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527 Organizations: How the Differences in Tax and Election Laws Permit Certain Organizations to Engage in Issue Advocacy without Public Disclosure and Proposals for Change

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527 Organizations: How the Differences in Tax and Election Laws Permitted Certain Organizations to Engage in Issue Advocacy without Public Disclosure and Proposals for Change

Summary

Virtually all political organizations are “section 527” political organizations. While most 527 organizations report to the Federal Election Commission (FEC) and, if they have taxable income, to the Internal Revenue Service (IRS), prior to the enactment of P.L. 106-230, political activists had formed 527 organizations which did not have to disclose their activities to either the FEC or the IRS. By structuring their activities so that they did not engage in express advocacy, these organizations did not meet Federal Election Campaign Act (FECA) criteria for political committees. The lack of federal oversight of certain 527 organizations’ political activities attracted those who want to participate anonymously in the political process, while it alarmed those who believed that there should be full disclosure of all political activities. In the 106th Congress, there were a number of proposals to increase public disclosure of non-reporting 527 organizations’ political activities.

This report compares the tax and election laws relating to political organizations and political committees prior to the enactment of P.L. 106-230 in an attempt to highlight the differences between them, and discusses some of the proposals in the 106th Congress to require additional reporting by organizations engaging in political activities. This report does not address the taxation of other tax-exempt organizations making political expenditures taxable under IRC § 527. For developments after the enactment of P.L. 106-230, please see CRS Report RS20650, *527 Organizations: Reporting Requirements Imposed on Political Organizations after the Enactment of P.L. 106-230*.

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Section 527 of the Internal Revenue Code defines “political organization” and specifies how political organizations and other tax-exempt organizations which make political expenditures are taxed. The Federal Election Campaign Act (FECA), 2 U.S.C. §§ 431, *et seq.*, was enacted to regulate federal elections by imposing certain contribution limits and reporting and disclosure requirements on various persons. FECA defines “political committee” and specifies the reporting and disclosure requirements that these committees must follow. For tax purposes, virtually all political organizations are “section 527” political organizations. While most 527 organizations report to the Federal Election Commission (FEC), prior to the enactment of P.L. 106-230, only those with taxable income reported to the Internal Revenue Service (IRS). In recent years, political activists formed 527 organizations which did not have to disclose their activities to either the FEC or the IRS. By structuring their activities so that they did not engage in express advocacy and had no taxable income, these organizations did not meet FECA criteria for political committees and did not trigger the return requirements of the Internal Revenue Code. The first section of this report compares the prior tax law and election law definitions and disclosure requirements of “political organization” and “political committee” to illustrate how organizations engaging in issue advocacy could avoid reporting to either the FEC or the IRS. The second section of the report summarizes the proposals to increase public disclosure of the activities of and contributors to these organizations.

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, whether they are at the federal, state, or local level, whether they are parties, PACs, or candidate committees. The Federal Election Campaign Act of 1971, P.L. 92-225, was enacted in 1972. FECA is intended to prevent corruption in federal elections. Section 301(d) of FECA defines “political committee” for purposes of regulating federal elections. Although the concepts are similar, the definitions of “political organization” and “political committee” are not identical. The congressional reports associated with the enactment of IRC § 527 did

not mention FECA.¹ The only concern was how the Internal Revenue Service should treat political organizations.

The prior law version of 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 only used for political 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. Political organizations were (and are) 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.

Unlike 527 organizations, organizations exempt under IRC § 501(a) which make political expenditures of more than \$100 per year are taxed on the lesser of their net investment income or their political expenditures. This provision gives exempt organizations an impetus to make political expenditures through a 527 organization.

Comparison of IRC § 527 and FECA

The first part of this report compares the definitions and reporting requirements of political organizations under the prior version of IRC § 527 and political committees under FECA in a chart form. Following the chart is a discussion of some of the provisions.

Comparison of Political Committees and Political Organizations

	Federal Election Campaign Act [FECA]	Internal Revenue Code [IRC]
Statute	2 U.S.C. §§ 431, <u>et seq.</u>	26 U.S.C. § 527
Purpose	Regulate federal election campaigns, reporting and disclosure.	Tax political organizations with investment income and other tax-exempt entities with political expenditures.
Organization called	Political committee.	Political organization.

¹ S.Rept. 93-1357; H.Rept. 93-1642 (1974).

	Federal Election Campaign Act [FECA]	Internal Revenue Code [IRC]
Definition includes	Unincorporated groups of persons, a committee, a club, an association; A separate segregated fund; A “local committee of a political party.”	Incorporated or unincorporated organization, a committee, an association, a fund; A separate segregated fund; A party; Newsletter funds of officeholders.
What the organization does	Receives “contributions” or makes “expenditures” aggregating greater than \$1,000 during a calendar year; exists as a separate segregated fund; or (if a local committee of a political party) collects or spends over \$5,000 in one year even if the expenditures fall outside the statutory definition of “contribution” or “expenditure,” or makes “contributions” or “expenditures” of more than \$1,000 in a year.	Accepts contributions or makes expenditures for influencing or attempting to influence the selection, nomination, election, or appointment of an individual to any federal, state, or local public office. No de minimis limits.
Purpose	Influencing an election to federal office.	Influencing or attempting to influence the selection, nomination, election, or appointment of an individual to any federal, state, or local public office.
Definition of candidate	2 U.S.C. § 431(2): “an individual who seeks nomination for election, or election, to Federal office, and . . . an individual shall be deemed to seek nomination for election, or election— (A) if such individual has received contributions aggregating in excess of \$5,000 or has made expenditure aggregating in excess of \$5,000; or (B) if [another person has received contributions or made expenditures of more than	26 U.S.C. 527(g)(3): “with respect to any Federal, State, or local elective public office, an individual who— (A) publicly announced that he is a candidate for nomination or election to such office, and (B) meets the qualifications prescribed by law to hold such office.”

	Federal Election Campaign Act [FECA]	Internal Revenue Code [IRC]
	\$5,000 with the consent of the individual].”	
Definition of contribution	<p>2 U.S.C. § 431 (8)(A): “any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing an election for Federal office; or the payment by any person of compensation for the personal services of another person which are rendered to a political committee without charge for any purpose.”</p> <p>[Long list of exceptions]</p>	<p>26 U.S.C. § 271(b)(2): “a gift, subscription, loan, advance, or deposit, of money, or anything of value, and includes a contract, promise, or agreement to make a contribution, whether or not legally enforceable.”</p> <p>[No statutory exceptions]</p>
Definition of expenditure	<p>2 U.S.C. § 431(9)(A): “any purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value, made by any person for the purpose of influencing any election for Federal office; and a written contract, promise, or agreement to make an expenditure.”</p> <p>[Long list of exceptions]</p>	<p>26 U.S.C. § 271(b)(3): “a payment, distribution, loan, advance, deposit, or gift, of money, or anything of value, and includes a contract, promise, or agreement to make an expenditure, whether or not legally enforceable.”</p> <p>[No statutory exceptions]</p>
Reporting requirements	<p>2 U.S.C. § 434(4)</p> <p>Political committees file either (A) quarterly reports in election years, plus a pre-election, and post-election report and semiannual reports in non-election years; or (B) monthly reports in all calendar years except that the November and December reports in election years follow the schedule for the pre- and post-election reports under (A).</p>	<p>26 U.S.C. § 6012(a)(6)</p> <p>Political organizations with taxable income of more than \$100 and newsletter funds with any taxable income must file an annual return 1120-POL due 15th day of the 3rd month after the end of the taxable year (e.g., March 15 for calendar year organizations).</p>

	Federal Election Campaign Act [FECA]	Internal Revenue Code [IRC]
Report contains	Name, address, FEC identification number of organization, summary of cash on hand and disbursements, debts; itemized list of contributors, showing name, address, occupation, employer, and amount of contribution; other receipts; disbursements, including independent expenditures, operating expenditures, refunds, transfers.	Name, address, employer identification number of organization, taxable income (i.e., dividends, interest, rent, royalties, capital gain income), deductions, taxable income, foreign bank accounts, foreign trust income, date of formation of organization, name and address of bookkeeper, candidate's name, telephone number.
Public disclosure	Form 3X is public.	Form 1120-POL is confidential.

Breadth of definitions. The first striking difference between political organizations and political committees is that the tax law definition is much broader than the election law definition. FECA only applies to federal elections. IRC § 527 applies to federal, state, and local elections, as well as to the selection, nomination, or appointment of an individual to federal, state, or local public office. Groups which want to influence the selection of federal and state judges and groups that want to encourage a state governor to select particular individuals to the state cabinet could be political organizations under the tax laws even though these activities are not covered by FECA.

Organizations covered. Both definitions encompass a “separate segregated fund,” which could be an organization as informal as a separate bank account. A political organization includes a party or any of its subdivisions. The political committee definition only refers to “a local committee of a political party.” This appears to be because a political party is separately defined in 2 U.S.C. § 431(16). Under the tax law, a newsletter fund of a federal, state, or local officeholder can be a political organization. Newsletter funds are not specifically mentioned by FECA. Newsletter funds of federal officeholders who are candidates for reelection could come within the definition of political committee if certain monetary thresholds are met, but newsletter funds of state or local officeholders would not be covered by FECA.

Candidates covered. Both statutes contemplate a candidate for public office. Only candidates for **elective federal** public offices are covered by FECA. The tax code covers candidates for **elective** and **appointive**, state, local, and federal offices. The FECA definition of candidate status turns on having collected or spent a certain amount of money. The tax definition is triggered by an individual's public announcement of candidacy for the office, providing the individual meets the

qualifications for the office. Under the tax law, there is no minimum monetary limit in order to be a political organization or to be a candidate.

Reporting requirements. The information collected under the two reporting requirements was almost mutually exclusive. Under the campaign laws, political committees report contributions and expenditures to the Federal Election Commission. Under the tax laws, a political organization did not report contributions and expenditures for an “exempt function” (i.e., influencing the selection, nomination, election, or appointment of an individual to a public or political office) to the Internal Revenue Service. Only investment income and expenses were reported and taxed. Political organizations which spent their contributions as fast as they were collected or which parked their contributions in non-interest-bearing checking accounts may not have had any taxable income. Only organizations with taxable income were required to file with the IRS on Form 1120-POL. Reports to the FEC on Form 3X are public information. IRS Form 1120-POL was confidential. Political committees which escape FEC reporting requirements, either because their activities do not cross the dollar thresholds or because their activities are not aimed at federal elections, could avoid public disclosure of their contributions and expenditures.

Use of 527 Organizations to Funnel Soft Money²

In December 1996 the IRS published the first of a series of private letter rulings³ which provided a blueprint for setting up an entity which would qualify as a political organization under IRC § 527, but would not have any expenditures or activities prohibited by or reportable under FECA. Basically, the activities that the organizations seeking the letter rulings planned to engage in were voter education activities which were intended to influence the outcome of an election, but which did not expressly advocate the election of a particular candidate, and grassroots lobbying on particular legislative issues. FEC Regulations, 11 CFR § 114.4(c)(4) and (5) permit the preparation, publicizing, and distribution of congressional voting records and voter guides on federal elected officials and candidates. The IRS rulings deemed enough of these activities to be for “an exempt function” (i.e., a political function) to qualify the organization as a political organization under IRC § 527, but the FEC does not deem these reportable activities. 11 CFR § 114.5(e).

After these rulings became public, tax and election law advisers realized that 527 organizations could be used to collect unlimited amounts of soft money for issue advertising in connection with elections; that the names of contributors to 527 organizations with no reportable activities under the election laws could remain secret; and that donors could transfer an unlimited amount of money to 527 organizations free of gift taxes. For these reasons, 527 organizations were superior to 501(c)(4) organizations as soft money vehicles. These three facts contributed to

² For an explanation of soft money, see CRS Issue Brief IB98025, Campaign Finance: Constitutional and Legal Issues of Soft Money; and CRS Report 97-91, Soft and Hard Money in Contemporary Elections: What Federal Law Does and Does Not Regulate. In this report, “soft money” is used to describe money that is not subject to the FECA contribution, expenditure, or disclosure limits.

³ PLR 9652026, PLR 9725036, PLR 9808037, and 199925051.

a rapid acceleration of the use of 527 organizations to finance soft money activities.

Proposals for Change

On January 28, 2000, the Staff of the Joint Committee on Taxation released its three-volume *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*. JCS-1-00. In Volume II, *Study of Disclosure Provisions Relating to Tax-Exempt Organizations*, [<http://www.house.gov/jct/pubs00.html>] (particularly pages 94-98), the staff recommended that IRC § 6104 be amended to require political organizations to disclose their 1120-POLs and annual returns, if any; that political organizations be required to file an annual return even if they had no taxable income; that the annual return be revised to include more information about the organization's activities; and that Form 990 be amended to gather more information about the transfer of funds among various exempt organizations so that the public and the IRS can better assess whether contributions to exempt organizations are being used to fund political activities.

On April 7, 2000, Common Cause released a report, *Under the Radar: The Attack of the "Stealth PACs" on our Nation's Elections*, [<http://www.commoncause.org/publications/utr/>] recommending that all 527 organizations register as political committees with the FEC, and that, at a minimum, Congress require disclosure of each 527's existence, officers, and major contributors. The report also endorsed the recommendations of the staff of the Joint Committee on Taxation.

House bills

H.R. 3688, the "Campaign Integrity Act of 2000". The bill would amend IRC § 527 to require political organizations to file with the FEC within 10 days of receiving or spending \$5,000 for a political purpose as defined under IRC § 527(e)(2). The filing would include the name, address, type of organization, the name, address, and relationship of any connected or affiliated organization; and the names, addresses, and titles of the custodian of books and accounts and the head of the organization. Organizations would be required to file a report of receipts and disbursements, and the names and addresses of contributors or recipients of over \$200 in a calendar year on the same schedule as political committees. Information would be publicly available. Organizations which only attempt to influence state or local elections, appointments to state or federal offices, or the selection of individuals to offices in a political organization; and groups which accept contributions or make expenditures of less than \$5,000 per calendar year would be exempt from these requirements. Groups which do not meet this criteria or which place advertisements which mention a clearly identified candidate or which contain the likeness of a candidate would not be exempt.

H.R. 4168, the "Underground Campaign Disclosure Act of 2000". H.R. 4168 would add a new IRC § 6033A to require political organizations to report to the

IRS within 10 days of formation (or within 10 days of enactment of the bill). The report would include the name and address of the organization; the name, address and relationship of any affiliated person; and the name, address, and title of the custodian of the books and the treasurer; and a listing of all banks and depositories used by the organization. Any changes would have to be reported within 10 days. Reports about contributions and disbursements, contributors, and recipients of greater than \$200 per year would be filed with the IRS on the same schedule as required of political committees under FECA. Organizations which are not involved with federal elections would only be required to file annually. The filings would be open to public inspection on similar terms as returns of tax-exempt organizations, including \$100 per day penalties on the organization and \$10 per day penalties on the organization managers for failure to file or furnish the required documents to the IRS; and \$20 per day penalties for failure to permit public inspection of the documents.

The exemption from the gift tax of transfers to political organizations in excess of \$10,000 per year would only apply to organizations in compliance with the reporting requirements.

H.R. 4621, the “Accountability and Disclosure Act of 2000”. H.R. 4621 would amend FECA and the Communications Act of 1934 to require “any person” (i.e., the bill applies to more than just 527 organizations) who spend \$10,000 or more in a year for advertisements that mention a federal officeholder or federal candidate by name or by picture to disclose the names of contributors of at least \$1,000. The FECA amendments apply to non-broadcast communications. When the reporting thresholds are triggered, the entity must include in the advertisement, its name, address, and telephone number or its internet site, which must contain the same information. Upon request, the entity must provide the following information within 24 hours of the request: name, address, and telephone number of officers and directors, if any; otherwise the same information about the person responsible for the communication; the name of each person who provided at least \$1,000 to the entity during the calendar year, along with the amount provided. Penalties are not specified in the bill, but existing penalties in 2 U.S.C. § 437g would apply. Potential civil and criminal penalties are similar to those described below.

The Communications Act amendments would apply similar requirements to broadcast communications, video programmers and multi-channel video program distributors, and require that the entity furnish similar information about itself and its contributors to the broadcast station, and that the station post the information on its internet site. The Communications Act violations would be enforced by civil money penalties up to the greater of \$5,000 or the amount spent on the advertisement. Willful violations would result in double penalties, and possible criminal action which could result in a fine of up to \$25,000 or 300% of the amount spent on the advertisement and/or imprisonment for up to one year.

H.R. 4717, the “Full and Fair Political Activity Disclosure Act of 2000”. H.R. 4717, as reported by the Committee on Ways and Means, would require newly formed 527 organizations to notify the IRS notice within 10 days of their formation. The information would be the same as is currently reported to the FEC by newly formed political committees. In addition, 527 organizations, social welfare [501(c)(4)] organizations, labor unions [501(c)(5)], and trade associations [501(c)(6)]

would be required to report to the IRS expenditures for “disclosable activities” and receipts from “reportable contributors.” Organizations with activities related to federal elections would report on the same schedule as political committees report to the FEC. Organizations whose only activities involve state or local elections or appointive offices would report annually. All reports, including names of contributors, would be subject to public disclosure.

Any activity conducted by a 527 organization would be disclosable. For organizations described in 501(c)(4), (5), or (6) of the Internal Revenue Code, disclosable activities would include “527-type” activities (i.e., any activity intended to influence the nomination or election of a candidate for public office); establishing, administering, or soliciting contributions to a 527 organization; contributing directly or indirectly to a 527 organization; contributing directly or indirectly to an exempt organization which had disclosable activities within the past 3 years; or any mass media communication or mass mailing which mentions or contains a picture of a clearly identified candidate for election to federal office, an individual who has formed an exploratory committee for election, or the political party of such a candidate. Non-527 organizations with total expenditures of less than \$10,000 would not be required to report.

Reportable contributors would be those who gave more than \$200 to a 527 organization and those who gave (whether as donations, dues, fees, or assessments) more than \$1,000 to a 501(c)(4), (5), or (6) organization. If the organization set up a segregated fund to conduct 527-type activities and made no expenditures for disclosable activities other than from the fund, then only earmarked contributions to the fund would have to be reported.

H.R. 4762. As introduced, the bill contained 3 sections which would require 527 organizations to disclose their political activities. Section 1 would require 527 organizations to notify the IRS of their 527 status within 24 hours of formation, unless the organization reasonably anticipates having annual gross receipts of less than \$25,000 or the organization reports to the FEC as a political committee. Section 2 would require 527 organizations to disclose contributions of \$200 or more and expenditures of \$500 or more, including the name, address, occupation, and employer of the contributor or recipient on a schedule consistent with the schedule for reporting under FECA. Excepted from this requirement would be those reporting to the FEC, any state or local committee of a political party or a political committee of a state or local candidate, organizations anticipating receipts of less than \$25,000, organizations exempt under other provisions of the Internal Revenue Code, and independent expenditures. Section 3 of the bill would require all 527 organizations, except those with gross receipts under \$25,000, to file an annual return and make such information, including contributor information, public. All the information proposed to be collected by the IRS would be subject to public disclosure.

House actions

H.R. 4168 was proposed as an amendment to the Taxpayer Bill of Rights legislation (H.R. 4163) being considered by the Committee on Ways and Means on April 5, but the amendment was defeated. On May 25, a motion to recommit the telephone excise tax repeal bill with instructions to add additional reporting

requirements for 527 organizations was defeated in the House (Cong. Rec. pp. H3851-53). On June 9, an attempt was made to recommit the estate tax repeal bill, H.R. 8, with instructions to include a provision similar to H.R. 4168. The motion to recommit was defeated (Cong. Rec. pp.H4160-63). On June 14, a petition to discharge H.R. 3688 was filed in the House. A Ways and Means Oversight Subcommittee hearing on proposals to strengthen public disclosure for 527 organizations was held on June 20. On June 22, the Committee on Ways and Means marked up H.R. 4717. House consideration of H.R. 4717 is expected on June 27 or 28. H.R. 4762 was introduced on June 27 and called up under a suspension of the rules. The bill was considered under a suspension of the rules and passed in the early morning hours of June 28.

Senate bills

S. 79, the “Advancing Truth and Accountability in Campaign Communications Act”. S. 79 does not specifically address 527 organizations. Instead it would require every person who makes a disbursement for an electioneering communication in excess of \$10,000 per calendar year to report to the FEC within 24 hours of making the disbursement. In addition to identifying information about the organization, the payee, and the candidate supported, contributors of \$500 or more would be disclosed. Corporations (except for certain 501(c)(4) organizations) and labor unions would be prohibited from making electioneering communications.

S. 2582. S. 2582 would require most 527 organizations to be political committees under FECA. Entities involved with state and local elections, selections, nominations, or appointments, with appointments to federal office, or with selections to office in political organizations would not be subject to the FECA registration requirement. (This could have the effect of denying 527 status to “issue advocacy” organizations which focus on federal issues.)

S. 2583. S. 2583 would increase public disclosure about 527 organizations by requiring 3 types of reports to be filed with the IRS. First, S. 2583 would require 527 organizations which are not required to register under FECA to notify the IRS within 24 hours of their formation. (Organizations already in existence would have 30 days after enactment to comply.) Organizations which do not anticipate having gross receipts of at least \$25,000 and organizations exempt under 501(a) and described in 501(c) which have political expenditures would not be subject to these requirements. Failure to do so would mean the organization could not be treated as a 527 organization until such time as it gave the IRS proper notice. The notice would contain the name, addresses, including e-mail address, and purpose of the organization; the names and addresses of its officers, highly compensated employees, contact person, custodian of records, and board members; the names and addresses of any related entities; and any other information the IRS may require. For any period an organization failed to give the IRS proper notice, the organization’s “exempt function” income (e.g. political contributions and fundraising income) would be subject to tax. The organization would be permitted to deduct any expenses in connection with producing the income.

The notice would be subject to public inspection under the same terms as other tax-exempt organizations’ returns are subject to public disclosure. In addition, the IRS

would be required to post a list of all political organizations which have filed notices with the IRS, along with the name, address, e-mail address, custodian of records, and contact person for each organization, on the internet.

Second, S. 2583 would require a 527 organization to file with the IRS either quarterly reports, plus pre- and post-election reports in election years and semiannual reports in non-election years, or monthly reports every year, plus pre- and post-election reports in election years. The report would include expenditures of \$500 or more, including the name and address, occupation and employer, if any, of each recipient. The report would also include a list of contributors of \$200 or more, along with the name, address, occupation, and employer, if any, of each contributor. Organizations which file with the FEC as political committees, state or local committees of political parties, political committees of state or local candidates, organizations with gross receipts of less than \$25,000 per year, tax-exempt organizations with political expenditures, and independent expenditures would not be subject to the reporting requirement. These reports, including the names and addresses of contributors, would be subject to public disclosure.

Third, most 527 organizations would be required to file an annual return similar to that filed by other tax-exempt organizations. The IRS would be given authority to add to or subtract from these requirements. The returns would be subject to public disclosure on the same terms, including penalties, as other tax-exempt organizations' returns.

Senate actions

On June 8, the Senate agreed to add amendment no. 3214, (see text at Cong. Rec. pp. S4715-16) which is identical to S. 2583, to the National Defense Authorizations bill (S. 2549) (vote on Cong. Rec. pp. S4808-09). Sen. Lott has proposed moving the amendment from S. 2549 to a tax bill that originated in the House, H.R. 3619, the telephone excise tax repeal bill. On June 28, the Senate received H.R. 4762. H.R. 4762 passed the Senate without amendment on June 29. The measure was cleared for the White House the same day. The bill was presented to the President on June 30 and signed on July 1, 2000, becoming Public Law 106-230.