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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. Those that qualify under section 527 of the Internal Revenue Code are generally treated as tax-exempt organizations, but are taxed on certain income. Section 527 organizations are subject to reporting requirements involving (1) registration, (2) periodic disclosure of contributions and expenditures, and (3) the annual filing of tax returns. In the 108th Congress, three bills have been introduced, S. 1059, H.R. 429, and H.R. 2368, that would affect 527 organizations; all would reduce the rate at which certain income is taxed.

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. In the early 1970s, as it became apparent that these organizations had sources of income besides contributions, the IRS began requiring those with investment and other types of income to file tax returns and pay tax at the corporate rate.

In 1975, Congress enacted section 527 to clarify the tax treatment of political organizations.¹ Section 527 has three purposes: (1) it clarifies that expenditures by political organizations on behalf of an individual are generally not income to the individual, (2) it imposes a tax on 501(c) organizations that make political expenditures,² and (3) it generally grants tax-exempt status to qualifying political organizations. The last rule is the focus of this report.

¹ P.L. 93-625. IRC §§ 84 and 2501(a)(5) were also enacted to address the donor's tax treatment. Prior to 1975, political contributions were subject to the gift tax but qualified for a limited deduction or credit. Section 84 requires a donor of appreciated property to include the amount of appreciation in gross income. Section 2501(a)(5) exempts contributions from the gift tax. The provisions allowing a deduction or credit were repealed by P.L. 95-600 and P.L. 99-514.

² These organizations are not considered 527 organizations for the reporting requirements that are discussed in this report.

Section 527 Organizations

Political organizations that qualify under section 527 are generally granted tax-exempt status, but are subject to tax on certain income. Political organizations that do not meet the requirements are taxed on all income. A political organization is any organization, including a party, committee, association, or fund,³ that is organized and operated primarily to directly or indirectly accept contributions and/or make expenditures for an exempt function.⁴

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.⁵ 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.⁶

Section 527 organizations are subject to tax only on political organization taxable income. This is the organization's gross income, excluding exempt function income, less (1) \$100 and (2) any allowable deductions that are directly connected to the production of the taxable income.⁷ Exempt function income is any amount received, to the extent that it is segregated to use for an exempt function, as:

- a contribution 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, any taxable income of the principal campaign committee of a Congressional candidate is taxed using

³ 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.

⁴ The organizational test is met if the articles of organization provide that the organization's primary purpose is to carry on at least one exempt function. 26 CFR § 1.527-2(a)(2). In the absence of formal articles, the IRS looks at the intent of the members at formation.

⁵ 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.

⁶ Rev. Rul. 2004-6.

⁷ The net operating loss deduction, IRC § 172, and special deductions for corporations, IRC chapter 1, subchapter B, part VIII (e.g., the dividends received deduction), are not allowed.

the graduated corporate tax rate schedule.⁸ This is not true for campaign committees of candidates for state or local office.

Section 527 organizations include the entities regulated by the Federal Election Campaign Act (FECA), as amended by the Bipartisan Campaign Reform Act (BCRA).⁹ For example, under BCRA, 527 organizations are subject to the disclosure requirements for “electioneering communications” and incorporated 527 organizations are restricted from using their general treasury funds to finance them.¹⁰ However, not all 527 organizations are regulated by FECA. They 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) is currently considering promulgating rules on when 527 organizations become subject to regulation under FECA.¹¹

Reporting Requirements

Prior to 2000, certain political organizations could receive the tax benefits of section 527 without reporting their existence to the IRS or the FEC. This was because not all 527 organizations reported to the FEC under FECA, yet organizations were only required to file a return to the IRS if they had taxable income. The fact that organizations could qualify under section 527 and not have to report to the FEC was largely unnoticed until 1996, when the IRS began issuing guidance on the types of activities that qualify as exempt functions.¹² This awareness helped lead to a growth 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 527 organizations report to the IRS, the FEC, or a state.¹³

Notification of status. An organization must notify the IRS of its section 527 status by electronically filing Form 8871 within 24 hours of its formation.¹⁴ If the deadline is not met, the organization will not be treated as a 527 organization (i.e., it must include any exempt function income in taxable income) for the period between its formation and the notification. The information provided on Form 8871 includes:

- the organization’s name, address, electronic address, and purpose,

⁸ IRC § 527(h).

⁹ For explanation of these Acts, please see the Campaign Finance Reform section in the CRS Electronic Briefing Book [www.crs.gov].

¹⁰ 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).

¹¹ See Kenneth P. Doyle, *FEC Plans to Write New 527 Rule by May; GOP Members Press Democrats for Action*, BNA DAILY REPORT FOR EXECUTIVES (January 16, 2004).

¹² PLR 9652026 (1996); PLR 9725036 (1997); PLR 9808037 (1997); PLR 199925051 (1999).

¹³ P.L. 106-230; P.L. 107-276.

¹⁴ IRC § 527(i).

- the names and addresses of its officers, highly compensated employees, contact person, records custodian, and directors,
- the name of and relationship to any related entities, and
- whether it is exempt from the other reporting requirements.

The organization must notify the IRS within thirty days of any material change to this information or the organization will not be treated as a 527 organization for the period between the change and the notification. The IRS may waive any tax imposed if the failure was due to reasonable cause and not due to willful neglect.

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.

Disclosure of expenditures and contributions. A 527 organization that accepts a contribution or makes an expenditure for an exempt function during the year must periodically file a disclosure report, Form 8872, with the IRS.¹⁵ The report may be filed electronically and organizations with annual contributions or expenditures that exceed \$50,000 must do so. The organization may file either (1) on a quarterly basis in a year with a regularly scheduled election and semi-annually in any other year or (2) on a monthly basis. There are additional requirements relating to pre-general election, post-general election, and year-end reports. 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 if the total annual expenditures to that person is at least \$500, along with the person's name, address, occupation, and employer.

The failure to file a timely or accurate Form 8872 is subject to a penalty equal to the highest corporate tax rate multiplied by the amount of contributions and/or expenditures to which the failure relates. The IRS may waive the penalty if the failure was due to reasonable cause and not due to willful neglect.

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.¹⁶

Further, the requirements 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).

¹⁵ IRC § 527(j).

¹⁶ 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 reporting requirements must be similar to the federal ones, including public access to the information. A federal candidate or officeholder may not be involved in the organization.

In 2002, a U.S. district court held that most of the disclosure requirements were unconstitutional.¹⁷ The foundation of the decision was that the requirements were part of a regulatory (campaign finance reform) scheme that was subject to a higher level of scrutiny than Congressional action under its taxing powers would be. As such, the court held that the requirements for organizations involved in state and local elections were an impermissible infringement on state and local affairs under the Tenth Amendment. The court also held that the required disclosure of expenditures violated the organizations' rights under the First and Fifth Amendments. The court reasoned that while Congress could refuse to subsidize political speech by withdrawing a tax exemption, the disclosure requirement for expenditures was subject to strict scrutiny since the penalty could exceed the value of the lost tax exemption. The court determined that the requirement was constitutionally inadequate because Congress had not (1) sufficiently tailored the requirement to meet its informational and corruption-related goals since certain independent expenditures were subject to disclosure and (2) established a compelling reason to treat political organizations differently than other tax-exempt organizations, which do not disclose expenditures. In 2003, this decision was vacated and remanded by the Eleventh Circuit Court of Appeals with instructions to dismiss for lack of jurisdiction.¹⁸ That court held that the disclosure requirements fell within Congress' power to tax and, therefore, the Anti-Injunction Act barred the suit.

Form 1120-POL. Any tax-exempt organization with political organization taxable income must file a tax return, Form 1120-POL, with the IRS.¹⁹ This is true regardless of whether the organization has section 527 tax-exempt status. The failure to file a timely or accurate return is \$20 per day, not to exceed the lesser of \$10,000 or 5 percent of the organization's gross receipts.²⁰ For organizations with more than \$1 million in gross receipts, the penalty is \$100 per day and the maximum is \$50,000.

Form 990. Section 527 organizations with gross receipts of at least \$25,000 (\$100,000 if a qualified state or local political organization) must file an information return, Form 990, with the IRS.²¹ Form 990 includes such information as the organization's revenue sources and functional expenses. Additionally, any organization that receives a contribution of at least \$5,000 from a single source must file the form's Schedule B. The failure to file a timely or accurate return is subject to the same penalties as the failure to file Form 1120-POL.

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

¹⁷ *National Federation of Republican Assemblies v. United States*, 218 F. Supp.2d 1300 (S.D. Ala. 2002).

¹⁸ *Mobile Republican Assembly v. United States*, 2003 U.S. App. Lexis 26286. The Anti-Injunction Act requires taxpayers to pay a tax before disputing it. No tax had been assessed against the plaintiffs in this case.

¹⁹ IRC § 6012(a)(6). P.L. 106-230 amended this section so that 527 organizations with gross receipts of at least \$25,000 had to file a return, regardless of whether they had taxable income. P.L. 107-276 repealed that requirement, thus returning the section to its prior language.

²⁰ IRC § 6652(c)(1)(A).

²¹ IRC § 6033(g), as amended by P.L. 107-276. The provision as enacted by P.L. 106-230 had required that organizations filing Form 1120-POL also file Form 990.

- 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.²²

Public access. The IRS and the 527 organization must make Forms 8871, 8872, and 990 publicly available.²³ The organization is subject to a penalty of \$20 per day, which is limited to \$10,000 for failures relating to Forms 8872 and 990.²⁴ Additionally, the IRS is required to post the electronically-submitted Forms 8871 and 8872 in a downloadable and searchable on-line database within 48 hours of their filing.

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

Legislation in the 108th Congress

Three bills have been introduced that would change the rate imposed on certain political organization taxable income. Currently, this income is generally taxed at the highest corporate rate, but the income of principal campaign committees of Congressional candidates is taxed using the graduated corporate tax rate schedule. S. 1059, introduced by Senator Hutchison, would tax all political organization taxable income using the graduated schedule. The bill would also reduce the penalty for failing to disclose contributions and expenditures under section 527(j) for those organizations with income taxed at a rate other than the highest rate. H.R. 429, introduced by Representative Sensenbrenner, and H.R. 2368, introduced by Representative Gene Green, would tax the political organization taxable income of the primary campaign committees of candidates for state and local public office using the graduated corporate tax rate schedule.

²² IRC § 6033(g)(3), as amended by P.L. 107-276. Additionally, the IRS may waive the filing requirement for an organization. IRC § 6033(g)(4).

²³ IRC § 6104. P.L. 107-276 repealed the requirement that Form 1120-POL be made available.

²⁴ IRC §§ 6652(c)(1)(C) and (D).