

Congress Requires Disclosure by Section 527 Organizations

The current push for campaign finance reform had its first victory in a modification of the tax laws.

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Congress has, somewhat unexpectedly, passed the first campaign finance legislation in over 20 years. The legislation requires Section 527 political organizations to disclose detailed information about their activities, sources of support, and expenditures to the IRS and the public. While many Section 527 organizations already make such disclosures to either the Federal Election Commission (FEC) or state election bodies, and through them to the public, many others have operated with no reporting or disclosure requirements whatsoever—until now.

A LITTLE HISTORY

Before 1975, political parties and campaign committees operated in a tax limbo. The Code was silent on the proper tax treatment of such organizations and gifts to them, leaving the IRS with the difficult task of making these determinations. Tax practitioners generally

assumed that these organizations were not subject to federal income tax. The IRS generally accepted this assumption with respect to gifts for political purposes, but over time shifted its views regarding whether other income received by such organizations would be exempt from tax and whether such organizations had to file returns.¹ The IRS and the courts also disagreed over whether gifts for political purposes were excluded from the federal gift tax.²

Section 527 and a simultaneous amendment to the gift tax provisions resolved this uncertainty. Effective for tax years beginning after 1974, Section 527 provides that political organizations are tax-exempt organizations. This exemption applies to all contributions, membership dues, and other political fundraising income segregated for use for the organization's "exempt function," but does not apply to other income, including investment income. A Section 527 organization's exempt function is "the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public of-

fice or office in a political organization, or the election of Presidential or Vice-presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed."³ To qualify as a Section 527 organization, an organization must be "organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function."⁴ For transfers made after 5/7/74, Congress also provided that transfers to Section 527 organizations are exempt from the gift tax.⁵

While Section 527 describes "political organizations" broadly, most if not all organizations that initially claimed this status were political parties, political committees, or campaign committees that expressly advocated for the election or defeat of particular candidates. These organizations were subject to an array of disclosure and contribution limits under the Federal Election Campaign Act of 1971 (FECA)⁶ and, if they were involved in state or local elections, under state election laws.⁷

Starting in the late 1990s, however, creative tax practitioners

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concluded that an organization could qualify as a Section 527 political organization without bringing itself into the ambit of the election law disclosure statutes. The key to this discovery was the realization that an organization can qualify as a Section 527 organization by engaging in grassroots lobbying, issue advocacy, voter registration, publishing incumbent or candidate scorecards, and similar activities—as long as those activities were targeted or otherwise designed to influence the outcome of elections. The IRS agreed with this conclusion in a series of private letter rulings.⁸ Because these activities could also be structured to avoid any reporting or other requirements or limitations imposed by the FECA, Section 527 organizations engaged in such activities could avoid reporting details of their activities to either the FEC or the IRS.⁹

Section 527 organizations were attractive for several reasons when

compared to other types of tax-exempt organizations. Section 501(c)(3) charitable organizations are eligible to receive tax-deductible contributions, but are absolutely barred from supporting or opposing any candidate for public office. Other Section 501(c) organizations, including organizations described in Sections 501(c)(4) (social welfare), (c)(5) (labor union) and (c)(6) (business associations), must operate primarily for a purpose that meets the requirements of the applicable subsection. Activities designed to influence elections do not meet this primary purpose requirement.¹⁰ The IRS has also taken the position that contributions to such organizations are subject to the gift tax.¹¹ None of these organizations are required to disclose the identities of their donors to the public, but they are required to provide information about major donors to the IRS and to provide to the IRS and the public certain

financial and other information on IRS Form 990 or 990-EZ.

Section 527 organizations did not have any reporting or disclosure requirements under the Code except for annually reporting net non-exempt function income—usually investment income—on Form 1120-POL if that income exceeded \$100.¹² Contributions to such organizations are also not subject to the gift tax.¹³ These facts, combined with the discovery that Section 527 organizations could operate without having to report to the FEC or state election bodies if they structured their activities properly, led to increasing numbers of “stealth” Section 527 organizations, operating to influence elections without having to report their activities, or sources of financial support, to anyone. News reports and leaks about particular organizations occasionally brought the activities of such organizations to light, but they usually operated with very lit-

¹ See, e.g., IT 3276, 1939-1 CB 108 (a political gift received by a political organization is not taxable income to the recipient); Rev. Rul. 54-80, 1954-1 CB 11 (modifying IT 3276 to clarify that political gifts diverted to the personal use of a candidate or other individual are taxable income to that individual); *Communist Party of the U.S.A.*, 373 F.2d 682, 19 AFTR2d 613 (D.C. Cir., 1967) (government taking the position that all political parties are taxable entities); Rev. Proc. 68-19, 1968-1 CB 810 (setting forth the factors to be considered by the IRS in determining the taxability of political gifts and fundraising proceeds received and disposed of by or on behalf of political candidates); Ann. 73-84, 1973-2 CB 461 (prospectively requiring political organizations to file tax returns, while reiterating that political gifts used for political purposes are not taxable); Rev. Rul. 74-21, 1974-1 CB 14 (same); Rev. Rul. 74-475, 1974-2 CB 22 (same).

² See, e.g., Rev. Rul. 59-57, 1959-1 CB 626 (gift tax applies to contributions to a political party or to a candidate for public office); *Stern*, 436 F.2d 1327, 27 AFTR2d 71-1647 (CA-5, 1971) (gifts to

promote a slate of candidates were not taxable gifts); Rev. Rul. 72-355, 1972-2 CB 532 (reiterating that gift tax applies to political gifts and rejecting the *Stern* decision); *Carson*, 641 F.2d 684, 47 AFTR2d 81-1619 (CA-10, 1981) (pre-1974 political contributions not taxable gifts), *acq.* in Rev. Rul. 82-216, 1982-2 CB 220.

³ Section 527(e)(2).

⁴ Section 527(e)(1).

⁵ Section 2501(a)(5).

⁶ 2 U.S.C. sections 431-441h, 451-455.

⁷ For a more in-depth discussion of Section 527 organizations, see Cerny and Hill, “The Tax Treatment of Political Organizations,” 71 *Tax Notes* 651 (4/29/96).

⁸ See Ltr. Ruls. 9652026, 9725036, 9808037, 199925051.

⁹ For an in-depth discussion of the rise of Section 527 organizations, see Hill, “Probing the Limits of Section 527 to Design a New Campaign Finance Vehicle,” 86 *Tax Notes* 387 (1/17/00).

¹⁰ See, e.g., Reg. 1.501(c)(4)-1(a)(2); Rev. Rul. 81-95, 1981-1 CB 332. Determining what exactly is an organization’s primary purpose can be a murky propo-

sition, as it depends on all of the relevant facts and circumstances. See Rev. Rul. 68-45, 1968-1 CB 259; Rev. Rul. 68-46, 1968-1 CB 260. Even the Service apparently has trouble making this determination, based on its difficulties in the recent *Christian Coalition* litigation. See “Christian Coalition Refunded for 1990 Taxes, Claims Victory in Battle for 501(c)(4) Status,” *Daily Tax Report*, 7/27/00, page G-3.

¹¹ See, e.g., Rev. Rul. 67-170, 1967-1 CB 272 (contributions to a Section 501(c)(13) cemetery corporation do not qualify for the gift tax charitable deduction); Rev. Rul. 54-243, 1954-1 CB 92 (contributions to tax-exempt organizations other than Section 101(6) (the pre-1954 predecessor to Section 501(c)(3)) organizations are deductible for income tax purposes only if placed in separate fund devoted exclusively to charitable or similar purposes); *Estate of Anita McCormick Blaine*, 22 TC 1195 (1954) (upholding the government’s position that gifts to a section 101(8) (predecessor to Section 501(c)(4)) organization were not deductible for gift tax purposes).

¹² Section 6012(a)(6); Reg. 1.6012-6.

¹³ Section 2501(a)(5).

tle public attention. Awareness of the situation grew in the first half of 2000, however, as various advocacy groups attacked them and the Democratic Congressional Campaign Committee (DCCC) filed a RICO lawsuit against House Majority Whip Tom DeLay (R-Tex.) and organizations associated with the Republican Majority Issues Committee, a Section 527 organization.¹⁴

THE LEGISLATION

This all changed on 6/8/00, with the unexpected passage of an amendment to a defense budget bill in the Senate that required Section 527 organizations to disclose certain information to the IRS and the public.¹⁵ Sponsored by Senator John McCain (R-Ariz.), a longtime campaign finance reform advocate, the failure of an attempt to block the amendment on procedural grounds by a 42 to 57 vote surprised political observers. The vote signaled a break in the dam that had successfully blocked campaign finance legislation for many years, and supporters of such legislation rushed to take advantage of its passage. After several weeks of debate, the introduction of alternative bills, and hearings in the House, a bill identical to Senator McCain's amendment passed the House and Senate. President Clinton promptly signed the bill on 7/1/00.

The legislation required the IRS to provide almost immediate guidance, given that its provisions required existing Section 527 organizations to register by 7/31/00 and new organizations to register within 24 hours, as well as requiring pre-election reports that might be due at any time after the legislation went into effect. Rising to the challenge, the IRS issued Form 8871 (Political Organization Notice of Section 527 Status) on

7/12/00, and Form 8872 (Political Organization Report of Contributions and Expenditures) less than a week later.¹⁶ The IRS also issued a proposed revenue ruling on 8/9/00, answering some of the initial questions about the new legislation.¹⁷ In the announcement of the proposed revenue ruling, the IRS stated that organizations may rely on the proposal until it is finalized.

Organizations affected. The final legislation applies only to organizations described in Section 527. Organizations described in Section 501(c) are not affected, even if they are taxed under Section 527(f),¹⁸ unless they maintain a separate segregated fund for engaging in Section 527 activity. Such a fund is treated as a separate organization under Section 527(f)(3), and therefore is subject to the new legislation, although the rest of the Section 501(c) organization is not.

Filing requirements. Section 527 organizations are subject to three

new filing requirements:

1. An initial notice of existence (Form 8871).
2. Periodic reports on contributions and expenditures (Form 8872).
3. Expanded annual return requirements (Form 990 or 990-EZ and Form 1120-POL).

Three categories of Section 527 organizations are completely or partially exempt from these new filing requirements:

- Organizations that reasonably expect to have annual gross receipts of less than \$25,000 in all tax years are exempt from the notice and periodic report requirements.¹⁹ Organizations that actually have gross receipts of less than \$25,000 in a given year are exempted from the new annual return requirements for that year.²⁰
- Organizations that are required to report under the FECA as a political commit-

¹⁴ See, e.g., *Under the Radar: The Attack of the 'Stealth PACs' on Our Nation's Elections* (Common Cause, 4/7/00), at www.commoncause.org/publications/utr; "DCCC Chairman Patrick Kennedy, on the Filing of a Civil RICO Suit Against Rep. Tom DeLay," DCCC Press Release (5/3/00). The Joint Committee on Taxation, earlier in the year, also recommended increased disclosure for Section 527 organizations. Staff of Joint Committee on Taxation, "Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998," 106th Cong., 2d Sess., Vol. II, at 94-96 (Comm. Print, 2000) (recommending public disclosure of Form 1120-POL and a more extensive annual return filing requirement for all Section 527 organizations).

¹⁵ "Senate Approves Step to Overhaul Campaign Finance," New York Times, 6/9/00, page A1 (hereinafter, "NYT Article"). While the passage of the amendment was played up in the press as a major

surprise, the level of attention paid to these organizations in previous months had created a growing pressure for action in this area. Several Section 527 disclosure bills had already been introduced in the first half of 2000, including a bill in the Senate (S. 2583) sponsored by Senators Joseph Lieberman (D-Conn.) and John McCain (R-Ariz.), among others, which was almost identical to the amendment passed by the Senate.

¹⁶ Both forms are available at www.irs.gov/bus_info/ef/pol-file.html.

¹⁷ Ann. 2000-72, IRB 2000-35, available at <http://ftp.fedworld.gov/pub/irs-drop>.

¹⁸ Sections 527(i)(5)(A), (j)(5)(D).

¹⁹ Sections 527(i)(5)(B), (j)(5)(C).

²⁰ If such organizations have annual net non-exempt function income (usually investment income) of over \$100 in a given year, however, they are still required to file Form 1120-POL for that year. Ann. 2000-72, Q&A-36.

Where in the Web is Form 8872?

The location of the Section 527 materials on the Service's Web site (www.irs.gov) is not immediately apparent. Once at its home page, scroll down to the main menu and click on "What's Hot." On the following page, scroll down to a section entitled "New Law Requires Reports and Disclosure by Political Organizations" and click on "select here." In addition to other information, the "Notices and Reports" section allows searches through the Forms 8871 and 8872 already filed, while the "Filing Requirements" section also allows downloading and filing of forms in the PDF format.

The first step may change later on this winter, if and when the issue ceases to be "Hot."

In addition, text lists of the names and employer identification numbers of filing organizations can be found at "ftp.fedworld.gov/pub." Form 8871 filers are listed at "[irs-8871/00-index.txt](#)," while groups that have filed Form 8872 are listed at "[irs-8872/00-index.txt](#)." (The latter file will load rather slowly.)

tee are exempt from the notice and periodic report requirements, but not the annual return requirement.²¹

- A state or local party committee or a state or local candidate committee is exempt from the periodic report requirement but not the notice or annual return requirement.²²

There is no exemption for Section 527 organizations that focus solely on state or local elections, even if such organizations already register and report to a state electoral body.²³

Some commentators have discussed publicly whether, if an organization has separate accounts, and some accounts must register and report under the FECA ("federal accounts") while others need not ("non-federal accounts"), the entire organization and all of its accounts fall under the FECA reporting exemption.²⁴ The IRS has specifically rejected this position in its proposed revenue ruling, stating that only separate federal accounts fall within this exemption, and not the same organization's non-federal accounts.²⁵

Notice requirement (Form 8871). A

Section 527 organization must file a notice of its existence with the IRS within 24 hours of being formed.²⁶ The notice must be filed *both in writing and electronically*. The written filing is accomplished by filing a completed Form 8871 with the IRS Service Center in Ogden, Utah. This form lists the organization's name, federal employer identification number, mailing address, business address (if different), e-mail address (if any), purpose, related entities and the nature

of the relationship, and the names and address of officers, board members, highly compensated employees, custodian of records, and a contact person.

"Highly compensated employees" are the five highest compensated employees, other than officers and directors, who are expected to receive compensation of over \$50,000 annually, including non-cash and deferred amounts, for the 12-month period beginning with the date the organization was formed.²⁷

Related entities are any of the following:

- Any two entities with significant common purposes and substantial common membership.
- Any two entities that are directly or indirectly subject to substantial common direction or control.
- Any two entities where one entity owns (directly or through one or more entities) a 50% or greater interest in the capital or profits of the other. For this purpose, any entities related under the first two categories are considered as one entity.²⁸

Each Section 527 organization

²¹ Sections 527(i)(6), (j)(5)(A).

²² Section 527(j)(5)(B).

²³ See Ann. 2000-72, Q&A-5.

²⁴ See, e.g., Davidson, "Campaign Reform Law: A Flawed Fix," *Legal Times*, 7/24/00, page 1; Bolen, "DeLay Claims Leadership PACs Exempt from New Disclosure Law, Saying Not 527s," *Daily Tax Report*, 7/21/00, page GG-1 ("DeLay Article").

²⁵ Ann. 2000-72, Q&A-4.

²⁶ Section 527(i)(2). Organizations already in existence before 7/31/00 had to file no later than that date. P.L. No. 106-230, 7/1/00, section 1(d)(2); 114 Stat. 477, 479; Notice 2000-36, 2000-33 IRB 173.

²⁷ Ann. 2000-72, Q&A-12. This definition matches the definition used for Form 990/990-EZ reporting purposes. See Reg. 1.6033-2(a)(2)(ii)(g). If formed before 7/1/00, the applicable period is the accounting period that includes that date.

²⁸ Ann. 2000-72, Q&A-11. As required by new Section 527(i)(3)(D), this definition is from Section 168(h)(4), relating to the application of the accelerated cost recovery system for depreciation deductions to tax-exempt use property. There is currently no IRS guidance on this definition of "related entity" or how the relationships between "related entities" need to be described on Form 8871.

²⁹ See Section 527(i)(1)(A); Ann. 2000-72, Q&A-7.

must also complete a shorter electronic form, listing its name, address, e-mail address (if any), custodian of records and contact person, at the IRS web site (www.irs.gov/bus_info/eo/pol-file.html).²⁹

The notice must list directors, officers, and highly compensated employees only if the Section 527 organization has people in those positions.³⁰ For example, Section 527 organizations that are not separately incorporated but are instead separate segregated funds of Section 501(c) organizations under Section 527(f)(3) may have only a treasurer and no directors or other officers.

Periodic report requirement (Form 8872).

A Section 527 organization that receives any contribution or makes any expenditures for Section 527 exempt functions during a calendar year must file periodic reports on Form 8872 during that year, beginning with the first month or quarter in which it accepts a contribution or makes an expenditure. These reports must list the names, addresses, amounts received from, and, for individuals, occupation and name of employer, of contributors who have given more than \$200 in the aggregate in a calendar year to the organization. They also must list the names, addresses, amounts received by, and, for individuals, occupation and name of employer, of persons who have received more than \$500 in expenditures in the aggregate in a calendar year from the organization.³¹ Contributions and expenditures are considered made when the person has contracted or is otherwise obligated to make the contribution or expenditure.³²

The only exception is for expenditures that are "independent expenditures" under the FECA.³³ An independent expenditure is one made by a person expressly ad-

vocating the election or defeat of a candidate for federal office without cooperation or consultation with, and not in concert with or at the request or suggestion of, any candidate for federal office, or any authorized committee or agent of such candidate.³⁴ These expenditures, and the sources of funds for these expenditures, must be reported to the FEC.

In non-election years, an organization may submit these reports on either a monthly or semi-annual basis.³⁵ Monthly reports generally are due on the twentieth day after the last day of each calendar month, except the report for December is due on January 31 of the following year. Semi-annual reports are due on the last days of July and January.

During an election year, an organization can choose to submit these reports either on a monthly or quarterly basis.³⁶ Quarterly reports are due on the fifteenth day after the last day of each calendar quarter, except the fourth quarter report is due on January 31 of the following year. An organization that chooses the quarterly option also has to file a pre-election report no later than 12 days before any election with respect to which the organization makes a

contribution or expenditure (15 days before if sent by registered or certified mail) and a post-general election report no more than 30 days after a federal general election.³⁷

"Elections" include elections for federal office (general, special, primary or runoff), a convention or caucus of a political party that

An organization can qualify under Section 527 without falling within the disclosure rules of federal election laws.

has authority to nominate a candidate for federal office, a primary election held for the selection of delegates to a national nominating convention of a political party, and a primary election held for the expression of a preference for the nomination of individuals for election to the office of President.³⁸ "Elections," therefore, do not include elections of a purely state or local nature.³⁹ An organization that chooses the monthly option is required only to file a pre-election and post-election report for a federal general election, in lieu of its reports for October and November, and its report for De-

³⁰ Ann. 2000-72, Q&A-10.

³¹ Section 527(j)(3).

³² Section 527(j)(4).

³³ Section 527(j)(5)(E).

³⁴ 2 U.S.C. section 431(17); Ann. 2000-72, Q&A-31.

³⁵ Sections 527(j)(2)(A)(ii), (B); Ann. 2000-72, Q&As -23, -25.

³⁶ Section 527(j)(2)(A)(i), (B); Ann. 2000-72, Q&As -24, -26.

³⁷ Sections 527(j)(2)(A)(i)(II), (III). As is typical for IRS filings, if the filing date falls on a Saturday, Sunday, or legal holiday, the report may be filed on the next

business day. Ann. 2000-72, Q&As 23-26. The options and filing dates parallel the reporting schedule provisions for political committees other than candidate-authorized committees under FECA. See 2 U.S.C. section 434(a)(4). The due date for any pre-election reports due during July 2000 was 7/31/00. Notice 2000-41, 2000-33 IRB 177.

³⁸ Section 527(j)(6). The definition of "election" is drawn from FECA, 2 U.S.C. section 431(1), and the IRS has stated that organizations may draw on the FEC's interpretation of this term in the absence of further IRS guidance. Ann. 2000-72, Q&A-29.

³⁹ Ann. 2000-72, Q&A-27.

cember is a year-end report due on January 31 of the following year.⁴⁰ If an election involves candidates for federal as well as state or local offices, only those organizations that make contributions or expenditures with respect to can-

The final legislation applies only to organizations described in Section 527.

didates for federal office are required to file pre-election reports.⁴¹ Any expenditure or contribution disclosed in a previous report does not have to be included in a later report.⁴²

Contributions received or expenditures made on or before 7/1/00 do not have to be disclosed on Form 8872. Contributions or expenditures made after 7/1/00, but made pursuant to a contract entered into on or before that date, also do not have to be disclosed on Form 8872.⁴³ The burden is on the organization to show that such a contract existed. If any organization has a July 1 to June 30 fiscal year, contributions of \$5,000 or more received on 7/1/00—although not required to be disclosed on Form 8872—will need to be disclosed on the organization's annual return (Form 990 or Form 990-EZ) if the organization is required to file such a return.

Annual return requirement (Form 990 or 990-EZ and Form 1120-POL). The organization must file Form 990 or 990-EZ and Form 1120-POL as long as it has at least \$25,000 in gross receipts for the year.⁴⁴ These requirements apply for tax years beginning after 6/30/00. These requirements are in addition to the existing requirement that a Section 527 organization with over

\$100 of net investment or other taxable income in a given fiscal year file Form 1120-POL for that year, regardless of its amount of total gross receipts for the year.⁴⁵ Form 1120-POL is due on the 15th day of the third month after the close of the organization's tax year—March 15 for calendar-year organizations.⁴⁶ Either Form 990 or 990-EZ is due on the 15th day of the fifth month after the close of the organization's tax year—May 15 for calendar-year organizations.⁴⁷

Example. Exhibit I on page 97 shows the return filing dates through 7/31/01 for two hypothetical Section 527 organizations that already existed on 7/1/00. One has chosen to follow a monthly schedule, the other has chosen to follow a quarterly schedule. The latter organization, besides making contributions or expenditures with respect to the general federal election, also made contributions or expenditures with respect to the Republican Convention and the New York State primary election, and therefore had to file pre-election reports relating to those elections. Dates have been adjusted when the due date fell on a Saturday, Sunday, or holiday, or before 7/31/00. All pre-election reports are assumed to have been sent by reg-

istered or certified mail, and therefore to be due (in the mail) 15 days before the election.

Public disclosure. All of the information, including information about donors, filed by a Section 527 organization is subject to public disclosure. The notice must be made available indefinitely; the periodic and annual reports must be made available for three years.

By the IRS on the Internet. The IRS is required to post the name, address, e-mail address, and the name and address of the custodian of records and of a contact person for each organization on the Internet. The posting must be made within five business days of receiving that organization's notice, except that for the first notices filed the IRS had until 8/14/00 to post them.⁴⁸ The IRS is in fact posting both this information and a complete copy of the written Form 8871 submitted by each organization at www.irs.gov/bus_info/eo/8871.html. The IRS is *not* required to post periodic reports (Form 8872) or annual reports (Form 990 or 990-EZ) for Section 527 organizations on the Internet. It is permitted to do so, however, and has begun doing so at the same site (see the sidebar at page 9497).⁴⁹

By the IRS in writing. The IRS

⁴⁰ Section 527(j)(2)(B); Ann. 2000-72, Q&A-24. A general election is defined as (1) an election for federal office held in even-numbered years on the Tuesday following the first Monday in November or (2) an election held to fill a vacancy in a federal office (i.e., a special election) that is intended to result in the final selection of a single individual to the office at stake. Ann. 2000-72, Q&A-28.

⁴¹ Ann. 2000-72, Q&A-27.

⁴² Section 527(j)(3).

⁴³ P.L. No. 106-230, section 2(d), 114 Stat. 477, 482.

⁴⁴ Sections 6012(a)(6), 6033(g); Ann. 2000-72, Q&As -36, -38.

⁴⁵ Section 6012(a)(6); Reg. 1.6012-6; Ann. 2000-72, Q&A-36.

⁴⁶ Section 6072(b); Ann. 2000-72, Q&A-37.

⁴⁷ Reg. 1.6033-2(e); Ann. 2000-72, Q&A-39.

⁴⁸ Section 6104(a)(3); P.L. No. 106-230, 7/1/00, section 1(d)(3), 114 Stat. 477, 479.

⁴⁹ IR-2000-64, 2000 TNT 178-14 (9/13/00).

EXHIBIT I: Monthly and Quarterly Filing Dates for Organizations in Existence on 7/1/00.

Monthly Filer		Quarterly Filer	
Later of * July 31, 2000 <i>or</i> * 24 hours after creation	Initial Notice	Later of * July 31, 2000 <i>or</i> * 24 hours after creation	Initial Notice
		July 31, 2000	Pre-election Report for Republican Convention
		July 31—August 3, 2000	Republican Convention
August 21, 2000	Monthly Report (July)	August 28, 2000	Pre-election Report for New York Primary
September 20, 2000	Monthly Report (Aug.)	September 12, 2000	New York Primary
October 20, 2000	Monthly Report (Sept.)	October 16, 2000	Quarterly Report (3rd quarter)
October 23, 2000	Pre-general Election Report (in lieu of Oct. Monthly Report)	October 23, 2000	Pre-general Election Report
November 7, 2000	General Election	November 7, 2000	General Election
December 7, 2000	Post-general Election Report (in lieu of Nov. Monthly Report)	December 7, 2000	Post-general election report
January 31, 2001	End-of-Year Report (Dec. Monthly Report)	January 31, 2001	End-of-Year Report (4th Quarter Report)
February 20, 2001	Monthly Report (Jan.)		
March 15, 2001	Form 1120-POL	March 15, 2001	Form 1120-POL
March 20, 2001	Monthly Report (Feb.)		
April 20, 2001	Monthly Report (Mar.)		
May 15, 2001	Form 990/990-EZ	May 15, 2001	Form 990/990-EZ
May 21, 2001	Monthly Report (Apr.)		
June 20, 2001	Monthly Report (May)		
July 20, 2001	Monthly Report (June)	July 31, 2000	Semi-annual Report (for Jan. 1 - June 30)

must make the notice (Form 8871), periodic reports (Form 8872), and annual reports (Form 990/990-EZ and Form 1120-POL) available to the public. Except for the requirement that some of this information be posted on the Internet, however, the exact means of doing so is left to the discretion of the Secretary of the Treasury.⁵⁰ The IRS has posted entire notices on the Internet and has indicated that it will post periodic reports

on the Internet. The current IRS practice with respect to annual reports filed by Section 501(c) organizations is to make them available through the EO Photocopy Unit in its IRS Ogden, Utah, Service Center. For Section 501(c)(3) organizations, the IRS has also made the returns available on CD-ROM, and the information from those CD-ROMs is in turn being posted on the Internet by Philanthropic Research Inc. at

www.guidestar.org, in cooperation with the Urban Institute's National Center for Charitable Statistics.

By the organization in writing. Each Section 527 organization must allow public inspection and provide copies of its notice, its periodic reports, and its annual re-

⁵⁰ Sections 6104(a)(1)(A), (b), (d)(6).

turns to the public on request.⁵¹ The disclosure requirements for the notice (Form 8871) are the same as the disclosure requirements that apply to applications for recognition of exemption (Form 1023 or Form 1024) filed by Section 501(c) organizations. The

The general penalty for failing to file a required annual return, whether Form 990, 990-EZ, or 1120-POL, is \$20 per day, with a maximum penalty equal to the lesser of \$10,000 or 5% of the organization's gross receipts for the year. For organizations with gross receipts of more than \$1 million for the year, the penalty is \$100 per day up to a maximum of \$50,000.⁵⁶

Failure to allow public inspection or to provide a copy of the notice (Form 8871) to the public can result in a penalty of \$20 for each day the failure continues, with no maximum.⁵⁷ Failure to provide a copy of a periodic report (Form 8872) or an annual return to the public can result in a penalty of \$20 per day, up to a maximum of \$10,000 per report.⁵⁸

EARLY RESULTS

On 9/13/00, the IRS said that it had scanned and posted more than 10,000 Form 8871 initial notices on the Internet.⁵⁹ The IRS also announced that it had received several hundred periodic reports on Form 8872, many of which probably represent pre-election reports relating to the primary elections or the national party conventions. While not specifically required to do so by the newly passed legislation, the IRS has begun to post periodic reports on its Web site, with 200 available as of 9/13/00.

A cursory review of the filing results to date shows a wide variety of organizations. Numerous candidate committees for state and local candidates have filed reports, as well as many Section 527 organizations associated with unions, other types of tax-exempt organizations, and for-profit companies, as well as organizations supporting a broad range of causes. Some of the more promi-

nent organizations that have made filings include:

- The non-federal account of Americans for a Republican Majority (ARMPAC), an organization associated with Rep. DeLay.
- The non-federal account of Dedicated Americans for the Senate and the House (DASHPAC), an organization associated with Senate Minority Leader Thomas Daschle (D-S.D.).
- The Sierra Club's Section 527 organization, the Sierra Club Voter Education Fund.

Not everyone is taking the registration process completely seriously. For example, someone has submitted an electronic filing (with no corresponding written Form 8871 posted by the IRS on the Internet as of yet) for ABC Incorporated, with Mickey Mouse listed as its custodian of records, Minnie Mouse as its contact person, and the same address as the IRS offices in New Carrollton, Maryland. There have been no reports to date that the IRS has tried

There is no exemption for Section 527 organizations that focus solely on state or local elections.

disclosure requirements for the periodic reports (Form 8872) and annual returns (Form 990 or 990-EZ and Form 1120-POL) are the same as the disclosure requirements that apply to annual information returns (Form 990 or 990-EZ) filed by Section 501(c) organizations.⁵²

Penalties. A Section 527 organization that fails to file the required notice will be subject to the highest corporate tax rate, currently 35%, on all of its exempt function income, less expenses necessary to generate that income.⁵³ The organization is not allowed to deduct its exempt function expenditures because political campaign expenditures are not deductible under Section 162(e).⁵⁴ This means that all contributions to the organization, less fundraising costs, will be subject to tax.

A Section 527 organization that fails to file a complete periodic report will be taxed on each expenditure and each contribution that is not properly reported at the highest corporate tax rate.⁵⁵ This can result in a double taxation. If an organization fails to report a contribution, and then fails to report the expenditure funded by that contribution, it will owe tax both on the amount of the contribution and on the amount of the expenditure.

⁵¹ Section 6104(d).

⁵² For a detailed discussion of these requirements, see Mayer, "Minimizing Risk and Maximizing Benefits Under the Final Disclosure Regs. for Exempt Organizations," 91 J/TAX 45 (July 1999). Organizations can post these documents on the Internet in lieu of providing copies if the copies posted on the Internet, when downloaded, exactly reproduce the documents as filed.

⁵³ Sections 11(b)(1)(D), 527(b)(1) and (i)(4).

⁵⁴ Ann. 2000-72, Q&A-13.

⁵⁵ Sections 11(b)(1)(D), 527(b)(1) and (i)(1).

⁵⁶ Section 6652(c)(1).

⁵⁷ Section 6652(c)(1)(D).

⁵⁸ Section 6652(c)(1)(C).

⁵⁹ IR-2000-64, 2000 TNT 178-14 (9/13/00).

to enforce the new legislation against late or non-filers, assuming the IRS could even find the latter. Neither is there any indication that the IRS has attempted to contact Mickey or Minnie about their Section 527 organization, which they apparently are operating illegally on federal property in violation of the Hatch Act.

OPEN ISSUES

The speed with which the legislation moved through Congress, and with which the IRS has acted to implement it, has not come without cost. There are number of difficult questions that have yet to be answered, and may in fact be years from being answered.

Constitutional issues. One of the first objections raised to the legislation was that it is unconstitutional, particularly with respect to requiring the disclosure of information about donors. The National Federation of Republican Assemblies, joined by a state unit and a local unit of the federation, has already challenged the new law based on the First and Tenth Amendments.⁶⁰

This First Amendment argument has some merit. In a series of decisions in the late 1950s and early 1960s involving local branches of the NAACP, the Supreme Court repeatedly held that the constitutional right to freedom of association prohibited various state and local government agencies from requiring the branches to provide the names of their members.⁶¹

This argument has at least two weaknesses as applied to the new disclosure requirements, however. The most obvious is that the negative ramifications of being publicly associated with the NAACP in those years and in the localities involved were well doc-

umented and relied on by the Court in some of the cases.⁶² It may be more difficult for most Section 527 organizations affected by the new legislation to provide evidence of similar, concrete, and immediate threats to their donors. The NAACP cases also involved what at the least the Justices in the majority perceived as thinly veiled attempts to stop the NAACP's legitimate and lawful activities. By contrast, there have been no credible accusations that the Section 527 legislation, which received bipartisan support, is either aimed at or being enforced only against organizations pursuing particular aims or sharing a common political stance. These factual differences do not, however, undermine the rights of association and expression that lay at the heart of the NAACP cases.

Perhaps more fundamentally, there is a serious question of the strength of the right to support anonymously a political organization described in Section 527. Unlike the local NAACP branches, which were Section 501(c)(4) organizations engaged in the promotion of social welfare, Section 527 organizations are by definition involved in the electoral process. The Supreme Court has shown a greater willingness to find constitutionally permissible laws designed to provide disclosure of and even limit the financial involvement of individuals in political activities than social or charitable activities.⁶³ Those decisions have, however, been limited to activities that are more directly supportive of or in opposition to the election of a particular candidate. Whether the Supreme Court would extend its reasoning to the less explicit activities engaged in by many of the "stealth" Section 527 organizations remains to be seen.

Disclosure of expenditures may

also raise First Amendment concerns. In *Brown v. Socialist Workers*, 459 U.S. 87 (1982), the Supreme Court held a state election law unconstitutional as applied to a minority party. The

A Section 527 organization must file a notice of its existence, both in writing and electronically, within 24 hours of being formed.

decision depended on extensive evidence that the members and supporters of the organizations, who received expenditures in the form of reimbursements for expenses as well as making contributions to the organization, faced harassment and persecution if their association with the organization became public.

The strength of the Tenth Amendment argument is less clear. State and local political organizations are claiming Section 527 status, with the still-existing exemption and gift tax benefits that accompany that status. Since they

⁶⁰ "Republican Group Launches Challenge to New Law on Section 527 Organizations," *Daily Tax Report*, 9/1/00, page G-4.

⁶¹ NAACP v. Alabama, 357 U.S. 449 (1958); Bates v. City of Little Rock, 361 U.S. 516 (1960); Louisiana v. NAACP, 366 U.S. 293 (1961); Gibson v. Florida Legislative Investigation Committee, 372 U.S. 539 (1963); see also NAACP v. Button, 371 U.S. 415 (1963) (holding unconstitutional under the First and Fourteenth Amendments state statutes that effectively prohibited the NAACP, its members, and its lawyers from associating for the purpose of assisting persons seeking legal redress).

⁶² Bates v. City of Little Rock, *supra* note 60; Louisiana v. NAACP, *supra* note 60.

⁶³ See, e.g., Buckley v. Valeo, 424 U.S. 1 (1976); FEC v. National Right to Work Committee, 459 U.S. 197 (1982).

are claiming a particular status under federal tax law, Congress would appear to have the power to require certain disclosures of organizations claiming that status without violating the Tenth Amendment.

During an election year, an organization can choose to submit periodic reports either monthly or quarterly.

Organizations covered. The ink of President Clinton's signature was not even dry before lawyers and politicians were speculating as to how certain organizations did not fall within the ambit of the new legislation. The attempt to shelter separate, non-federal funds from scrutiny by arguing that the existence of a single fund reporting to the FEC in an organization will exempt all of the organization's funds from the legislation—an attempt that has so far been rejected by the IRS—has already been mentioned. This attempt appears to be based on the argument that, under the FECA, a “person” includes an entire organization,⁶⁴ and the exception applies “to any person” required to report under the FECA.⁶⁵ The problem with this argument is that “person,” under FECA includes a “committee,” and a “political committee” can mean “any separate segregated fund established under the provisions of section 441b(b) [of FECA].”⁶⁶ Similarly, Section 527(f)(3) treats a separate segregated fund as a separate organization for federal tax purposes.

Another potential loophole is that certain organizations, particularly certain congressional leadership political action committees, apparently have not

claimed Section 527 status previously and so are now claiming they are not covered by the new legislation.⁶⁷ Section 527 applies to “political organizations,” which are defined as:

[A] party, committee, association, fund or other organizations (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.⁶⁸

An exempt function is

[T]he function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of presidential or vice-presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.⁶⁹

This broad definition would on its face appear to sweep in leadership PACs and similar organizations. The Service has not previously had to force organizations into Section 527, however. Organizations chose to claim that status because of its obvious benefits. It is therefore not clear if the Service would attempt to force organizations under Section 527, even assuming that the Service could find them.⁷⁰

A number of commentators have also criticized the congressional choice to include state and local political action committees in the new legislation, when those organizations generally are also subject to extensive disclosure requirements under state law. The American Society of Association Executives has already asked Congress to eliminate this aspect

of the legislation.⁷¹ The ASAE and other commentators have not, however, addressed whether the state disclosures are as detailed and, perhaps more importantly, as readily accessible to the public as the IRS filings will be.

Where will the money go? Assume that a donor is interested in financially supporting particular candidates for federal public office. The donor does not want to be connected to these candidates or groups that support them, however; perhaps out of fear of business associates or other politicians, perhaps out of a high value placed on privacy. Stealth Section 527 organizations met these needs, but under the new legislation the donor cannot avoid having his or her name disclosed. What are the other options? Several are readily available.

- Fund issue ads or other activities that could influence elections but do not rise to a level that would subject the donor to disclosure under the FECA. Federal Communications Commission rules require, however, identification of funding sources for

⁶⁴ 2 U.S.C. section 431(11).

⁶⁵ Sections 527(i)(6), (j)(a)(5)(A).

⁶⁶ 2 U.S.C. sections 431(11), (4)(B).

⁶⁷ DeLay Article, note 24, *supra*.

⁶⁸ Section 527(e)(1).

⁶⁹ Section 527(e)(2).

⁷⁰ See FSA 200037040, 2000 TNT 181-47. If the IRS did force organizations into the Section 527 category, such an action could strengthen the First Amendment arguments for striking down the donor and expenditure disclosure aspects of the new legislation.

⁷¹ “ASAE Urges 527 Disclosure Rules Exemption for State, Local Political Action Committees,” Daily Tax Report, 8/28/00, page G-2.

most types of broadcast advertising, including issue advocacy, so the types of activities that could be funded personally would necessarily be limited.⁷² Funding activities directly also makes it more likely that a contractor or volunteer supported by that funding might learn the donor's identity and then inadvertently (or purposefully) make it public.

- Fund a non-Section 527 private corporation that engages in these types of activities. If the primary or exclusive activities of that corporation involved issue advocacy and similar efforts, however, there is an open question as to whether the IRS would consider it to be a Section 527 organization even if it did not claim that status.⁷³ It would be awkward for a donor to fund an organization under the apparent cover of anonymity, only to have the IRS force that organization into Section 527 and therefore subject it to the new disclosure requirements.
- Fund a Section 501(c)(4) organization that engages in some Section 527 exempt function activity. These organizations are subject to some reporting and disclosure requirements, specifically the requirement of filing a Form 990 or 990-EZ annually, but information about large donors is provided only to the IRS, not the public. There are, however, major disadvantages with this option. One is that a Section 501(c)(4) organization must have a primary purpose other than engaging in exempt function activity.

Its primary purpose must be promoting social welfare, and political activity does not count as promoting social welfare. According to the IRS, what an organization's primary purpose is depends on all the facts and circumstances, arguably making it difficult for a donor to judge whether a Section 501(c)(4) organization that engages in some Section 527 exempt function activity continues to promote social welfare as its primary purpose. A second major disadvantage is that the IRS has taken the position that gifts to a Section 501(c)(4) organization, unlike gifts to Section 527 organizations, is subject to the gift tax.

The right regulator? The IRS has, until now, not been required to handle disclosure filings relating to Section 527 organizations or other political entities. The IRS is certainly able to handle the volume of filings, but whether it can review and post the documents in a timely fashion remains to be seen. Congress clearly intended that reports be reviewed and available very

quickly, as is the case with filings with the FEC. Unlike the FEC, though, the IRS is not experienced in providing such speedy action (remember, the IRS usually has at least three years to complete an

All of the information, including information about donors, is subject to public disclosure.

audit on a return, even assuming the taxpayer refuses to consent to an extension of the statute of limitations). The IRS certainly has done a heroic job so far, but it remains to be seen whether its enforcement efforts will match its speed in producing the required forms and making them available to the public.

The traditional IRS audit process, which is based on a selected review of specific organizations rather than universal review, may also create problems. The FEC reviews all filings and has a processing system for complaints filed by individuals and organizations against others. The IRS generally reviews selected filings and does not have a public complaint review process.⁷⁴ Adop-

⁷² Another possibility is to use a single member LLC as the immediate funder. If the LLC chooses to be ignored for tax purposes, however, there might a question regarding whether it should also be ignored for FCC or other purposes.

⁷³ An IRS Field Service Advice dated 6/19/00 (FSA 200037040, 2000 TNT 181-47) holds that Section 527 is not an elective provision, and that whether an organization is a Section 527 organization "is determined by whether it is in fact organized and operated in the manner described in section 527(e)." It should also be noted that if an organization is able to avoid being classified as a Section 527 organization by the IRS, it then faces the risk that the IRS could claim that gifts to a non-

exempt private corporation for political purposes do not fall under Section 102 and therefore are taxable to the organization (with no offsetting deductions, other than fundraising costs, because under Section 162(e) political expenditures are not deductible).

⁷⁴ The IRS would almost certainly not be able to disclose complaints submitted to third parties about Section 527 organizations, or its response to those complaints, because such information would constitute nondisclosable return information under Section 6103. See *Lehrfeld v. Richardson*, 132 F.3d 1463, 81 AFTR2d 98-529 (CA-D.C., 1998); *Landmark Legal Foundation*, 87 F. Supp. 2d 21, 85 AFTR2d 2000-1278 (DC D.C., 2000).

tion of this methodology to Section 527 organization filings could expose the IRS to accusations of selective prosecution.

CONCLUSION

The ultimate question is whether, when the dust clears and assuming the new rules survive the various legal challenges that are already forming, this new legislation will have significantly changed the political landscape in terms of public knowledge of political activities and sources of financial support for those activities. Any predictions at this early stage are educated guesses at best, but a few modest ones can be made.

- *There will be more disclosure.* The Section 527 organization is a convenient form for engaging in political activity, even activity that is not subject to FECA filing requirements. Some donors, perhaps most, will not be troubled by the loss of anonymity, at least not troubled enough to sacrifice the gift tax advantages that accompany such organizations. State and local organizations, usually already subject to disclosure requirements, also will not have any strong incentive to shift their activities to another type of organization.
- *There will not be extensive enforcement.* The IRS Ex-

empt Organizations Division has shown a remarkable ability to quickly produce the forms and initial guidance required to implement these new rules, but its resources are limited and it has many other responsibilities.⁷⁵ Unlike the FEC, the EO Division also has to enforce numerous other types of requirements and restrictions. Given the already low incidence of audits of tax-exempt organizations, it is unlikely that the IRS will aggressively search for non-compliance or even respond quickly to complaints that are filed.⁷⁶

- *Money will move.* Some donors, whether on their own initiative or at the urging of advisors, will move their support to other vehicles. This shift in funds will lead to increased attention to legal issues relating to the two most likely types of recipients of this support—non-exempt organizations engaged in political activities and Section 501(c)(4) organizations. These issues include (1) whether an organization without a tax exemption could be considered a Section 527 organization even though it has not elected to be so treated, and (2) what the standards are for determining the primary

purpose of an organization for Section 501(c)(4) purposes. There also may be attempts to challenge the applicability of the gift tax to contributions to Section 501(c)(4) organizations. It will, however, probably take years for these issues to wind through the IRS and the courts and reach any type of resolution.

The new legislation adds to the complexity of both the Code and, indirectly, federal election laws. At the same time, it will promote, to some degree, greater disclosure about the role that different organizations and contributors play in the electoral process. Whether the costs out balance the benefits remains to be seen, and will likely be debated for some time to come. ■

⁷⁵ See Boisture et al., "How the IRS Plans to Restructure Its Exempt Organization Operations," 10 JTEO 195 (Mar/Apr 1999) (discussing the insufficient staffing of the Exempt Organizations division and the resulting lack of precedential guidance in recent years).

⁷⁶ See Department of the Treasury, *Internal Revenue Service Data Book* 14, 33 (1996) (showing that the IRS audited only 11,000 exempt organization returns, less than 50% of which were annual information returns—generally Form 990/990-EZ; the others being employment tax returns or unrelated business income tax returns—as compared to over 563,000 annual information returns filed).