



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

September 14, 2012

The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Senate Committee on Homeland Security
and Government Affairs
United States Senate
Washington, D.C. 20515

Dear Senator Levin:

I am responding to your letter to Commissioner Shulman dated August 31, 2012, requesting additional information about section 501(c)(4) organizations. This response supplements the previous responses dated June 4, 2012, July 13, 2012 and August 24, 2012, and addresses the additional questions raised in your recent letter.

Question 1. If the IRS determines that an organization that has been given 501(c)(4) status has not engaged primarily in social welfare activities, but instead was primarily engaged in activity within the scope of section 527, what are the consequences for the organization? What are the consequences for such an organization having not filed timely Forms 8871 and 8872? Must they file such forms after the fact? What taxes will be due? Will contributions that already have been made to that organization be taxable to that organization?

If an IRS audit or examination concludes that a section 501(c)(4) organization does not engage primarily in social welfare activities, the IRS may revoke the tax-exempt status of that organization. If the tax-exempt status is revoked, the organization is a taxable entity effective, in general, as of the first day of the tax year under examination. The organization is required to file Federal income tax returns, generally a Form 1120, U.S. Corporation Income Tax. The tax treatment of the organization's contributions and other income is determined under normal rules of Subtitle A.

Whether an organization no longer qualifies to be tax-exempt under section 501(c)(4) does not determine whether it is a political organization under section 527. Section 527(e)(1) defines a political organization as a party, committee, or other organization that is organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures for an exempt function (as defined in § 527(e)(2)). If an organization meets this definition, then its tax status is determined under section 527.

Subject to certain exceptions, to be tax-exempt under section 527,¹ a political organization is required to give notice electronically to the Service.² The required notice form is Form 8871, *Political Organization Notice of Section 527 Status*. To be tax-exempt, the political organization must file Form 8871 within 24 hours after the date on which it was established. If the organization has a material change in any of the information reported on Form 8871, it must file an amended Form 8871 within 30 days of the material change to maintain its tax-exempt status. When the organization terminates its existence, it must file a final Form 8871 within 30 days of termination.³

An organization that is required to file Form 8871, but fails to file on a timely basis, will not be treated as a tax-exempt political organization for any period before the date Form 8871 is filed.⁴ The taxable income of the organization for any period in which it failed to file Form 8871 (or, in the case of a material change, the period beginning with the date of the material change and ending on the date it satisfies the notice requirement) is subject to tax and must be reported on the annual income tax return Form 1120-POL.⁵ The tax is computed by multiplying the organization's taxable income by the highest federal corporate tax rate,⁶ currently 35 percent. For purposes of computing its taxable income for any period, the organization includes its exempt function income (including contributions received, membership dues, and political fundraising receipts), minus any deductions directly connected with the production of that income,⁷ but may not deduct its exempt function expenditures for the period.⁸

Generally, tax-exempt political organizations that have, or expect to have, contributions or expenditures exceeding \$25,000 during a calendar year are required to file Form 8872, *Political Organization Report of Contributions and Expenditures*, beginning with the first month or quarter during the calendar year in which they accept contributions or make expenditures.⁹ A tax-exempt political organization subject to the periodic reporting requirement may choose to file Form 8872 on a monthly basis or on a quarterly/semiannual basis, but it must file on the same basis for the entire calendar year. In addition, tax-exempt political organizations that make

¹ Tax-exempt political organizations generally are subject to tax on the excess of their gross income (excluding any exempt function income) over allowable deductions that are directly connected with the production of the gross income (excluding exempt function income). IRC § 527(c).

² IRC § 527(i)(1)(A), (i)(5), (i)(6); Rev. Rul. 2003-49, 2003-1 C. B. 903.

³ IRC § 527(i)(2).

⁴ IRC § 527(i)(1)(B).

⁵ IRC § 527(i)(4). A political organization, whether or not tax-exempt, that has taxable income in excess of the \$100 specific deduction allowed under § 527 is required to file an annual income tax return on Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*. IRC § 6012(a)(6); Rev. Rul. 2003-49.

⁶ IRC § 527(b); Rev. Rul. 2003-49.

⁷ IRC § 527(i)(4); Rev. Rul. 2003-49.

⁸ IRC § 162(e) denies a deduction for political campaign expenditures.

⁹ IRC § 527(j); Rev. Rul. 2003-49. All tax-exempt political organizations are subject to the reporting requirements of IRC § 527(j), except for those political organizations described in § 527(j)(5).

contributions or expenditures with respect to an election for federal office (as defined in § 527(j)(6)) may be required to file pre-election reports for that election.¹⁰

A tax-exempt political organization that does not timely file the required Form 8872, or that fails to include the information required on the Form 8872, must pay an amount calculated by multiplying the amount of contributions and expenditures that are not disclosed by the highest federal corporate tax rate,¹¹ currently 35 percent.

Question 2. How many 501(c)(4) organizations which appear to be primarily engaged in political activity have been notified by the IRS within the last 6 months that they may be in violation of the law?

When the IRS examines a section 501(c)(4) organization, the objective of the audit is to determine whether that organization qualifies for tax-exempt status as a social welfare organization. As discussed in our June 4, 2012 response to your March 30, 2012 letter, that determination looks to whether the organization is primarily engaged in activities that promote social welfare, not organized or operated for profit, and the net earnings of which do not inure to the benefit of any private shareholder or individual. The examination looks at the activities engaged in during the complete taxable year at issue. Although the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office, a section 501(c)(4) social welfare organization can engage in political activities as long as it is primarily engaged in activities that promote social welfare.

If the IRS believes that an organization does not meet the requirements under section 501(c)(4), the IRS notifies the organization of its intention to revoke the organization's exempt status, explaining the law and reasons for the proposed revocation. The organization has 30 days from the date of that letter to protest or appeal the determination before a final revocation letter is issued to the organization.

During the past six months, no notices of proposed or final revocation were issued to section 501(c)(4) organizations. Note that the IRS currently has more than 70 ongoing examinations of section 501(c)(4) organizations (this includes examinations for a variety of issues, some of which include whether the organization is primarily engaged in activities that promote social welfare). It is also important to note that the Service also maintains a determination process to review the operations of an organization to determine whether it should be recognized as tax exempt. In this area, we also review compliance with the legal requirements, including whether an organization is primary engaged in activities that promote social welfare. There are currently more than 1,600 organizations in the determination process seeking recognition as a section 501(c)(4) organization. The level of political activity is an issue in a number of these determination cases.

¹⁰ IRC § 527(j)(2)(A)(i)(II); Rev. Rul. 2003-49.

¹¹ IRC § 527(j)(1).

I hope this information is helpful. If you have questions, please contact me or have your staff contact Catherine Barre at (202) 622-3720.

Sincerely,

A handwritten signature in black ink, appearing to read "S. T. Miller". The signature is fluid and cursive, with a large initial "S" and "M".

Steven T. Miller
Deputy Commissioner
for Services and Enforcement