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527 Organizations: Reporting Requirements Imposed on Political Organizations after the Enactment of P.L. 106-230

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Summary

On July 1, 2000, President Clinton signed H.R. 4762, P.L. 106-230. The law amended the Internal Revenue Code [IRC] to require political organizations described in IRC § 527 to disclose their political activities, if they were not already required to do so by the Federal Election Campaign Act [FECA]. This report summarizes the three major changes made by the law and some of the major responses to the legislation. First, all 527 organizations which expect to have over \$25,000 in gross receipts during a taxable year and which are not required to report to the Federal Election Commission [FEC] are required to register with the IRS within 24 hours of their formation, whether they are involved in state, local, or federal elections. Second, 527 issue advocacy organizations, which previously reported neither to the IRS nor the FEC, are required to file regular disclosure statements with the IRS. Third, all 527 organizations with gross receipts in excess of \$25,000 per year are required to file annual reports with the IRS. The registration statements, disclosure forms, and annual reports will be made public. H.R. 527 and S. 527 in the 107th Congress would exempt most state and local 527 organizations from the requirements of P.L. 106-230.

Background. Section 527 of the Internal Revenue Code was enacted in 1975 by P.L. 93-625 to clarify the tax treatment of “political organizations.” Section 527 covers the tax treatment of all political organizations intended to influence the nomination, selection, appointment, or election of a candidate for federal, state, or local public office, whether the organizations are parties, PACs, or candidate committees. Prior to the enactment of P.L. 106-230, political activists had formed special 527 organizations which did not have to disclose their activities to either the FEC or the IRS because they structured their activities so that they neither engaged in express advocacy nor had taxable income. The lack of federal oversight of certain 527 organizations’ political activities attracted those who wanted to participate anonymously in the political process and alarmed those who believed that there should be full disclosure of all political activities. P.L. 106-230 was the result of desires to increase public disclosure of non-reporting 527

organizations' political activities. On July 1, 2000, President Clinton signed P.L. 106-230, which passed the 106th Congress as H.R. 4762.

Under prior law, it was possible to have a 527 organization and not realize that fact. This was because there was no requirement to report to the IRS unless the organization had taxable income, and no requirement to register with the FEC unless the organization engaged in express advocacy. The "organization" could be as informal as a separate bank account used to fund a candidate's campaign. Under prior law, IRC § 527 treated political organizations as tax-exempt for purposes of any federal law referring to tax-exempt organizations. It provided that as long as their money was used only for "exempt function"¹ purposes, 527 organizations were not taxed on contributions of money or property; membership dues, fees, or assessments; proceeds from political fundraising or entertainment events; proceeds from sales of political campaign materials (providing the organization is not in the business of conducting such events or selling such materials); and proceeds from conducting bingo games. This "exempt function" income did not have to be reported to the IRS. Political organizations were taxed on investment income, capital gains, and on any expenditures which are not for political purposes. IRC § 2501(a)(5) provides that transfers of money or other property to a political organization are not subject to gift taxes. IRC § 84 provides that if someone transfers appreciated property to a 527 organization, he is treated as if he had sold the property to the 527 organization for fair market value. The transferor has to recognize and pay taxes on any gain.

Summary of changes. The new law changed the prior 527 regime. First, all 527 organizations which expect to have over \$25,000 in gross receipts during a taxable year and which are not required to report to the FEC, whether they are involved in state, local, or federal elections, are required to register with the IRS within 24 hours of their formation. The registration statements are subject to public disclosure. Second, 527 issue advocacy organizations, which previously reported neither to the IRS nor the FEC, are required to file periodic disclosure statements with the IRS. These statements are made public. Third, all 527 organizations with gross receipts in excess of \$25,000 per year are required to file annual reports with the IRS. The annual reports will be made public.

Registration requirements. Under prior law, a political organization was a 527 organization with no action on its part. An organization could be a 527 organization or could have a 527 organization without even being aware of the fact. Unless it had taxable (generally, investment) income, it did not have to report anything to the IRS. Section 1 of the new law prohibits an organization from being a 527 organization unless it notifies the IRS, *electronically and in writing*, within 24 hours after formation. There are three exceptions: one for organizations which do not anticipate having more than \$25,000 of gross receipts per year; another for "persons" which are required to report to the FEC under the Federal Election Campaign Act [FECA] as "political committees;" and a third for tax-exempt organizations that conduct 527-type activities directly instead of in a separate organization. The penalty for failure to register is that the organization will be taxed at the maximum corporate tax rate on all gross receipts (less certain expenses) for the period of the failure. The IRS has issued Form 8871 for organizations to register and

¹ Exempt function is defined in IRC § 527(e)(2) as "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office"

has provided a place on its website to register electronically. The IRS notes in its informational material that the organization will need an employer identification number [EIN] in order to register.

Immediately after enactment of P.L. 106-230, there was a question about how to interpret the statutory exception for a “political committee” required to report to the FEC, and thus exempted from registration with the IRS. The definition of political committee under 2 U.S.C. § 431(4) is

(A) any committee, club, association, or other group of persons which receives contributions aggregating in excess of \$1,000 during a calendar year or which makes expenditures aggregating in excess of \$1,000 during a calendar year; or

(B) any separate segregated fund established under the provisions of section 441b(b) of this title; or

(C) any local committee of a political party which receives contributions aggregating in excess of \$5,000 during a calendar year, or makes payments exempted from the definition of contribution or expenditure as defined in paragraphs (8) and (9) of this section aggregating in excess of \$5,000 during a calendar year, or makes contributions aggregating in excess of \$1,000 during a calendar year or makes expenditures aggregating in excess of \$1,000 during a calendar year.

Political committees only report to the FEC if they are involved in “express advocacy,” i.e., they make statements for or against a candidate in federal elections. The question involved political committees with multiple funds. Some took the position that if the political committee had one fund that reported to the FEC and others that did not (because they only engaged in either issue advocacy or state elections), the whole committee, including the non-disclosing funds, was exempt from registering with the IRS. Others took the position that each separate fund should be viewed as a separate 527 organization, and, if a fund did not report to the FEC, it had to register with the IRS. In Announcement 2000-72, the IRS took the position that the separate accounts which are not registered with the FEC must file Form 8871. See Q&A 4. The IRS reiterated this position in Rev. Rul. 2000-49, Q&A 6.

The law requires state and local candidate committees, federal and state issue advocacy committees, and funds that intend to influence an election or the selection, nomination, or appointment of a candidate to public office to register with the IRS. The information on the Form 8871 is to be made public by the IRS not later than 5 business days after it receives the notice from the political organization. An organization can comply with the public disclosure requirement by furnishing the IRS website address to the requester. Rev. Rul 2000-49.

Disclosure of contributions and expenditures. Section 2 of the law requires “disclosures” by political organizations. The disclosure requirements do not apply to “persons” required to report to the FEC as political committees; state or local committees of political parties; political committees of state or local candidates; organizations which anticipate having gross receipts of less than \$25,000 per year; organizations exempt from

tax under other sections of the Code; or to “expenditures” which are “independent expenditures” under FECA.

Political organizations which are required to disclose must report each expenditure of \$500 or more, including the name and address and, if applicable, occupation of the person or organization to whom the expenditure was made; and each contribution of \$200 or more, including the name, address, and, if applicable, occupation and employer of all contributors. Contracts to spend or contribute are treated as contributions or expenditures. The statute applies to expenditures made and contributions received after July 1, 2000. The IRS has issued Form 8872, *Political Organization Report of Contributions and Expenditures*, for use in complying with the periodic reporting requirement.

The statute includes two schedules for disclosure which are similar to the schedules in FECA. The organization can choose to comply with either one. Schedule A provides for quarterly reports in the calendar year in which a regularly scheduled election is held, plus a pre-election report, and a post-election report. In non-election years, two reports, each covering six months, must be filed. Schedule B provides for monthly reports, with special reports to be filed in November and December in the years of regularly scheduled elections, with a special year end report to be filed by the end of January. The penalty on organizations failing to file Form 8872, or failing to include required information, is a tax equal to the highest corporate tax rate, currently 35%, multiplied by the amount not disclosed.

Form 8872, including the names of the contributors, is subject to public disclosure. The penalty for failing to make the reports public is a \$20 per day penalty, up to a maximum of \$10,000 per return. An organization can comply with the public disclosure requirement by furnishing the IRS website address to the requester. Rev. Rul. 2000-49.

Annual reporting requirements. Under prior law, 527 organizations with taxable income over \$100 were required to file Form 1120-POL. Section 3 of the new law retains this requirement and, in addition, requires 527 organizations with gross receipts of \$25,000 or more to file Form 1120-POL plus an annual information return [Form 990] with the IRS for taxable years *beginning* after June 30, 2000. If an organization uses a calendar year, the first year covered by these annual reporting requirements would be 2001. Under prior law, tax-exempt organizations with gross receipts of \$25,000 or more filed an annual information return [Form 990] with the IRS, but 527 organizations were not required to do so. The new law brings 527 organizations with gross receipts of at least \$25,000 per year under the annual information return requirement. In addition to the information that other exempt organizations supply, 527 organizations will be required to publicly disclose information about their substantial contributors. Form 1120-POL is due on the 15th day of the *third* month following the close of the taxable year. For a calendar year organization, Form 1120-POL is due March 15. Form 990 is due on the 15th day of the *fifth* month after the close of the taxable year. For calendar year organizations, Form 990 is due on May 15.

Annual information returns may be disclosed by the IRS, and the new law requires 527 organizations to make their annual returns and Forms 1120-POL available to members of the public requesting copies. Existing law requires exempt organizations to supply a copy of any return filed during the prior 3 years. As 527 organizations acquire a back file of information returns and 1120-POLs, this requirement will apply to them as well. The

penalty for failing to file the annual information return or failing to include the correct information on the return is imposed on the organization is \$20 per day for each day the return is not filed, up to the lesser of \$10,000 or 5 percent of the organization's gross receipts for the year. For organizations with gross receipts over \$1,000,000, the daily penalty is \$100, with a maximum penalty of \$50,000. For failing to comply with the public inspection requirements in IRC § 6104(d), the organization is charged \$20 per day for each day the failure continues, up to a maximum of \$10,000 per return. IRC § 6652(c)(1).

Responses to the legislation. The IRS has issued two forms and instructions. Form 8871 is used for meeting the registration requirements and Form 8872 is used to fulfill the disclosure of contributions and expenditure requirements. The forms are available on the IRS website. The IRS posts on the Internet a list of all organizations that have filed Form 8871, with links to the Form 8871, which includes the name, address, electronic mailing address, contact person, and record custodian of each organization. The URL is [http://www.irs.gov/bus_info/eo/posearch.html]. The IRS has done the same for Form 8872. The URL is [http://www.irs.gov/bus_info/eo/posearch2.html]. The IRS has not yet finalized Forms 990 and 1120-POL for political organizations, but draft forms are available for comment at [http://www.irs.gov/bus_info/tax_pro/dftform2.html].

In October the IRS released Rev. Rul. 2000-49, 2000-44 IRB 430 (Oct. 30, 2000); available at [<http://ftp.fedworld.gov/pub/irs-irbs/irb00-44.pdf>] which provides guidance about the new reporting and disclosure requirements for 527 organizations.

On August 21, 2000, the National Federation of Republican Assemblies filed a suit in the Federal District Court for the Southern District of Alabama challenging the constitutionality of P.L. 106-230. *Mobile Republican Assembly v. United States*, Docket No. 00-CV-759. During the fall, an amended complaint and a request for a preliminary injunction were filed and new plaintiffs were added to the suit. To date, this is the only lawsuit of which we are aware challenging the constitutionality of the statute.

Three bills to limit or eliminate the effect of P.L. 106-230 on state and local 527 organizations were introduced near the end of the 106th Congress. S. 3193 would have exempted state and local candidates' campaign committees from the section 1 registration requirements. H.R. 5265 would have exempted state and local 527 organizations from the registration and the disclosure of contributions and expenditures requirements, providing the organizations were subject to state or local reporting requirements and the state and local reports were publicly available. H.R. 5277 contained similar provisions to those in H.R. 5265 as well as a number of technical corrections such as eliminating the requirement that electronic filings with the IRS be duplicated in writing, imposing a gift tax on undisclosed contributions, and clarifying some of the penalties.

In the 107th Congress, H.R. 527 and S. 527 would exempt state and local political organizations from the registration requirement, the disclosure of contributions and expenditures requirements, and the annual report requirements, providing the organizations are subject to state or local reporting requirements and the state and local reports were publicly available.