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Political Organizations Under Section 527 of the Internal Revenue Code

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Summary

Political organizations have the primary purpose of influencing federal, state, or local elections and conducting similar activities. Those that qualify under section 527 of the Internal Revenue Code are taxed only on certain income. Under the Code, 527 organizations are subject to reporting requirements that involve registration, the periodic disclosure of contributions and expenditures, and the annual filing of tax returns. Section 527 organizations must also comply with applicable campaign finance laws. This report will briefly describe these organizations and the reporting requirements they face under the Code. The report will be updated as events warrant.

Background. Prior to 1975, the Internal Revenue Code (IRC) was silent as to the tax treatment of organizations whose primary purpose is influencing elections. The Internal Revenue Service (IRS) treated contributions to political organizations as gifts, which meant that the organizations did not have taxable income and were not required to file tax returns. By the early 1970s, it was apparent that these organizations had sources of income besides contributions, and the IRS began requiring those with investment and other types of income to file tax returns and pay tax at the corporate rate.

P.L. 93-635, enacted in 1975, added section 527 to the IRC to address the tax treatment of political organizations. The section grants tax-exempt status to qualifying political organizations. This treatment is the focus of this report, but it should be noted that section 527 has two other purposes: it imposes a tax on 501(c) organizations that make political expenditures¹ and it clarifies that expenditures by political organizations on behalf of an individual are generally not income to the individual.

¹ These organizations are not treated as 527 organizations for purposes of the reporting requirements discussed in this report.

Section 527 Political Organizations

Political organizations that qualify under section 527 are granted tax-exempt status and taxed only on certain income. Organizations that do not qualify are taxed on all income. A political organization is any organization, including a party, committee, association, or fund,² that is organized and operated primarily to directly or indirectly accept contributions and/or make expenditures for an *exempt function*.

An *exempt function* is the influencing or attempting to influence the selection, nomination, election, or appointment of an individual to a federal, state, or local public office, to an office in a political organization, or as a Presidential or Vice-Presidential elector.³ An *exempt function* does not necessarily involve explicitly advocating for or against the individual. For example, when determining whether an issue advocacy communication is for an *exempt function*, the IRS looks at such things as whether it identifies a candidate, identifies his or her position on the issue and this has been raised to distinguish the candidate from others, is timed to coincide with an election, targets voters in a particular election, and is not part of an ongoing series of similar communications by the organization on the same issue.⁴

527 organizations are subject to tax only on *political organization taxable income*. This is the organization's gross income, excluding *exempt function income*, less \$100 and any allowable deductions. *Exempt function income* is any amount received, to the extent that it is segregated to use for an *exempt function*, as:

- contributions of money or other property,
- membership dues, fees, or assessments,
- proceeds, which are not received in the ordinary course of business, from political fundraising and entertainment events or from the sale of campaign materials, and
- proceeds from conducting a bingo game.

The tax rate is generally the highest corporate income tax rate. However, under IRC § 527(h), income of the principal campaign committee of a Congressional candidate is taxed using the graduated corporate tax rate schedule. This is not true for campaign committees of candidates for state or local office.

527 organizations include the entities regulated by the Federal Election Campaign Act (FECA), as amended by the Bipartisan Campaign Reform Act (BCRA).⁵ For example, political parties and candidate committees are 527 organizations. Furthermore,

² This includes qualifying newsletter funds. IRC § 527(g). In order to qualify, the fund must be established and maintained (1) by an individual who holds or is a candidate for elective public office and (2) for the exclusive use of preparing and circulating the individual's newsletter.

³ An *exempt function* includes making expenditures relating to these offices if the expenses would be allowed as a business deduction if incurred by the individual.

⁴ Rev. Rul. 2004-6.

⁵ For an explanation of these Acts, see CRS Report RL31402, *Bipartisan Campaign Reform Act: Summary and Comparison with Previous Law*, by Joseph E. Cantor and L. Paige Whitaker.

527 organizations are subject to BCRA's disclosure requirements for "electioneering communications" and prohibition on incorporated entities using general treasury funds to finance them.⁶ However, not all 527 organizations are regulated by FECA. 527 organizations may be able to raise and/or spend money outside of FECA for activities that are (1) unrelated to federal elections (e.g., those intending to influence state elections or the appointment to a federal office) or (2) issue advocacy communications that are not electioneering communications. The Federal Election Commission (FEC) has been considering whether to promulgate rules to further address when 527 organizations are subject to regulation under FECA. On August 19, 2004, the FEC adopted a rule that would generally subject an organization to regulation if it solicits contributions to support or oppose a clearly-identified federal candidate.

Reporting Requirements

Prior to 2000, certain political organizations received the tax benefits of section 527 without reporting their existence to the FEC or the IRS. This was because not all 527 organizations reported to the FEC under FECA and organizations only filed a return to the IRS if they had taxable income. The fact that organizations could qualify under section 527 without reporting to the FEC was largely unnoticed until 1996, when the IRS began issuing guidance on the types of activities that qualify as *exempt functions*.⁷ This awareness helped lead to an increase in the number of 527 organizations, called "stealth PACs," that were designed to avoid reporting to the FEC. In 2000 and 2002, Congress amended section 527 to require that organizations report to the IRS, the FEC, or a state.⁸

Notification of Sstatus. An organization must notify the IRS of its 527 status by electronically filing Form 8871 within 24 hours of its formation.⁹ The information provided on Form 8871 includes the organization's name, address, and purpose; names and addresses of certain employees and directors; and name of and relationship to any related entities. An organization that fails to timely file the form will not be treated as a 527 organization (i.e., it will be subject to tax on all income) for the period between its formation and the filing. An organization that fails to notify the IRS within thirty days of any material change to the reported information will not be treated as a 527 organization for the period between the change and the notification.

The notice requirements do not apply to a 527 organization that:

- anticipates having gross receipts of less than \$25,000 for any year,
- is a political committee of a state or local candidate,
- is a state or local committee of a political party, or
- is required to report to the FEC as a political committee.

⁶ Electioneering communications are broadcast, cable, or satellite advertisements that refer to a clearly-identified federal candidate within sixty days of a general election or thirty days of a primary election and, if a House or Senate election, are targeted to the relevant electorate. 2 USC § 434(f)(3)(A)(i).

⁷ PLR 9652026 (1996); PLR 9725036 (1997); PLR 9808037 (1997); PLR 199925051 (1999).

⁸ P.L. 106-230; P.L. 107-276.

⁹ IRC § 527(i).

Disclosure of Expenditures and Contributions. A 527 organization that accepts a contribution or makes an expenditure for an *exempt function* must periodically file a disclosure report, Form 8872, with the IRS.¹⁰ The report may be filed electronically, and organizations with annual contributions or expenditures exceeding \$50,000 must do so. The organization may file on a (1) quarterly basis in a year with a regularly scheduled election and semi-annually in any other year or (2) monthly basis. There are additional requirements for pre-general election, post-general election, and year-end reports. An organization that fails to file a timely or accurate Form 8872 is subject to a penalty that equals the highest corporate tax rate multiplied by the amount of contributions and/or expenditures to which the failure relates.

A periodic report must include (1) the name, address, occupation, and employer of any contributor who makes a contribution during the reporting period and has given at least \$200 during the year, along with the amount and date of the contribution, and (2) the amount, date, and purpose of each expenditure made to a person during the reporting period if that person has received at least \$500 during the year, along with the person's name, address, occupation, and employer.

The disclosure requirements do not apply to a political organization that is not required to or did not file a Form 8871 (see above) or is a qualified state or local political organization.¹¹ The requirements also do not apply to any expenditure that is an independent expenditure (i.e., an expenditure that expressly advocates for a candidate but is made without the candidate's cooperation).

In 2003, the Eleventh Circuit Court of Appeals vacated and remanded, with instructions to dismiss for lack of jurisdiction, a district court's decision that held most of the disclosure requirements were unconstitutional.¹² The district court had held that the requirements for organizations involved in state and local elections violated the Tenth Amendment¹³ and the requirement to disclose expenditures violated the First and Fifth Amendments. The basis of the district court's decision was that the requirements were part of a regulatory (campaign finance reform) scheme that was subject to a higher level of scrutiny than action under Congress' taxing powers would be. The district court then closely examined the requirements and found some to be impermissible. For example, the district court held that the requirement to disclose expenditures was unconstitutional because Congress had not sufficiently tailored the requirement to meet its informational

¹⁰ IRC § 527(j).

¹¹ Under section 527(e)(5), a qualified state or local political organization is (1) intended to influence the selection, nomination, election, or appointment of an individual to a state or local political office or office in a state or local political organization and (2) required to report information regarding contributions and expenditures to the state. The state's reporting requirements must be similar to the federal ones. A federal candidate or officeholder may not be involved in the organization.

¹² *Mobile Republican Assembly v. United States*, 353 F.3d 1357 (11th Cir. 2003), *vacating and remanding* *National Fed'n of Republican Assemblies v. United States*, 218 F.Supp.2d 1300 (S.D.Ala. 2002), *as amended by* 2002 U.S. Dist. LEXIS 20845 (S.D.Ala. 2002).

¹³ Congress has since exempted these organizations from the requirements. P.L. 107-276.

and corruption-related goals or established a compelling reason to treat political organizations differently than other tax-exempt organizations. The Court of Appeals held that the disclosure requirements fell within Congress' power to tax and that the Anti-Injunction Act, which requires taxpayers pay a tax before disputing it, barred the suit.

Information Return. Section 527 organizations with gross receipts of at least \$25,000 (\$100,000 if a qualified state or local political organization) must annually file an information return, Form 990, with the IRS.¹⁴ Form 990 includes such information as the organization's revenue sources and functional expenses. Contributions of at least \$5,000 must be reported on the form's Schedule B. An organization that fails to file a timely or accurate return is subject to a penalty of \$20 per day, not to exceed the lesser of \$10,000 or 5% of the organization's gross receipts.¹⁵ For organizations with more than \$1 million in gross receipts, the penalty is \$100 per day and is limited to \$50,000.

A 527 organization is not required to file Form 990 if it is:

- a state or local committee of a political party,
- a political committee of a state or local candidate,
- required to report to the FEC as a political committee,
- a caucus or association of state or local officials,
- an authorized committee under FECA § 301(6) of a candidate for federal office,
- a national committee under FECA § 301(14) of a political party, or
- a Congressional campaign committee of a political party committee.¹⁶

Tax Return. Any tax-exempt organization with *political organization taxable income* must file a tax return, Form 1120-POL, with the IRS.¹⁷ An organization that does not file a return will be penalized for each month the return is late in an amount that equals 5% of the tax due, not to exceed 25% of the tax due.¹⁸ An organization that is late in paying its taxes will be penalized for each month the payment is late in an amount that equals 0.5% of the unpaid tax, not to exceed 25% of the unpaid tax.¹⁹ Neither penalty will be imposed if the organization shows that the failure was due to reasonable cause. The penalties may be increased if the failure was due to negligence or fraud.²⁰

¹⁴ IRC § 6033(g).

¹⁵ IRC § 6652(c)(1)(A).

¹⁶ IRC § 6033(g)(3).

¹⁷ IRC § 6012(a)(6).

¹⁸ IRC § 6651(a)(1). Under IRC § 6652(c)(1)(A), the penalty for failing to file Form 1120-POL is the same penalty that applies for failing to file Form 990. It appears to be the IRS's position that the penalty under IRC § 6651 applies rather than the penalty under IRC § 6652 and that "[a] technical correction may be needed to clarify that penalties under § 6652 that apply to failure to file Form 990 . . . do not apply to a failure to file Form 1120-POL." Rev. Rul. 2003-49.

¹⁹ IRC § 6651(a)(2).

²⁰ IRC § 6662 and 6663.

Public Access. The IRS and the 527 organization must make Forms 8871, 8872, and 990 publicly available.²¹ An organization that fails to do so is subject to a penalty of \$20 per day, which is limited to \$10,000 for failures relating to Forms 8872 and 990.²² Furthermore, the IRS must post electronically-submitted Forms 8871 and 8872 in an on-line database within 48 hours of their filing. The database also includes some organizations' Forms 8871, 8872, and 990 that were submitted on paper. The database is available at [<http://forms.irs.gov/politicalOrgsSearch/search/basicSearch.jsp?ck>].

Dual Reporting. Some 527 organizations may have to report to the IRS and the FEC. As discussed above, organizations that report to the FEC as political committees do not file Forms 8871, 8872, and 990 with the IRS. Under BCRA, organizations that spend more than \$10,000 on electioneering communications must report to the FEC. Organizations that report to the FEC solely under this rule are not exempt from the IRS reporting requirements since they are not reporting to the FEC as political committees.

²¹ IRC § 6104. P.L. 107-276 repealed the requirement that Form 1120-POL be made available.

²² IRC §§ 6652(c)(1)(C) and (D).