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## FIRST GENERAL COUNSEL'S REPORT

**SENSITIVE**

MUR: 5283

DATE COMPLAINT FILED: July 3, 2002

DATE OF NOTIFICATION: July 9, 2002

DATE ACTIVATED: November 12, 2002

EXPIRATION OF SOL: January 31, 2007

MUR: 5285

DATE COMPLAINT FILED: July 19, 2002

DATES OF NOTIFICATION: July 26, 2002  
July 30, 2002

DATE ACTIVATED: November 12, 2002

EXPIRATION OF SOL: January 31, 2007

COMPLAINANTS: MUR 5283: New Jersey Democratic State Committee  
MUR 5285: The Gray PanthersRESPONDENTS: Douglas K. Forrester  
Forrester 2002 Committee  
Ronald R. Gravino, as treasurer of Forrester 2002<sup>1</sup>  
BeneCard Services, Inc.RELEVANT STATUTES: 2 U.S.C. § 441b(a)  
2 U.S.C. § 441b(b)  
2 U.S.C. § 1361  
2 U.S.C. § 1362  
11 C.F.R. § 110.10  
11 C.F.R. § 114.1  
11 C.F.R. § 114.2

INTERNAL REPORTS CHECKED: Disclosure Reports

FEDERAL AGENCIES CHECKED: None

<sup>1</sup> At the time the complaints initiating MURs 5283 and 5285 were filed, Jill K. Holtzman was the designated treasurer of the Forrester 2002 Committee. On August 13, 2002, the Forrester 2002 Committee filed an amended Statement of Organization, designating Ronald R. Gravino as its new treasurer, replacing Holtzman. Consequently, Gravino has been substituted for Holtzman as a Respondent in these matters.

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**I. GENERATION OF MATTER**

These matters were generated by two separate complaints, one filed on July 3, 2002 by the New Jersey Democratic State Committee, and another filed on July 19, 2002 by the Gray Panthers (collectively "Complainants"). Each complaint alleges that New Jersey Republican Senate candidate, Douglas K. Forrester, violated 2 U.S.C. § 441b(a) by illegally funneling corporate funds into his campaign in the form of personal loans made with money that he obtained from BeneCard Services Inc. The same four Respondents were named and notified in each of these two matters: Douglas K. Forrester, the Forrester 2002 Committee, Jill K. Holtzman, as treasurer,<sup>2</sup> and BeneCard Services Inc. (collectively "Respondents"). Respondents all designated the same counsel to represent them in these matters and they collectively filed a single response to both complaints. Because the two complaints are substantially similar, and because Respondents filed one response to address both complaints, this report also addresses both matters together.

**II. FACTUAL AND LEGAL ANALYSIS**

**A. Applicable Law**

The Federal Election Campaign Act of 1971, as amended ("the Act"),<sup>3</sup> limits to \$1,000 the amount an individual may contribute to a political committee per election. 2 U.S.C. § 441a(a)(1)(A); 11 C.F.R. § 110.1(b)(1). However, federal candidates may make unlimited expenditures from personal funds. 11 C.F.R. § 110.10(a). Personal funds are defined as "[a]ny

<sup>2</sup> See *supra* note 1.

<sup>3</sup> All of the facts relevant to these matters occurred prior to the effective date of the Bipartisan Campaign Reform Act of 2002 ("BCRA"), Pub. L. 107-155, 116 Stat. 81 (2002). Accordingly, unless specifically noted to the contrary, all citations to the Act or statements of law regarding provisions of the Act contained in this report refer to the Act as it existed prior to the effective date of BCRA. Similarly, all citations to the Commission's regulations or statements of law regarding any specific regulation contained in this report refer to the 2002 edition of Title 11, Code of Federal Regulations, published prior to the Commission's promulgation of any regulations under BCRA.

assets which, under applicable state law, at the time he or she became a candidate the candidate had legal right of access to or control over, and with respect to which the candidate had either: (i) legal and rightful title, or (ii) an equitable interest." 11 C.F.R. § 110.10(b)(1). Personal funds include, "[s]alary and other earned income from bona fide employment and dividends and proceeds from the sale of the candidate's stocks or other investments." 11 C.F.R. § 100.10(b)(2).

The Act prohibits the making and acceptance of corporate contributions in connection with an election for federal office. 2 U.S.C. § 441b; 11 C.F.R. § 114.2(a)-(b).

Furthermore, the Act defines a contribution as "any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office." 2 U.S.C. § 431(8)(A)(i). Similarly, the Act defines an expenditure as "any purchase, payment distribution, loan, advance, deposit, or gift of money or anything of value made by any person for the purpose of influencing any election for Federal office." 2 U.S.C. § 431(9)(A)(i). Corporate contributions or expenditures include, "any direct or indirect payment, distribution, loan, advance, deposit, or gift of money, or any services, or anything of value ... to any candidate, campaign committee, or political party or organization, or any other person" in connection with any primary or general election for the office of Senator. 2 U.S.C. § 441b(a), (b)(2); 11 C.F.R. § 114.1(a)(1).

The Technical Amendments Act of 1958 added Subchapter S to the Internal Revenue Code. Pursuant to this provision, a small business corporation may elect to have its income passed through and taxed to its shareholders as ordinary income rather than pay corporate income tax. See 26 U.S.C. §§ 1361-1362. Net operating losses may also be passed through. *Id.* A shareholder's gross income is deemed to include his or her pro rata share of the gross income of

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1 the corporation, while the aggregate amount of losses and deductions which the shareholder may  
2 take into account may not exceed the adjusted basis of the shares held by the individual and the  
3 adjusted basis of any indebtedness to that individual. 26 U.S.C. § 1366(c)–(d).

4 **B. Factual Background**

5 Respondent Douglas K. Forrester, a New Jersey businessman, was the Republican  
6 candidate for a New Jersey Senate seat in the November 2002 election. Forrester filed his  
7 Statement of Candidacy on January 15, 2002 and designated Forrester 2002 Inc. as his  
8 campaign's principal campaign committee,<sup>4</sup> with Jill Holtzman as its treasurer.<sup>5</sup> Forrester won  
9 the Republican nomination in the June 4, 2002 New Jersey primary race, and was set to face  
10 incumbent Senator Robert Torricelli in the general election. Subsequently, Senator Torricelli  
11 dropped out of the race and the Democratic Party replaced Torricelli on the Democratic ticket  
12 with Frank Lautenberg, to whom Forrester lost the November general election.

13 Forrester's campaign was largely self-financed.<sup>6</sup> On January 31, 2002, two weeks after  
14 filing his Statement of Candidacy, Forrester loaned the Forrester 2002 Committee \$3,985,000 to  
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<sup>4</sup> Forrester 2002 was the candidate's only campaign committee throughout most of his campaign. On September 7, 2002 and October 16, 2002, the treasurer of Forrester 2002, Inc. designated Forrester Victory Committee and Ferguson-Forrester 2002 Committee, respectively, as two additional authorized campaign committees for Forrester's campaign. Most of the disbursements made by each of these committees were transfers of funds to Forrester 2002. None of the transactions of either of these two committees are relevant to the issues raised by the complaints in these two matters.

<sup>5</sup> See *supra* note 1.

<sup>6</sup> Forrester spent a total of \$9.9 million on his campaign. According to Forrester's disclosure reports, \$8 million of the total amount was supplied by personal loans from Forrester to his principal campaign committee.

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fund his primary campaign.<sup>7</sup> See Forrester 2002 Inc., Amended April Quarterly Report dated 7/5/02, Schedule C; Amended July Quarterly Report dated 8/13/02, Schedule A.

The source of the money that Forrester used to make the loans in question was income he received from his privately owned company, BeneCard Services Inc. ("BeneCard"). See Signed Statement of Douglas K. Forrester, dated 9/04/02. BeneCard is a New Jersey based benefit service corporation specializing in supplemental benefit plans such as prescription drug and vision care. The company, formed in 1989, was incorporated in New Jersey and is organized under Subchapter S of the Internal Revenue Code. See Response at 2; Forrester Statement at 1. Forrester owns a majority of the shares in BeneCard and is one of two partners who own the company. *Id.* His shares of BeneCard have an estimated market value of over \$50 million and he reportedly received \$400,000 in salary and \$5 million of retained earnings in the year 2002. *Id.*

On May 14, 2002, Forrester filed his Public Financial Disclosure Report for Candidates with the Secretary of the Senate, as required of all federal candidates by the Ethics in Government Act of 1978. Forrester reported receiving \$5 million of retained earnings from BeneCard. See Douglas K. Forrester Personal Financial Disclosure Report for Candidates at 4, filed with the Secretary of the Senate on May 14, 2002, attached to MUR 5283 Complaint

<sup>7</sup> The funds were disbursed to the Committee in eight separate payments over two months as follows:

January 31, 2002	\$100,000
February 13, 2002	\$100,000
February 26, 2002	\$50,000
March 20, 2002	\$60,000
March 22, 2002	\$500,000
March 22, 2002	\$400,000
March 31, 2002	\$1,925,000
June 1, 2002	\$850,000

See Forrester 2002 Inc., Amended April Quarterly Report dated 7/5/02, Schedule A; Forrester 2002, Inc., Amended July Quarterly Report dated 8/13/02, Schedule A.

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1 ("Forrester Financial Disclosure Report"). Forrester reported the income in Part IIIB of the  
2 report, which called for the disclosure of the candidate's non-publicly traded assets and unearned  
3 income sources. Forrester identified the type of this income as a "Dividend" on the disclosure  
4 form by placing an "X" in the box labeled accordingly.<sup>8</sup> See Forrester Financial Disclosure  
5 Report, Part IIIB at 4. These funds were the source of the \$3,985,000 in personal loans that  
6 Forrester made to Forrester Inc. for the purpose of financing his primary campaign. See  
7 Response at 2; Forrester Statement at 1.

8 On July 1, 2002, the New Jersey Democratic State Committee filed a complaint with the  
9 Commission alleging that Forrester funneled corporate money into his campaign. Central to  
10 Complainant's allegations was that the personal loans provided by Forrester to his campaign  
11 committee for the purpose of funding his primary election campaign, were illegal corporate  
12 contributions because the source of the loan money was the \$5 million payment of retained  
13 earnings from BeneCard Services, Inc. The Complainant attached various materials to the  
14 complaint to support the assertions contained therein, including Forrester's publicly disclosed  
15 financial statement, financial disclosure reports of Forrester 2002 Inc. filed with the Commission,  
16 and copies of newspaper articles discussing Forrester's campaign financing.

17 On July 19, 2002, the Gray Panthers followed suit and also filed a complaint against  
18 Forrester and his campaign. The new complaint was substantially similar to the one previously  
19 filed by the New Jersey Democratic State Society. The complaint repeated the allegation that

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<sup>8</sup> Part IIIB of the form, requiring disclosure of all non-publicly traded assets and unearned income sources, requests three different pieces of information about each item listed in the section: the identity of the item, the valuation of the asset, and the type and amount of income derived from each item. The form offers eight different choices for identifying the type of income. These choices include (1) dividend (2) rent (3) interest (4) capital gains (5) excepted investment fund (6) excepted trust (7) qualified blind trust and (8) other. See Forrester Financial Disclosure Report at 4.

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Forrester funneled corporate money into his campaign by using the BeneCard payments to fund loans to Forrester 2002, personal funds of the individual); *Amended Complaint*, 11 C.F.R. § 110.10(a); 2 U.S.C. § 441b. Respondents filed a single response to both complaints on August 30, 2002, including a "Signed Statement" by Douglas Forrester ("Forrester Statement"). Respondents asserted that the funds given to Forrester from BeneCard were Forrester's personal funds, and he was therefore, free to loan those funds to his Senate campaign committee.

Subsequent to the filing of the Complaints in these matters, Forrester continued to make personal loans to the Forrester 2002 Committee to fund his general campaign. As with the loans he made to his campaign committee to fund his primary campaign, he financed the loans with payments of retained earnings he received from BeneCard. Forrester made \$4,557,831.59 in additional loans to his committee during his general election campaign.<sup>9</sup> Over the entire course of his Senate campaign, Forrester loaned a total of \$8,042,831.59 to his campaign.

### C. Analysis

Because candidates for federal office may make unlimited contributions from personal funds to their own campaign, while corporations are prohibited from making contributions to any political campaign, the central issue in this case is whether the funds used by Respondent Forrester to finance loans to his own campaign were his personal funds or those of his corporation, BeneCard Services, Inc. See 11 C.F.R. § 110.10(a); 2 U.S.C. § 441b. Complainants

<sup>9</sup> The funds were disbursed to the Committee in five separate payments over two months as follows:

June 30, 2002	\$2,000,000
August 4, 2002	\$1,335,798
September 12, 2003	\$722,033.59
October 30, 2002	\$200,000
November 1, 2002	\$300,000

See Forrester 2002, Inc., Amended July Quarterly Report dated 8/13/02, Schedule A, Forrester 2002 Inc.; October Quarterly Report, dated October 14, 2002, Forrester 2002 Inc.; Post-Election Report dated November 25, 2002, Detailed Summary Page.

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1 allege that the funds received by Forrester from BeneCard to fund loans to his campaign  
2 amounted to "a corporation paying corporate assets to a federal candidate for the purpose of  
3 influencing a federal election." MUR 5283, Complaint at 2. In response, Respondents argue that  
4 the payments made to Forrester by BeneCard "became [his] personal funds and BeneCard lost all  
5 claim on or interest in those funds." Response at 7. In order to determine whether the loans at  
6 issue were permissible loans financed with Forrester's personal funds, or impermissible loans  
7 financed with corporate funds from BeneCard, we must consider the nature of the payments at  
8 issue and how BeneCard's corporate structure affects ownership of the funds.

9 **1. Nature of Payment from BeneCard**

10 The MUR 5283 complaint observes, "Forrester's explanations of the payment have  
11 varied," first characterizing the payment as a "dividend," and later as a "distribution." MUR  
12 5283, Complaint at 1. Furthermore, both complaints allege that Forrester began using the term  
13 "distribution" to describe the payments from BeneCard only after he was unable to show that  
14 such a dividend was proper.<sup>10</sup> Complainants argue that Respondent Forrester's use of  
15 'conflicting' terms at different times to describe the funds that he received from BeneCard (and  
16 subsequently used to fund loans to Forrester 2002) "raise serious questions about his compliance  
17 with campaign finance law." MUR 5285, Complaint at 4.

18 The facts before us indicate that Complainants are correct in their assertion that  
19 Respondents have characterized the funds received by Forrester from BeneCard in two different  
20 ways. As discussed above, Forrester's Financial Disclosure Report, filed with the Senate on May

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<sup>10</sup> The New Jersey Democratic State Committee argued, "When asked to show whether BeneCard had a history of paying such "dividends," Forrester changed his story. He began calling the payment a "distribution" from an S-corporation, permissible because he was one of its shareholders." MUR 5283, Complaint at 2. Similarly, the Gray Panthers noted that "Mr. Forrester changed his story when pressured about the dividends initially and began to classify the payment more as a distribution from an S-corporation." MUR 5285, Complaint at 2.

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1 14, 2002, reports that in 2002, Forrester earned a 'dividend' from BeneCard in an amount  
2 exceeding \$5,000,000. *See* Forrester Financial Disclosure Report at 4, Part IIIB. However, in  
3 their response to the complaints in these matters, Respondents characterize the payments  
4 received by Forrester from BeneCard as "authorized distributions of some retained earnings," a  
5 portion of which Forrester used to make loans to his campaign committee. *See* Response at 2;  
6 Forrester Statement at 1. Forrester also describes the source of the funds as a 'distribution' in  
7 newspaper articles and press interviews. *See, e.g.,* David Kinney, *Democrats Challenge*  
8 *Forrester on Legality of Campaign Funding*, THE STAR-LEDGER, June 13, 2002, at A1, attached  
9 to MUR 5283 Complaint.

10 Despite Respondents' use of different terms to describe the nature of the payments from  
11 BeneCard, there is no evidence to support Complainants' allegation that Respondents described  
12 the payments in different manners in order to disguise a violation of the Act. First, under New  
13 Jersey statute, a distribution may be made in the form of a dividend. *See* N.J. STAT. ANN. § 14A:  
14 7-15(1) (West 2002). Therefore, in some cases it is appropriate to use the terms interchangeably,  
15 or in conjunction with one another. Second, the only instance in which Forrester himself referred  
16 to the payments exclusively as a 'dividend' was in his Financial Disclosure Report.<sup>11</sup> Notably, in  
17 the form provided for the completion of that report, the term 'dividend' was one of the seven  
18 specific choices provided for describing unearned income sources, while 'distribution' was not

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<sup>11</sup> The references to dividends contained in the complaints refer to third party press reports that are most likely based on Forrester's filed Financial Disclosure Report. *See, e.g.,* Associated Press account on 5/29/02, cited in MUR 5285, Complaint at 1; Iver Peterson, *A New Jersey Senate Candidate Lists \$3 Million from Dividends*, THE NEW YORK TIMES, May 14, 2002, at B5 ("Douglas R. Forrester, a candidate for the Republican nomination for the United States Senate, has used at least \$3 million in dividends from his company to pay for his campaign, he reported today in documents required under Senate ethics rules.").

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among the choices listed.<sup>12</sup> In almost all other instances noted in the complaints and the response, the Forrester campaign has used the term 'distribution' to describe the payments he received from BeneCard.<sup>13</sup>

Complainant Gray Panthers also suggests that if the funds Forrester received from BeneCard are dividends, such a dividend may be impermissible under law, negating the dividend and making the funds corporate funds. First, the Gray Panthers argue that the funds do not qualify as dividends because BeneCard did not declare them on an annual basis. *See* MUR 5285, Complaint at 2. Second, the Gray Panthers argue that dividends must be based on corporate profits; therefore, if the dividends are overvalued, the overvalued amount would not be a bona fide dividend of the company and would therefore constitute a corporate contribution by BeneCard. *Id.* However, the Gray Panthers do not present any factual evidence or legal authority to support their arguments. In particular, the allegation that there were insufficient assets to support a \$5 million dividend from BeneCard to Forrester is wholly speculative and does not withstand the type of scrutiny needed at this stage of the enforcement process to support a reason to believe finding.

New Jersey Statute states that "a corporation may, from time to time, by resolution of its board, pay dividends on its shares in cash, in its own shares, in its bonds or in other property." N.J. STAT. ANN. § 14A: 7-15(1) (West 2002). Therefore, New Jersey corporations are not

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<sup>12</sup> *See supra* note 6.

<sup>13</sup> There is one internet news article which reports that a Forrester spokesman, Tom Rubino, explained that the source of the money loaned by Forrester to his campaign as a dividend from BeneCard. *See* Brian P. Murphy, *With \$6 Million, Torricelli Battles Forrester's Deep Pockets* (July 15, 2002) [http://www.politicsnj.com/murphy071502\\_FEC.htm](http://www.politicsnj.com/murphy071502_FEC.htm). However, in an article appearing on the same internet site three days later, Rubino reportedly combined the terms to describe the source of the money as a "dividend distribution". *See* Brian P. Murphy, *Group Files Complaint Against Forrester's Use of Personal Funds* (July 15, 2002) [http://www.politicsnj.com/murphy071802\\_graypanthers.htm](http://www.politicsnj.com/murphy071802_graypanthers.htm).

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1 limited to annual dividends. However, the authority to pay dividends is "subject to any  
2 restrictions contained in the certificate of incorporation and to the provisions of section 14A: 7-  
3 14.1." *Id.* Section 14A: 7-14.1 prohibits dividends "if, after giving effect thereto, either: (a) The  
4 corporation would be unable to pay its debts as they become due in the usual course of its  
5 business; or (b) The corporation's total assets would be less than its total liabilities." N.J. STAT.  
6 ANN. § 14A: 7-14.1(2)(a) and (b) (West 2002). There is no evidence to suggest that BeneCard  
7 would be prohibited from declaring a dividend of over \$5 million to Forrester under these  
8 statutes. Forrester indicates that BeneCard is currently valued at over \$50 million. *See Response*  
9 *at 2; Forrester at 1.* None of the information before us even suggests that BeneCard would be  
10 unable to pay its debts or that the company's assets would be less than its liabilities if such a  
11 dividend were declared.<sup>14</sup> As a result, there is no indication that a \$5 million dividend to  
12 Forrester would be impermissible under New Jersey law.<sup>15</sup>

13 Based on the foregoing, this Office concludes that Respondent's use of two different  
14 terms to describe the funds Forrester received from BeneCard offers no evidence that  
15 Respondents have violated any provisions of the Act. Next, we must examine whether Forrester  
16 had ownership of the funds at issue, in order to make them "personal funds" within the meaning  
17 of the Act.

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<sup>14</sup> This Office searched public records to verify the financial information provided by Respondents regarding BeneCard. However, because BeneCard is a closely held private corporation, this Office found no available public records to independently verify the information. Nevertheless, this Office has found no reason to doubt the veracity of the information provided by Respondents in their response to the complaint. Similarly, BeneCard's certificate of incorporation is not available for inspection.

<sup>15</sup> Similarly, there is no evidence to suggest that the payment would be improper in the form of a distribution. A distribution is defined as "a direct or indirect transfer of money or other property ...or incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect to any of its shares. N.J. STAT. ANN. § 14A: 7-14.1(1)(West 2002). Under New Jersey statute, distributions are subject to the same limitations described above for dividends. N.J. STAT. ANN. § 14A: 7-14.1(2)(a) and (b)(West 2002). Therefore, again, there is no evidence to suggest that BeneCard would be prohibited from distributing over \$5,000,000 to Forrester under these statutes. Consequently, this Office finds credible Forrester's claim that he received the money in the form of a distribution.

**2. Ownership of Funds from BeneCard**

Here, we are faced with the issue of whether the funds Forrester received from BeneCard were his "personal funds" within the meaning of the Act, or whether they belonged to the corporation at the time they were used to make loans to Forrester's campaign. Personal funds are defined as "[a]ny assets which, under applicable state law, at the time he or she became a candidate the candidate had legal right of access to or control over, and with respect to which the candidate had either: (i) legal and rightful title, or (ii) an equitable interest." 11 C.F.R. § 110.10(b)(1). Personal funds include, "[s]alary and other earned income from bona fide employment and dividends and proceeds from the sale of the candidate's stocks or other investments." 11 C.F.R. § 100.10(b)(2).

In the case of S-corporations, like BeneCard, we are presented with unique circumstances in resolving the issue of when funds of an S-corporation become personal funds of the corporation's shareholders. Pursuant to Title 26, Subtitle A, Chapter 1, Subchapter S of the Internal Revenue Code, a small business corporation may elect to have its income and net operating losses passed through and taxed to its shareholders as ordinary income rather than pay corporate income tax. *See* 26 U.S.C. § 1362. The purpose of Subchapter S status is to permit small businesses to avoid double taxation, i.e., of the corporation and then again of shareholders. *U.S. v. Falcone*, 934 F.2d 1528, 1548 (11<sup>th</sup> Cir. 1991), citing *Ad-Vantage Tel. Directory Consultants v. GTE Directories Corp.*, 849 F.2d 1336, 1352 (11<sup>th</sup> Cir. 1987). *See generally* 1 F. O'Neal & Thompson, *Close Corporations* § 2.06 (3<sup>rd</sup> ed. 1986). With Subchapter S status, a shareholder's gross income is deemed to include his or her pro rata share of the gross income of the corporation. 26 U.S.C. § 1366(c)–(d).

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1 A shareholder of an S-corporation may not actually receive his share of the profits at the  
2 time that he pays personal income tax on the profit.<sup>16</sup> Rather, a majority of the shareholders of  
3 the corporation must declare a dividend or a distribution before the shareholders receive the  
4 funds. *U.S. v. Falcone*, 934 F.2d 1528 (11<sup>th</sup> Cir. 1991), *aff'd en banc*, 960 F.2d 988 (11<sup>th</sup> Cir.  
5 1992), *cert. denied*, 506 U.S. 902 (1992), *Falcone*, 934 F.2d at 1548. Therefore, the relevant  
6 issue in this case is whether a shareholder's profits become their own personal funds within the  
7 meaning of the Act at the time the shareholder pays taxes on the profits, when the profits are  
8 distributed to the shareholders, or at some other time.

9 The 11<sup>th</sup> Circuit confronted this issue in *U.S. v. Falcone*, 934 F.2d 1528 (11<sup>th</sup> Cir. 1991),  
10 where two criminal defendants appealed their convictions on bank larceny charges, among  
11 others. The defendants argued that they were entitled to the funds they were convicted of  
12 stealing because the funds were withdrawn from a subchapter S-corporation of which one of the  
13 defendants was a shareholder. The crux of their argument was that funds of an S-corporation

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<sup>16</sup> The unique nature of structure of S-corporations has required the Commission to confront the issue of whether Section 441b's prohibition on corporate contributions applies to S-corporations. In MUR 3119, the respondent argued that the constitutional justifications for Section 441b's prohibition on corporate contributions do not apply to S-corporations because such a corporation does not pose the danger of aggregated wealth amassed through the corporate form, since its shareholders must pay individual income tax on its income. MUR 3119, Response at 3. Respondents wrote, "the primary Congressional motivation for singling out corporations for different treatment than that accorded to partnerships or other forms of business operations under the Act was the corporate potential for amassing large aggregations of wealth due to the favorable tax treatment accorded corporations." MUR 3119, Response at 6. See *FEC v. MCFL*, 479 U.S. 238, 257 (1986). The Commission rejected this argument. The First General Counsel's Report adopted by the Commission stated that "although [the corporation] is treated as an S corporation for tax purposes, it remains a corporation for purposes of the Federal Election Campaign Act ("the Act"). The tax ramifications of an S corporation does not remove the funds from corporate control." MUR 3119, *First Gen. Counsel's Rep.* dated 8/6/91. The report concluded that "to view the [corporation] funds as personal rather than corporate funds, ...solely based on tax consequences to the shareholder - would erode the clear meaning of the statute at Section 441b and go far beyond the Commission's consistent application of Section 441b to all corporations regardless of their structure and purpose." *Id.* at 4-5.

The Commission has, by regulation, allowed an exception for political committees incorporated for liability purposes only. 11 C.F.R. § 114.12(a). The Supreme Court made a limited exception in *FEC v. Mass. Citizens for Life*, 479 U.S. 238 (1986), for a particular type of entity organized to promote ideas rather than for economic gain.

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1 belong to the individual shareholders of that corporation. The Court found that profits of an S-  
2 corporation remain the property of the corporation until a majority of its shareholders declare a  
3 dividend or distribution. *Id.* at 1548. The Court wrote, "although the shareholders of a  
4 subchapter S corporation report, pay taxes on, and take deductions for a pro rata share of the  
5 corporation's income and losses on their personal tax returns, the corporation retains its income  
6 until the board of directors, in its discretion, declares a dividend." *Id.* at 1547-8, citing *O'Neal*  
7 & R. Thompson, *Close Corporations* (3<sup>rd</sup> ed. 1986), § 2.06 at 34 ("shareholder is taxed on his  
8 proportionate part of corporate income, even though income is not actually distributed to him."  
9 Because 'declaration of dividends is entirely within the discretion of the corporation's board of  
10 directors"). Because the defendants in *Falcone* could not show that a majority of the  
11 shareholders of the corporation declared such a dividend, the Court upheld the convictions.

12 As noted in both complaints and the response filed in this case, the Commission  
13 previously has considered whether funds originating from a subchapter S-corporation were a  
14 candidate's "personal funds" within the definition set forth at 11 C.F.R. § 110.10, or were funds  
15 belonging to the corporation. See MURs 3119 and 3191.

16 In MUR 3119, the Commission considered a complaint alleging that a committee violated  
17 the Act by accepting loans from the candidate which "were derived from the borrowings by the  
18 candidate from an S-corporation of which the candidate was a principal stockholder." MUR  
19 3119, Complaint at 1. In response to the complaint, the respondents conceded that the candidate  
20 borrowed the funds at issue directly from the corporation, but argued that "because of 'the  
21 corporate and tax structure of [an S-corporation], the funds loaned to [the committee] were

1 "personal funds" of the candidate within the definition set forth at 11 C.F.R. § 110.10." MUR  
2 3119, First Gen. Counsel's Rep. dated 8/6/91, at 2.

3 Under those circumstances, the Commission found reason to believe that Respondents  
4 had violated 2 U.S.C. § 441b regarding loans from the S-corporation to the candidate, noting that  
5 "the money provided to [the candidate] in this matter originated directly from [the corporation's]  
6 general treasury funds in the forms of loans which [the candidate] was required to satisfy, thus  
7 evidencing that these funds were controlled by [the corporation] and not [the candidate]."<sup>17</sup>  
8 MUR 3119, First Gen. Counsel's Rep. dated 8/6/91, at 4; *see also* MUR 3119, Factual and Legal  
9 Analysis dated 1/18/02.

10 In MUR 3191, the Commission again confronted the issue of whether a committee  
11 accepted prohibited corporate contributions when a candidate borrowed money from his personal  
12 equity in an S-corporation in which he had a 50% interest, and then loaned the money to his  
13 campaign. The issue was whether the loan from the S-corporation was a permissible use of the  
14 candidate's personal funds, or an impermissible use of the S-corporation's funds. Again, this  
15 Office reiterated that, "a Subchapter S corporation retains as its own any income taxed to  
16 individual shareholder [sic] until such time as a distribution or dividend is declared." MUR  
17 3191, First Gen. Counsel's Rep. dated 11/30/90, at 13. In that case, the Commission found that  
18 the Committee violated 2 U.S.C. § 441b(a) because the candidate took a loan from the S-  
19 corporation of which he was a shareholder based upon his equity in the corporation, rather than  
20 taking a draw down of that equity. In other words, the candidate had a loan from a drawing

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<sup>17</sup> On this point respondents argued that "had [the candidate] understood the technical significance of the Commission's interpretation of Section 441b, she could simply have directed that [the corporation] distribute \$266,000 to her rather than borrow it from [the corporation]," liquidated her interest in the corporation and used the proceeds, or used her interest in the corporation as collateral to obtain a bank loan. MUR 3119, Response at 4.

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1 account which was repayable to the corporation. Because the loan was repayable to the  
2 corporation, the Commission found that it had been made with corporate funds. *Id.*  
3 In this case, Forrester, as a shareholder in the S-corporation, pays taxes on his respective  
4 shares of BeneCard's earnings. According to the response filed in this case, Forrester has  
5 typically chosen to leave any of his earnings in BeneCard to provide working capital for the  
6 company. See Response at 2; Forrester Statement at 1. In 2002, the Board of Directors of  
7 BeneCard authorized distributions of retained earnings of each of its two shareholders. *Id.*  
8 Although the response does not provide the precise dates and amounts of the authorized  
9 distributions, it is implied that that they preceded each loan from Forrester to his campaign.

10 Complainants argue that "distributions from BeneCard to Mr. Forrester's campaign  
11 appear to violate a core principle of campaign finance law. Federal law prohibits any corporation  
12 to make a contribution in the election for United States Senate." MUR 5285, Complaint at 3.  
13 Both complaints point to the outcomes of MURs 3119 and 3191 as support for their conclusion.  
14 See MUR 5285, Complaint at 3; MUR 5283, Complaint at 2.

15 However, the fact that Forrester, prior to loaning the money to his campaign, received the  
16 funds from BeneCard in the form of a Board of Directors approved distribution of earnings he  
17 had retained in the corporation, distinguishes this case from MURs 3119 and 3191 in a most  
18 significant way. Unlike the candidate respondents in MURs 3119 and 3191, who each borrowed  
19 funds directly from their respective corporations, Forrester was not required to repay the  
20 distributed funds to BeneCard, nor did BeneCard maintain any interest in those funds once the  
21 distribution was made. Therefore, in this case the funds from BeneCard became Forrester's  
22 "personal funds" at the time the funds were distributed to him. See *Falcone*, 934 F.2d at 1547-8

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(once a corporation declares a dividend or makes a distribution, the funds no longer belong to the corporation, but are the personal funds of the individual); *Athens Lumber Co. v. FEC*, 531 F. Supp. 756, 761 (M.D. Ga. 1982), *rev'd on other grounds*, 689 F.2d 1006 (11<sup>th</sup> Cir. 1982) (personal funds include dividends from corporations on which personal income tax has already been paid). As such, Forrester was free to loan the amounts received from BeneCard to his campaign in whatever amount he pleased. *See* 11 C.F.R. § 110.10(a).

Based on the foregoing, this Office concludes that whether the payments to Forrester were dividends or distributions is a distinction without difference in this case. The funds received by Forrester from BeneCard became "personal funds" of Forrester within the meaning of the Act whether they were characterized as a dividend or a distribution. Consequently, this Office recommends that the Commission find no reason to believe that any of the named respondents in either MUR 5283 or 5285 violated 2 U.S.C. § 441b(a).

**V. RECOMMENDATIONS**

**A. MUR 5283**

1. Find no reason to believe that Douglas K. Forrester, the Forrester 2002 Committee, Ronald R. Gravino, as treasurer of Forrester 2002, and BeneCard Services Inc. violated 2 U.S.C. § 441b(a).
2. Approve the appropriate letters.
3. Close the file.

**B. MUR 5285**

1. Find no reason to believe that Douglas K. Forrester, the Forrester 2002 Committee, Ronald R. Gravino, as treasurer of Forrester 2002, and BeneCard Services Inc. violated 2 U.S.C. § 441b(a).
2. Approve the appropriate letters.
3. Close the file.

1 allege over the funds recovered by the FBI from the effort to identify and locate  
2 **Lawrence H. Norton**

3 **General Counsel** for the Department of Justice  
4

5  
6 2/12/03  
7 Date

8 BY:

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