guide (CCH) ¶ 5968 (1989); AO 1991-23, Fed. Election Camp. Fin. Guide (CCH) ¶ 6026 (1991).

The significance of the "one-third rule" is twofold in the context of the TAM. First, it underscores the legitimacy of raffles as political fundraising devices for PACs. Second, it ensures that PAC raffles will not promote extravagant prizes in exchange for political contributions. The costs of the prizes must be reasonable and the PAC sponsor has an incentive to ensure reasonable cost because failure to do so may result in forfeiture by the PAC of some portion of the raffle proceeds.

3. Mandatory Notices

The Federal Election Commission regulations require notices on all solicitations by separate segregated funds, including solicitations via PAC raffles. Specifically, all solicitations must inform the potential contributor that contributions to the PAC are strictly voluntary; that the individual may refuse to contribute without reprisal; and of the political purposes of the fund at the time of the solicitation. 11 C.F.R. § 114.5(a)(5). Furthermore, if guidelines for contributions are suggested, the potential contributor must be notified that the guidelines are merely suggestions, and that the individual may contribute more or less than the guidelines suggest and that the corporation or labor organization may not favor or disadvantage anyone by reason of the amount of their contribution or their decision not to contribute. Id. Thus, contrary to the facts described in the Technical Advice Memorandum, under federal law those "purchasing" raffle tickets to a raffle held by a separate segregated fund could not be unaware that their funds were being distributed to the federal PAC unless the PAC failed to comply with FEC notice requirements.

4. PAC Bank Accounts

FEC regulations permit multiple bank accounts for a PAC. 11 C.F.R. § 103.2. However, efficient PAC management discourages such practices. Contributions to and by a PAC must be accounted for and reported to the FEC. Id. §§ 102.9 & 104.3. Transactions must be itemized if in the aggregate they exceed a dollar threshold of \$200 per year. See FEC Form 3X, Schedules A & B. In order to monitor compliance with these requirements, PACs (and all political committees for that matter) tend to deposit all receipts into a single account and correlate deposits with electronically compiled and maintained data. The data often is stored through software which creates FEC reports when due. All contributor data, including the name, address, date, and amount of any purchaser of a PAC raffle ticket ordinarily would be collected and inputted at the time of deposit of the contribution into the PAC account. As a result, all PAC receipts, including raffle proceeds, are deposited and monitored for FEC compliance in the same way and through the same bank account. The TAM's conclusion that all PAC funds are taxable when commingled with raffle proceeds penalizes PACs which are following prudent procedures for complying with FEC requirements. This is an undesirable result as well as unjustified.

Conclusion

In light of how a PAC raffle operates for a federally registered separate segregated fund, NABPAC urges the Internal Revenue Service to reconsider and/or clarify Technical Advice Memorandum 9847006. Please feel free to contact me if I can be of further assistance.

Sincerely,

Jan Witold Baran

[1] Other employees may only be solicited in writing to their home addresses, twice yearly and under very strict custodial conditions. 11 C.F.R. § 114.6. It is the exception, rather than the rule, for these individuals to be solicited for PAC contributions.

[2] The “restricted class” for a labor union is its “members.” 11 C.F.R. § 114.5(g). Unions may solicit their members without prior approval.

[3] There are political committees registered with the FEC which are PACs, but are not sponsored by a corporation, union or trade association. They are “non-connected” political committees. Their administrative expenses may not be paid by a corporation, union, or trade association. Therefore, if they have a raffle, the PAC must pay the cost of the prize and the one-third rule does not apply.