

**Additional Actions Are Needed to Ensure  
Section 527 Political Organizations Publicly  
Disclose Their Activities Timely and  
Completely**

**August 2005**

**Reference Number: 2005-10-125**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

August 10, 2005

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT  
ENTITIES DIVISION

*Pamela J. Gardiner*

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Additional Actions Are Needed to Ensure  
Section 527 Political Organizations Publicly Disclose Their  
Activities Timely and Completely (Audit # 200410024)

This report presents the results of our review assessing the effectiveness of the Exempt Organizations (EO) function's efforts to ensure political organizations file timely and complete Political Organization Notices of Section 527 Status (Form 8871) and Political Organization Reports of Contributions and Expenditures (Form 8872).

With certain exceptions, Internal Revenue Code (I.R.C.) Section (§) 527<sup>1</sup> requires each political organization that desires to be tax exempt<sup>2</sup> to notify the Internal Revenue Service (IRS) using Form 8871 that it is to be treated as a Section 527 political organization. An organization must also file a Form 8872 if it has filed Form 8871, has not claimed Qualified State or Local Political Organization (QSLPO) status, and has received contributions or made expenditures during the calendar year. The Center for Public Integrity reported that Section 527 political organizations raised approximately \$535 million during the 2004 election cycle, compared to approximately \$268 million raised by Section 527 political organizations during the 2002 election cycle. Given this situation, proper disclosure of the financial activities of Section 527 political organizations is a concern to both regulators and the general public. Without timely and complete contribution and expenditure information, the public cannot gain a true

---

<sup>1</sup> I.R.C. § 527 (2003).

<sup>2</sup> Contributions to these organizations are not included in taxable income if the organizations meet the requirements of I.R.C. § 527. However, contributions to Section 527 political organizations are not tax deductible by the contributor.

understanding of a Section 527 political organization's financial information or track the flow of funds related to legislative issues and political campaigns.

In summary, we identified some degree of noncompliance by both new and existing Section 527 political organizations in filing their applicable public disclosure reports. Our audit tests showed that an estimated 580 Section 527 political organizations may have started receiving contributions or making expenditures before notifying the IRS of their existence. We estimate these organizations may have received \$26.8 million that should have been reported as taxable income, and as a result, may be subject to approximately \$9.4 million in tax. In addition, Section 527 political organizations did not timely or completely report their contributions and expenditures by filing Forms 8872. We estimate that Section 527 political organizations filed 248 untimely or incomplete Forms 8872. As a result, these organizations may be subject to over \$7.5 million in penalties.

In addition, legislative changes to reporting requirements increased the risk QSLPOs may not disclose information as required, for several reasons. First, the IRS is not required to determine if QSLPOs are in compliance with State reporting requirements. Second, the IRS does not know the degree to which the States are ensuring compliance with State reporting requirements. Third, EO function management stated there was little coordination between the IRS and the States regarding this issue. As a result, the potential exists that organizations claiming QSLPO status may avoid filing documents detailing contributions and expenditures with either the IRS or the applicable State, and the public may not receive timely data regarding contributions and expenditures by State or local Section 527 political organizations.

We recommended the Director, EO, clarify instructions on Form 8872; develop plans for periodically reviewing the timeliness and completeness of Forms 8871 and 8872 if implementation of computer changes are delayed beyond January 1, 2006; and ensure taxes and penalties are assessed, as appropriate, on noncompliant Section 527 political organizations filing late or incomplete Forms 8871 and 8872. Further, we recommended the Director, EO, research State laws to determine if the statutes related to the reporting of political contributions and expenditures by State and local political organizations have at least the same dollar thresholds as those required by Public Law 107-276<sup>3</sup> for QSLPOs and take appropriate action to ensure Section 527 political organizations file Forms 8872, as required. Finally, we recommended the Director, EO, initiate a compliance project to identify a process to address QSLPOs operating beyond the scope of their authorized activities and identify areas in which coordination with the States can be improved.

**Management's Response:** The Tax Exempt and Government Entities (TE/GE) Division agreed with the findings and recommendations contained in the report. EO function management agreed to clarify the instructions for Form 8872 to more clearly explain the information required in Schedules A and B; develop plans for reviewing the timeliness and completeness of Forms 8871 and 8872, if implementation of changes to IRS

---

<sup>3</sup> Pub. L. No. 107-276, 116 Stat. 1929 (2002).

computer systems are delayed beyond January 1, 2006; ensure taxes and penalties are assessed, as appropriate, for Section 527 political organizations that file late and incomplete Forms 8871 and 8872; and recommended that guidance on reasonable cause for Section 527 filings be included in next year's Treasury Guidance Plan. In addition, the EO function will propose a project to identify a process to address QSLPOs operating beyond the scope of their authorized activities and will include a review of relevant State laws to determine if the States have the same reporting thresholds for contributions and expenditures.

While TE/GE management agreed with our findings and recommendations, they did not agree with the \$17 million reported as outcome measures (additional tax and penalties for Section 527 political organizations that either received contributions before filing Form 8871 with the IRS or filed an incomplete or late Form 8872 with the IRS). The Commissioner, TE/GE Division, responded that based upon the results of the Section 527 Compliance Project completed by the TE/GE Division, most of the penalties we calculated would be waived or abated due to the existing general reasonable cause standard. In addition, EO function management informed us that although the Section 527 Compliance Project did not include untimely Forms 8871, the additional taxes owed based on late Forms 8871 could also be subject to being waived due to reasonable cause and, therefore, may not be as much as we estimated. Management's complete response to the draft report is included as Appendix VI.

We believe the \$17 million in Outcome Measures is still an accurate reflection of the amount of additional taxes and penalties that could be assessed for noncompliant Section 527 political organizations. Until appropriate enforcement action is taken on noncompliant Section 527 political organizations, there is an increased risk that these organizations may continue to submit untimely and incomplete Forms 8871 and 8872. The Director, EO, recommended to IRS Counsel and the Department of the Treasury that specific guidance on reasonable cause for Section 527 filings be included for consideration in next year's Treasury Guidance Plan. As noted in management's response, this will allow the IRS to ensure the appropriate assessment of taxes and penalties for noncompliant Section 527 political organizations.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

**Additional Actions Are Needed to Ensure Section 527 Political Organizations  
Publicly Disclose Their Activities Timely and Completely**

---

**Table of Contents**

Background .....	Page 1
Section 527 Political Organizations Are Not Always Reporting Contribution and Expenditure Information Timely and Completely .....	Page 3
<u>Recommendations 1 through 3:</u> .....	Page 12
Legislative Changes to Reporting Requirements Increase the Risk That Section 527 State or Local Political Organizations May Not Disclose Information As Required .....	Page 13
<u>Recommendation 4:</u> .....	Page 16
<u>Recommendation 5:</u> .....	Page 17
Appendix I – Detailed Objective, Scope, and Methodology .....	Page 18
Appendix II – Major Contributors to This Report .....	Page 20
Appendix III – Report Distribution List .....	Page 21
Appendix IV – Outcome Measures .....	Page 22
Appendix V – Organizations Required to Notify the Internal Revenue Service of Section 527 Status and Report Contributions and Expenditures .....	Page 25
Appendix VI – Management’s Response to the Draft Report .....	Page 27

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

### **Background**

---

Political organizations are organized and operated primarily to accept contributions and make expenditures to influence the selection, nomination, election, or appointment of any individual to Federal, State, or local public office. There are a variety of political organizations, including political parties; campaign committees for candidates for Federal, State, or local office; and political action committees.

With certain exceptions, Internal Revenue Code (I.R.C.) Section (§) 527<sup>1</sup> requires political organizations that desire to be tax exempt<sup>2</sup> to notify the Internal Revenue Service (IRS) that it is to be treated as a Section 527 political organization. Additional information on who is required to file is included in Appendix V. To notify the IRS, the political organization must electronically file a Political Organization Notice of Section 527 Status (Form 8871). In addition, Section 527 political organizations must file an amended Form 8871 within 30 days of the occurrence of a material change to the organization and file a final Form 8871 within 30 days of termination.

A Section 527 political organization must also file a Political Organization Report of Contributions and Expenditures (Form 8872) if it has filed Form 8871, has not claimed Qualified State or Local Political Organization (QSLPO) status, and has received contributions or made expenditures during the calendar year. A Section 527 political organization with contributions or expenditures less than \$50,000 can file the Form 8872 either electronically or on paper.

The Bipartisan Campaign Reform Act of 2002 (BCRA)<sup>3</sup> significantly changed Federal campaign law. The BCRA prohibits the raising and spending of “soft money”<sup>4</sup> by Federal Government officeholders and candidates and severely restricts the use of soft money by State and local

---

<sup>1</sup> I.R.C. § 527 (2003).

<sup>2</sup> Contributions to these organizations are not included in taxable income if the organizations meet the requirements of I.R.C. § 527. However, contributions to Section 527 political organizations are not tax deductible by the contributor.

<sup>3</sup> Pub. L. No. 107-155, 116 Stat 81 (2002).

<sup>4</sup> Soft money is money given to political parties that is not subject to Federal contribution and spending limits.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

parties related to Federal Government election activities. Experts suggested the BCRA would result in increased contributions to Section 527 political organizations. News reports seem to have confirmed the expectations of increased activity by Section 527 political organizations. The Center for Public Integrity reported that Section 527 political organizations raised approximately \$535 million during the 2004 election cycle, compared to approximately \$268 million raised by Section 527 political organizations during the 2002 election cycle. Given this situation, proper disclosure of the financial activities of Section 527 political organizations is a concern to both regulators and the general public.

This concern has also been raised by the media. For example, reports released by public interest groups and various media sources during 2004 have indicated Section 527 groups are not reporting all contributions and expenditures to the IRS. This incomplete information includes accounts of Section 527 political organizations filing returns late and filing amended returns with additional contributions of at least \$100,000, including 9 specific instances in which the total gap was \$1 million or more. It was also reported that 1 organization filed 7 Forms 8872 at the same time to cover a 3-year period that included over \$300,000 in contributions and expenditures.

On November 2, 2002, Public Law 107-276<sup>5</sup> was enacted, amending the I.R.C. § 527. The Congress implemented Public Law 107-276 to improve the quality of information disclosed by Section 527 political organizations and to enable the public to review information that political groups disclose to the IRS. In addition, the law retroactively changed the filing requirements for certain State and local political organizations. In response to the legislation, the IRS Tax Exempt and Government Entities (TE/GE) Division implemented a new Political Organization Filing and Disclosure (POFD) web site. The POFD web site allows political organizations to electronically file Forms 8871 and 8872 and allows the public to view, search, or download the entire database of electronic filings by

---

<sup>5</sup> Pub. L. No. 107-276, 116 Stat. 1929 (2002).

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

political organizations. The TE/GE Division is responsible for ensuring compliance with the requirements of I.R.C. § 527.

This review was performed in the TE/GE Division Headquarters Office in Washington, D.C., during the period August 2004 through March 2005. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

We identified some degree of noncompliance by both new and existing Section 527 political organizations in filing their applicable public disclosure reports. Specifically, based on our statistically valid samples of Forms 8871 and 8872 filed during the period January 1, 2002, through July 2, 2004, we determined:<sup>6</sup>

- There were an estimated 580 Section 527 political organizations (primarily newly established organizations) that may have started receiving contributions or making expenditures before filing a Form 8871 with the IRS. According to the tax law, these contributions are considered taxable and must be reported as ordinary income on the organizations' tax returns (minus any deductions associated with the production of that income). We estimate these Section 527 political organizations may have received \$26.8 million in taxable contributions prior to filing Forms 8871 and consequently may be subject to approximately \$9.4 million in tax. We researched the organizations' U.S. Income Tax Returns for Certain Political Organizations (Form 1120-POL) but did not identify any additional tax reported on the returns related to these contributions.
- Both existing and new Section 527 political organizations did not timely or completely file all their Forms 8872. According to the tax law, the IRS can assess a 35 percent penalty on the \$21.6 million

---

### **Section 527 Political Organizations Are Not Always Reporting Contribution and Expenditure Information Timely and Completely**

---

---

<sup>6</sup> See details of computations in Appendix IV.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

in contributions and expenditures reported on 248 untimely or incomplete Forms 8872. We estimate this could be over \$7.5 million in penalties.

- Section 527 political organizations also did not file all their required Forms 8872 during the year. We determined in 36 of the 277 cases in our Form 8871 sample, organizations did not file 1 or more Forms 8872. Although the tax law allows the IRS to assess a penalty for these missed returns, the IRS would have difficulty determining the penalty amount because it does not know what contributions and expenditures were not reported.

Exempt Organizations (EO) function management generally agreed with the untimely and incomplete Forms 8871 and 8872 in our sample.<sup>7</sup> We researched the Section 527 political organizations' accounts included in our samples on the IRS' database and did not identify any penalties assessed against these organizations. However, management disagreed with the amount of the potential penalties because they believed the results of their 2004 compliance project<sup>8</sup> showed most of the penalties would not be applicable due to the reasonable cause provision of the law, which allows the penalty to be waived if the omission was due to reasonable cause and not due to willful neglect. In addition, although EO function management did not include untimely Forms 8871 in the compliance project, they advised us the additional taxes owed based on late Forms 8871 would also be subject to being waived due to reasonable cause and therefore may not be as much as we estimated.

Without timely and complete contribution and expenditure information, the public cannot gain a true understanding of a Section 527 political organization's financial information or track the flow of funds related to legislative issues and political campaigns. Timely and complete information will

---

<sup>7</sup> EO function management did not agree with one exception case because it was a contribution to a candidate committee. However, our review of the case indicated the contribution was received by a political action committee, not a candidate committee.

<sup>8</sup> The EO function's compliance project on Forms 8872 is explained in detail later in this section of the report.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

ensure the public's ongoing confidence regarding the funding of our nation's elections.

Public Law 106-230<sup>9</sup> was passed in July 2000. This law established requirements for certain political organizations to notify the IRS that they were Section 527 organizations and disclose their contributions and expenditures to the IRS. EO function management stated many Section 527 political organizations were not aware of these requirements, and as a result, there was a need to educate these organizations of the filing requirements established by Public Law 106-230. This educational effort continued when the law was amended in November 2002. However, EO function management indicated this lack of awareness was still evident in the 2004 compliance project and further education and outreach, combined with compliance efforts, is needed to bring Section 527 political organizations into compliance.

The EO function started to focus on compliance issues in late 2003. In 2004, EO function management requested enhancement of the IRS computer system to more effectively identify Section 527 political organizations that are not filing necessary information as required. As previously mentioned, EO function management initiated a compliance project in August 2004 in an effort to improve reporting and disclosure by Section 527 political organizations. Additional details about EO function management's actions to address noncompliance are discussed later in the report.

### **Forms 8871 were not always submitted timely**

We determined that Forms 8871 were not submitted timely in 19 (7 percent)<sup>10</sup> of the 277 cases in our sample. Applying this error rate to the population of 8,458 Forms 8871 filed for the period January 1, 2002, through July 2, 2004, we estimate there were 580 Forms 8871 (new and amended) not submitted timely by Section 527 political organizations.

---

<sup>9</sup> Pub. L. No. 106-230, 114 Stat 477 (2000).

<sup>10</sup> Figure was rounded to 7 percent. Other percentage figures shown in the report are also rounded.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

If a political organization does not file a Form 8871 timely, it will not be treated as a tax-exempt organization until the date the Form 8871 is filed. In addition, if a political organization does not timely file an amended Form 8871 to provide notice of a material change, it will not be considered a tax-exempt Section 527 political organization for the period beginning when the change occurred until the amended Form 8871 is filed. As a result, a political organization will need to include any contributions received during this time as taxable income on the Form 1120-POL.

### **Forms 8872 were not always submitted timely and completely**

Based on our statistical samples, we determined Section 527 political organizations did not always file Forms 8872 timely or neglected to file the Forms 8872 as required. Specifically, Forms 8872 were not submitted timely in 15 (5 percent) of the 299 cases in our Form 8872 sample.<sup>11</sup> In addition, in 36 (13 percent) of the 277 cases in our Form 8871 sample, Section 527 political organizations did not submit 1 or more required Forms 8872.

We also determined electronic Forms 8872 were not always complete. Specifically, 65 (22 percent) of 299 Forms 8872 in our sample did not always include the required information. The missing information usually involved contribution information reported on Form 8872, Schedule A,<sup>12</sup> such as contributor's employer and occupation (47 instances), or expenditure information reported on Form 8872, Schedule B, such as recipient's employer, occupation, and purpose of the expenditure (39 instances).<sup>13</sup> In many instances, these fields included the words "N/A," "unknown," or "information requested." Instructions for Form 8872 do not currently address what an

---

<sup>11</sup> We considered any Form 8872 filed within 7 days of the due date as timely.

<sup>12</sup> We did not count any information as missing from Form 8872 if the aggregate contribution amounts shown on the return for any contributor were less than \$200 for the year. Form 8872 does not require information on contributors if the total amount of their contributions to a Section 527 organization for that year are less than \$200.

<sup>13</sup> In 21 of the 65 cases involving incomplete Forms 8872, both Schedules A and B of the sampled Form 8872 were incomplete.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

organization should do if it does not have the required information for Schedules A and B. We recognize Section 527 political organizations may not always receive the information required for the Form 8872 from contributors, if they choose not to provide it to the Section 527 political organization. However, Section 527 political organizations should know and report the employers and occupations of individuals to whom they make expenditures.

In addition, Section 527 political organizations did not always include all contributions and expenditures on the original Forms 8872. In some cases, organizations submitted amended Forms 8872 after the due dates of the original Forms 8872 (ranging from 8 to 281 days later) with additional contributions and expenditures. The amended amounts would be subject to the 35 percent penalty for late filing.

Based on our results, we estimate, from the population of 2,100 Forms 8872 filed during the period January 1, 2002, through July 2, 2004, there were 74 Forms 8872 not submitted timely by tax-exempt organizations that may be subject to \$3.5 million in penalties. We also estimate 174 Forms 8872 filed during this period did not contain complete information and may be subject to \$4 million in penalties.

We also analyzed a judgmental sample of 30 Forms 8872 filed on paper by Section 527 political organizations and determined that 4 (13 percent) of the 30 were untimely. These Forms 8872 included contributions and expenditures of almost \$120,000 for which the IRS could assess penalties of approximately \$42,000.

Due dates for filing a Form 8872 vary depending on whether the Form is due during a calendar year that includes a regularly scheduled election, general election, primary election, or nominating convention for a Federal Government office. During a calendar year that includes a regularly scheduled Federal election (e.g., 2000, 2002, and 2004), a Section 527 political organization can choose to file its Form 8872 either on a quarterly or monthly basis, but it must file on the same basis for the entire calendar year. In addition, a Section 527 political organization must

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

file a preelection report and postelection report during calendar years that include regularly scheduled elections. The preelection report is generally filed 12 to 15 days before the election, and the postelection report is required to be filed within 30 days after the election. In nonelection years (e.g., 2001, 2003), Form 8872 must be filed either semi-annually or monthly.

The IRS has the legal authority to impose penalties if a Section 527 political organization fails to file Form 8872 by the due date. Penalties may also be assessed if the organization reports incorrect information or fails to report all of the information required on the Form. This could include information such as identity of contributor, contributor's address, date/amount of contribution, contributor's employer/occupation, recipient's identity, recipient's address, date/amount of expenditure, and recipient's employer/occupation. The penalty is 35 percent of the total amount of contributions and expenditures not properly reported. The penalty can be waived if the Section 527 political organization establishes reasonable cause that the late or incomplete filing was not due to willful neglect.

### **The EO function initiated actions to improve oversight of Section 527 political organizations' compliance with I.R.C. § 527 filing requirements**

As stated previously, EO function management has initiated actions to improve the reporting and disclosure of information by Section 527 political organizations. In May 2002, the IRS issued Notice 2002-34, which stated the IRS would not assert any tax, penalty, or interest that arose solely because the political organization failed to file or filed an incorrect return, as long as the political organization filed a return or corrected return by July 15, 2002. EO function management officials stated, due to resource limitations and changes in the law in November 2002 that required the IRS to redesign the POFD web site, their priority was to finish work on the POFD web site before focusing on compliance activities. After the update to the POFD web site was finished in July 2003, the EO function resumed focus on I.R.C. § 527 compliance issues. To date,

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

EO function management has initiated two significant activities in this area:

- Requesting modification of the IRS computer system to systemically identify Section 527 political organizations that have not adhered to their filing obligations.
- Initiating a compliance project to identify Section 527 political organizations whose filed Forms appear to be incomplete, were filed late, or were amended and are materially different from the original filing.

In late 2003, the EO function began work on an action plan to address potentially noncompliant political organizations and issued a project proposal in February 2004. In July 2004, EO function officials started developing three Requests for Information Services<sup>14</sup> (RIS) to more effectively identify Section 527 political organizations that have not filed Forms 8871 and 8872 as required. Collectively, these RISs will modify the Business Master File<sup>15</sup> (BMF) to allow the posting of information from Forms 8871 and 8872 to this computer system.<sup>16</sup> Currently, these Forms are entered only on the POFD web site. In addition, these RISs will enable IRS management to identify organizations not meeting their filing obligations and issue notices to these organizations. EO function management stated updates to the BMF are major programming changes that require substantial Modernization and Information Technology Services staff resources. EO function management added that a structured process has been established to control and prioritize system changes; however, this process requires substantial lead time for implementation. EO function personnel indicated these

---

<sup>14</sup> A formal memorandum from any Customer Organization requesting support for changes to current or planned programming, computer hardware, Commercial Off-the-Shelf software, system testing, etc.

<sup>15</sup> The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

<sup>16</sup> The BMF was modified in 2000 to show whether Section 527 political organizations filed Forms 8871 and 8872, but the modification did not allow information from these forms to be posted to the BMF.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

RISs were approved for implementation on January 1, 2006. If implementation of the requests are delayed due to the complexity involved in requesting changes to IRS computer systems, the possibility exists that another election cycle may proceed without automating the process to verify that Section 527 political organizations are complying with Public Law 107-276.

As part of the IRS' renewed emphasis on enforcement of the tax laws, the EO function initiated a project to identify the noncompliance issues related to late-filed returns, incomplete returns, and amended returns filed by Section 527 political organizations. Specifically, the EO function analyzed the POFD web site and contacted 30 organizations that appeared not to have fully met their filing and disclosure requirements relating to contributions. These 30 organizations were identified based on the following criteria:

- Forms 8872 with missing contributor information, such as occupation and employer, for at least \$100,000 in contributions or for 10 percent of the total contributions.
- Amended Forms 8872 filed 30 days or more after the initial filings, and the amendments either represented changes equaling at least \$100,000 or 10 percent of the total contributions.
- Forms 8872 filed at least 2 weeks after the due date.

For each organization included in the project, the EO function identified all areas of potential noncompliance (late, amended, and missing information) and included a review of contributions and expenditures. The project's preliminary results<sup>17</sup> indicate 22 of the 30 organizations established reasonable cause for not filing and disclosing the information timely and completely. As a result, no penalties were assessed. For the eight remaining organizations, the IRS:

---

<sup>17</sup> Preliminary results as of January 14, 2005.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

- Determined three organizations believed they were not required to file Forms 8872 because they qualified for QSLPO status.<sup>18</sup>
- Assessed penalties in two cases.
- Was still working two cases.
- Closed one case even though the organization filed incomplete Forms 8872 because further review of the organization's records would be necessary to sustain the penalty.

According to the EO function, there is currently no specific reasonable cause standard in I.R.C. § 527 for failure to comply with the filing and disclosure requirements of Public Law 107-276. As a result, EO function management stated they will not assess a penalty under I.R.C. § 527(j) if the organization can show the cause of the untimeliness or incompleteness was not due to willful neglect. This appears easy for Section 527 political organizations to meet and has effectively prevented the IRS from assessing penalties for noncompliance. As of January 2005, IRS management has indicated this penalty has been assessed only twice (as part of the compliance project).

Our research of the IRS Penalty Handbook showed there is one reasonable cause standard applicable to all taxpayers. Reasonable cause relief is generally granted when taxpayers exercise ordinary business care and prudence but nevertheless were unable to comply with the law because of circumstances beyond their control. EO function management informed us the Penalty Handbook was used to determine if relief was appropriate for the compliance project cases.

EO function management should continue to focus on noncompliant Section 527 political organizations to identify the reasons for the late/incomplete filings and to address noncompliance through a combination of enforcement actions and education and outreach. The assessment of taxes and penalties for incomplete or untimely filing of

---

<sup>18</sup> The QSLPO status is explained in detail in the next section of the report.

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

Forms 8871 and 8872, when appropriate, could lead to increased accountability and disclosure by Section 527 political organizations. Without the use of penalties, the IRS' ability to ensure more accurate and complete filing of contribution and expenditure information for Section 527 political organizations is severely limited.

### **Recommendations**

The Director, EO, should:

1. Clarify the instructions for Form 8872 to more clearly explain what information is required in Schedules A and B of Form 8872.

Management's Response: The instructions to the Form 8872 are being amended to more clearly explain what information is required based on the results of the Section 527 Compliance Project, particularly relating to the occupation and employer information for individuals. The Director, EO, will request the amended instructions be included in the next revision of the Form 8872.

2. Develop plans for periodically reviewing the timeliness and completeness of Forms 8871 and 8872 if implementation of the RISs related to the Forms 8871 and 8872 are delayed beyond January 1, 2006.

Management's Response: If implementation of the RISs is delayed, the Director, EO, Rulings and Agreements, will develop a plan for reviewing the timeliness and completeness of Forms 8871 and 8872. EO function management will monitor the anticipated implementation of the RISs and if potential problems arise will establish an appropriate action plan for reviewing the timeliness of the forms.

3. Ensure taxes and penalties are assessed, as appropriate, for Section 527 political organizations that file late and incomplete Forms 8871 and 8872.

Management's Response: The Director, EO, agrees taxes and penalties should be assessed, as appropriate, and will take steps to address compliance in this area. To ensure appropriate assessment, the Director, EO, has recommended to IRS Counsel and the Department of the Treasury that

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

guidance on reasonable cause for Section 527 filings be included for consideration for next year's Treasury Guidance Plan.

However, the Commissioner, TE/GE Division, disagreed with the \$17 million reported as Outcome Measures based upon the results of the Section 527 Compliance Project, that showed most of the penalties we calculated would be waived or abated due to the existing general reasonable cause standard.

Office of Audit Comment: We believe the \$17 million in Outcome Measures is still an accurate reflection of the amount of additional taxes and penalties that could be assessed for noncompliant Section 527 political organizations. Until appropriate enforcement action is taken on noncompliant Section 527 political organizations, there is an increased risk that these organizations may continue to submit untimely and incomplete Forms 8871 and 8872. The Director, EO, recommended to IRS Counsel and the Department of the Treasury that specific guidance on reasonable cause for Section 527 filings be included for consideration in next year's Treasury Guidance Plan. As noted in management's response, this will allow the IRS to ensure the appropriate assessment of taxes and penalties for noncompliant Section 527 political organizations.

---

**Legislative Changes to Reporting Requirements Increase the Risk That Section 527 State or Local Political Organizations May Not Disclose Information As Required**

---

Public Law 107-276 created a new category of Section 527 political organization called a QSLPO. A QSLPO is required to notify the IRS of its existence by filing Form 8871, but it is required to report its contribution and expenditure information to its respective State instead of to the IRS. This change increased the risk that QSLPOs may not disclose information as required, for several reasons. First, the IRS is not required to determine if QSLPOs are in compliance with State reporting requirements. Second, the IRS does not know the degree to which the States are ensuring compliance with State reporting requirements. Third, EO function management stated there was little coordination between the IRS and the States regarding this issue. As a result, the potential exists that organizations claiming QSLPO status may avoid filing documents detailing contributions and expenditures with either the IRS or the applicable State, and the public may not receive

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

timely data regarding contributions and expenditures by State or local Section 527 political organizations. Without proper disclosure, the IRS and the public may not know if the QSLPOs are operating beyond the scope of their authority, such as by participating in Federal election campaigns.

We determined some of the Section 527 political organizations at the State or local level did not always file the required reports of contributions and expenditures with their States, operated beyond the scope of authorized QSLPO activities, or improperly claimed QSLPO status. Based on our audit results, we estimate, with 90 percent confidence from the population of 8,458 Forms 8871 filed during the period January 1, 2002, through July 2, 2004, there were 366<sup>19</sup> Section 527 political organizations improperly claiming QSLPO status or not filing Forms 8872 with the IRS as required.

### **Section 527 political organizations may not be meeting the requirements for a QSLPO**

Based on our review of the Form 8871 statistical sample, we determined 39 of the 277 Section 527 political organizations claimed QSLPO status on the Form 8871. Of these 39 cases, we determined 12 (31 percent) did not meet the requirements of Public Law 107-276 as a QSLPO organization and should file Forms 8872 with the IRS. Specifically:

- In nine cases, the activities of the organization did not relate solely to the purposes of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any State or local public office or office in a State or local political organization. In one of the cases, the organization made contributions to candidates running for election to the United States Congress. In the other eight cases, the purpose of the organization was to support/oppose ballot measures or other purposes, which appears to be beyond the

---

<sup>19</sup> Figure was computed by multiplying the percentage of Section 527 political organizations improperly claiming QSLPO status by the universe of Forms 8871 ( $12/277 * 8,458 \cong 366$ ).

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

scope of authorized QSLPO activities. We identified these issues based on information filed on the applicable States' web sites or information filed with the IRS on Form 8871. These QSLPOs reported approximately \$2.4 million of contributions and expenditures to their States.

- In one case, State reporting requirements were not consistent with the requirements of Public Law 107-276. Specifically, the dollar thresholds for reporting contributions and expenditures in that State were higher than those established under Public Law 107-276. This QSLPO reported approximately \$64,000 of contributions and expenditures to its State.
- In two cases, we could not locate any report filed with the State detailing the organization's contributions and expenditures.

Public Law 107-276 defines QSLPOs as political organizations with the following characteristics:

- All of their exempt functions relate solely to the purpose of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any State or local public office or office in a State or local political organization.
- State law requires the organization to report contribution and expenditure information to the State that is similar to the information required to be reported to the IRS.
- The organization files the reports with the State.
- The organization and State make these reports available to the public.
- No Federal Government officeholder or candidate controls or materially participates in the organization, solicits contributions to the organization, or directs disbursements from the organization.

However, EO function management informed us they do not review or verify whether Section 527 political organizations

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

qualify for QSLPO status when their Forms 8871 are received. The Forms 8871 are electronically filed and are automatically entered on the POFD web site without going through a manual screening by the IRS. In addition, EO function management explained it is not easy to determine if Section 527 political organizations are valid QSLPOs because the reporting laws in each State are different. Consequently, the EO function would need to research each State's laws regarding the reporting of political contributions and expenditures to determine if the State statutes meet the requirements of Public Law 107-276. For example, one organization in our sample was from a State in which political action committees receiving contributions totaling less than \$750 in a calendar year do not need to report to the State, whereas I.R.C. § 527 requires political organizations to report contributions of more than \$500 to the State to qualify for QSLPO status. Since the State statute has a higher reporting requirement than that required in I.R.C. § 527, the organization would not qualify for QSLPO status and should file Forms 8872 with the IRS.

A more significant limitation on the IRS is the limited coordination between the IRS and the States regarding QSLPO compliance with State reporting guidelines. EO function management informed us they have not been advised by any States that a political organization has not been reporting its contributions and expenditures as required. We believe the IRS should evaluate this issue to identify potential ways to improve coordination with the States and ensure QSLPOs are complying with reporting guidelines.

### **Recommendations**

The Director, EO, should:

4. Research State laws to determine if the statutes related to the reporting of political contributions and expenditures by State and local political organizations have at least the same dollar thresholds as the requirements of Public Law 107-276 for QSLPOs. For those States whose statutes do not meet the threshold, take appropriate action to ensure Section 527 political organizations file Forms 8872, as required.

**Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

Management's Response: The Director, EO, will include a review of relevant State laws as part of the Fiscal Year 2007 project discussed in the management response to Recommendation 5.

5. Initiate a compliance project to identify a process to address QSLPOs operating beyond the scope of their authorized activities and identify areas in which coordination with the States can be improved.

Management's Response: The Director, EO, has proposed a project to improve the quality of information regarding the number of QSLPOs on the PODF web site, which EO function management believes needs to be completed first. For FY 2007, the Director, EO, will propose a project to identify a process to address QSLPOs operating beyond the scope of their authorized activities and identify areas in which coordination with the States can be improved.

**Additional Actions Are Needed to Ensure Section 527 Political Organizations  
Publicly Disclose Their Activities Timely and Completely**

---

**Appendix I**

**Detailed Objective, Scope, and Methodology**

The overall audit objective was to determine the effectiveness of the Exempt Organizations (EO) function's efforts to ensure political organizations file timely and complete Political Organization Notices of Section 527 Status (Form 8871) and Political Organization Reports of Contributions and Expenditures (Form 8872). To accomplish this objective, we:

- I. Assessed the EO function's process for ensuring compliance with Internal Revenue Code (I.R.C.) Section (§) 527<sup>1</sup> filing requirements for Forms 8871 and 8872.
  - A. Interviewed EO function management to obtain background information on I.R.C. § 527 filing requirements.
  - B. Identified controls in place since January 1, 2002, that are designed to determine whether Forms 8871 and 8872 are timely and complete when submitted/processed.
  - C. Identified the EO function's efforts since January 2002 to monitor and enforce filing compliance and determine if noncompliance is addressed.
  - D. Determined if the EO function makes use of compliance cases contained on the Federal Election Commission (FEC) and/or State web sites for political organizations to identify potential leads about nonfiling, the filing of inaccurate information, and the filing of incomplete information with the FEC or States that could be related to Section 527 political organizations.
- II. Determined if the EO function received timely and complete Forms 8871 and 8872. If Forms 8871 and 8872 were not timely or complete, we determined if the EO function took appropriate action to address the noncompliance.
  - A. Downloaded filing data from the Internal Revenue Service Political Organization Filing and Disclosure web site for Forms 8871 and 8872 received during the period January 1, 2002, through July 2, 2004.
  - B. Consulted with the Treasury Inspector General for Tax Administration Office of Chief Counsel on issues discussed in the report.
  - C. Selected a statistically valid sample of 277 electronically filed Forms 8871 from a universe of 8,458 Forms 8871 filed for the period January 1, 2002, through July 2, 2004, to determine if the sampled political organizations filed a timely and complete Form 8871, paid any additional tax due, and filed Forms 8872. We also determined if political organizations claiming Qualified State or Local Political Organization status met the Form 8872 exemption requirements. Our estimates were

---

<sup>1</sup> I.R.C. § 527 (2003).

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

- made at 90 percent confidence with an actual error rate of .06859.<sup>2</sup> Based on this value, we determined the precision levels of our projections to be the following: for the number of untimely Forms 8871 (+2.5 percent), for taxable contributions received by these organizations (\$5.3 million to \$48.3 million), and for the potential tax owed by these organizations (\$1.9 million to \$17 million).
- D. Selected a statistically valid sample of 299 electronically filed Forms 8872 (stratified by the total dollar amounts of the contributions and expenditures reported) from the universe of 2,100 Forms 8872 filed for the period January 1, 2002, through July 2, 2004, to determine if the sampled political organizations filed a timely and complete Form 8872, paid any penalty due, and filed a Form 8871. Our estimates were made at 90 percent confidence with an actual error rate of .03524 for the untimely Forms 8872 and .08292 for the incomplete Forms 8872. Based on this value, we determined the precision levels of our projections to be the following:
1. For the number of untimely Forms 8872 (+1.2 percent), for contributions received and expenditures made (\$7 million to \$13.3 million), and for potential penalties (\$2.4 million to \$4.7 million).
  2. For the number of incomplete Forms 8872 (+1.7 percent), for contributions received and expenditures made (\$10.8 million to \$12.1 million), and for potential penalties (\$3.7 million to \$4.2 million).
- E. Selected a judgmental sample of 30 electronically filed amended Forms 8872 from a universe of 222 amended Forms 8872 filed during the period January 1, 2002, through July 2, 2004, to determine if the sampled political organizations filed timely and complete Forms 8872. We selected a judgmental sample due to resource considerations.
- F. Selected a judgmental sample of 30 paper-filed Forms 8872 from a universe of 18,484 paper Forms 8872 filed during the period January 1, 2002, through July 2, 2004, to determine if the sampled political organizations filed timely and complete Forms 8872. We selected a judgmental sample due to resource considerations.

---

<sup>2</sup> All decimals in this appendix are rounded to five decimal places.

**Additional Actions Are Needed to Ensure Section 527 Political Organizations  
Publicly Disclose Their Activities Timely and Completely**

---

**Appendix II**

**Major Contributors to This Report**

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy A. Nakamura, Director

Jeffrey M. Jones, Audit Manager

Thomas F. Seidell, Lead Auditor

Margaret A. Anketell, Senior Auditor

Kenneth C. Forbes, Senior Auditor

Michael R. Van Nevel, Senior Auditor

Donald J. Martineau, Auditor

Jeffrey E. Williams, Information Technology Specialist

**Additional Actions Are Needed to Ensure Section 527 Political Organizations  
Publicly Disclose Their Activities Timely and Completely**

---

**Appendix III**

**Report Distribution List**

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T  
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Management Controls OS:CFO:AR:M  
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities  
Division SE:T:CL

## Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely

---

### Appendix IV

### Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to the Congress.

#### Type and Value of Outcome Measure:

- Increased Revenue/Revenue Protection – Potential; \$17 million<sup>1</sup> in additional tax and penalties for Section 527 political organizations<sup>2</sup> that met either of the following conditions: 1) received contributions before filing Political Organization Notice of Section 527 Status (Form 8871) with the Internal Revenue Service (IRS) or 2) filed an incomplete or late Political Organization Report of Contributions and Expenditures (Form 8872) with the IRS (see page 3).

#### Methodology Used to Measure the Reported Benefit:

We selected two statistically valid samples and one judgmental sample and projected the results of the statistical samples. The size of each universe and sample is shown in the following table. The first statistical sample consisted of 277 Forms 8871 electronically filed between January 1, 2002, and July 2, 2004, that were randomly selected from a Political Organization Filing and Disclosure (POFD) web site data extract. The second statistical sample consisted of 299 Forms 8872 electronically filed between January 1, 2002, and July 2, 2004, that were randomly selected from a POFD web site data extract. We stratified this sample by the total amounts of contributions and expenditures reported into 3 strata - low (total contributions and expenditures less than \$50,000), medium (total contributions and expenditures from \$50,000 to less than \$500,000), and high (total contributions and expenditures equal to and over \$500,000). The third sample was a judgmental sample of 30 paper Forms 8872 filed between January 1, 2002, and July 2, 2004, that were randomly selected from a POFD web site data extract.

---

<sup>1</sup> Exempt Organizations management disagreed with the amount of the potential penalties because they believed the results of their compliance project showed that most of the penalties would not be applicable due to the reasonable cause provision of the law, which allows the penalty to be waived if the omission was due to reasonable cause and not due to willful neglect.

<sup>2</sup> Internal Revenue Code Section 527 (2003) requires each political organization that desires to be tax exempt to notify the IRS that it is to be treated as a Section 527 political organization.

**Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

Sample	Strata	Size of Universe	Attribute Sample Size
Sample 1 (Forms 8871)		8,458	277
Sample 2 (Forms 8872)	Strata 1 (low)	1,509	88
	Strata 2 (medium)	508	128
	Strata 3 (high)	83	83
Sample 3 (Forms 8872)		18,484	30

We estimated these Section 527 political organizations may owe \$17 million in additional tax and penalties. To arrive at our estimates, we:

1. Projected the results of Sample 1 to the universe and, based on a 90 percent confidence level, estimated 580 Section 527 political organizations filed Form 8871 untimely and may be subject to approximately \$9.4 million in tax. The estimated number of political organizations filing an untimely Form 8871 was calculated by multiplying the universe of Forms 8871 times the percentage of untimely Forms 8871 in our sample ( $8,458 * .06859 \cong 580$ ). The \$9.4 million in taxes was estimated by multiplying the average potential penalty amount for contributions received by these political organizations prior to the filing of Forms 8871 by the universe of Forms 8871 ( $\$1,110.59897 * 8,458 \cong \$9,393,446$ ).
2. Projected the results of Sample 2 (by strata) to each universe and, based on a 90 percent confidence level, estimated 248 Section 527 political organizations that filed late or incomplete Forms 8872 may be subject to over \$7.5 million in penalties. The estimated number of political organizations filing an untimely Form 8872 was calculated by multiplying the universe of Forms 8872 by the weighted percentage of untimely Forms 8872 in our sample ( $2,100 * .03524 \cong 74$ ). The estimated number of political organizations filing an incomplete Form 8872 was calculated by multiplying the universe of Forms 8872 by the weighted percentage of incomplete Forms 8872 in our sample ( $2,100 * .08292 \cong 174$ ). The total number of estimated Section 527 political organizations that filed late or incomplete Forms 8872 was calculated by adding the estimated number of untimely Forms 8872 to the estimated number of incomplete Forms 8872 ( $74 + 174 = 248$ ).

The estimated amount of penalties that Section 527 political organizations may be subject to for the untimely filing of Forms 8872 was calculated by multiplying the average weighted penalty dollars for untimely Forms 8872 by the universe of Forms 8872 ( $\$1,687.22207 * 2100 \cong \$3,543,166$ ). The estimated amount of penalties that Section 527 political organizations may be subject to for filing incomplete Forms 8872

## **Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely**

---

was calculated by multiplying the average weighted penalty dollars for incomplete Forms 8872 by the universe of Forms 8872 ( $\$1,891.35552 * 2,100 \cong \$3,971,847$ ). The total estimated penalties for Section 527 political organizations that filed late or incomplete Forms 8872 was calculated by adding the estimated penalty amount for untimely Forms 8872 to the estimated penalty amount for incomplete Forms 8872 ( $\$3,543,166 + \$3,971,847 = \$7,515,013$ ).

3. Determined 4 Section 527 political organizations that filed late or incomplete paper Forms 8872 may be subject to \$41,970 in penalties. These results are not being projected, as this is a judgmental sample.
4. The overall total of \$17 million in taxes and penalties was calculated by adding the amounts due for the untimely filing of Forms 8871, untimely filing of Forms 8872, incomplete filing of Forms 8872, and untimely paper filing for Forms 8872 ( $\$9,393,446 + \$3,543,166 + \$3,971,847 + \$41,970 = \$16,950,429$ ) or \$17 million when rounded.

**Additional Actions Are Needed to Ensure Section 527 Political Organizations  
Publicly Disclose Their Activities Timely and Completely**

---

**Appendix V**

**Organizations Required to Notify the Internal Revenue Service of Section 527  
Status and Report Contributions and Expenditures**

Every political organization that is to be treated as a tax-exempt political organization under Internal Revenue Code (I.R.C.) Section (§) 527<sup>1</sup> must electronically file a Political Organization Notice of Section 527 Status (Form 8871), except:

- An organization that reasonably expects its annual gross receipts to always be less than \$25,000. I.R.C. § 501(c).<sup>2</sup>
- A political committee required to report under the Federal Election Campaign Act of 1971 (2 U.S.C. 431 et seq.).
- A political committee of a State or local candidate.
- A State or local committee of a political party.
- A tax-exempt organization described in I.R.C. § 501(c) that is treated as having political organization taxable income under I.R.C. § 527(f)(1).

Every Section 527 political organization that accepts a contribution or makes an expenditure for an exempt function during a calendar year must file a Political Organization Report of Contributions and Expenditures (Form 8872), except: a political organization that is not required to file Form 8871, a political organization that is subject to tax on its income because it did not file or amend a Form 8871, or a Qualified State or Local Political Organization (QSLPO).

Public Law 107-276<sup>3</sup> defines QSLPOs as political organizations with the following characteristics:

- All of their exempt functions relate solely to the purpose of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any State or local public office or office in a State or local political organization.
- State law requires the organization to report contribution and expenditure information to the State that is similar to the information required to be reported to the Internal Revenue Service.
- The organization files the reports with the State.
- The organization and State make these reports available to the public.

---

<sup>1</sup> I.R.C. § 527 (2003).

<sup>2</sup> I.R.C. § 501(c) (2003).

<sup>3</sup> Pub. L. No. 107-276, 116 Stat. 1929 (2002).

**Additional Actions Are Needed to Ensure Section 527 Political Organizations  
Publicly Disclose Their Activities Timely and Completely**

---

- No Federal Government officeholder or candidate controls or materially participates in the organization, solicits contributions to the organization, or directs disbursements from the organization.

# Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely

Appendix VI

## Management's Response to the Draft Report

07/26/2005 10:38 FAX 202 283 8858

001



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

JUL 20 2005

### MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:   
Steven T. Miller  
Commissioner, Tax Exempt and Government Entities Division

SUBJECT: Draft Audit Report - Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely (Audit # 200410024)

I am pleased to respond to your draft audit report ("report") on the effectiveness of the Exempt Organizations (EO) function's efforts to ensure political organizations file timely and complete Political Organization Notices of Section 527 Status (Form 8871) and Political Organization Reports of Contributions and Expenditures (Form 8872).

TE/GE agrees in principal with the recommendations, with caveats as enumerated below, along with additional comments on the background and findings in the draft report.

We agree with the report's finding that the statistical sample reviewed by TIGTA reflected compliance issues; however, as noted in your report, we do not agree that this would necessarily result in the amount of penalties calculated by TIGTA as an Outcome Measure. Based on our findings in the 2004 Section 527 Compliance Project, the existing general reasonable cause standard would likely result in the waiver or abatement of most of the penalties. Until reasonable cause guidance specific to section 527(l) is issued, the existing general reasonable cause standard must be applied.

The report recommends that TE/GE develop plans to periodically review Forms 8871 and 8872 if implementation of the Request for Information Services (RISs) related to Forms 8871 and 8872 is delayed beyond January 2006. We have been assured that the RISs are on schedule and do not anticipate delay.

## Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely

07/26/2005 10:37 FAX 202 283 8858

002

2

Our response to the recommendations in your report follows:

### IDENTITY OF RECOMMENDATION 1

The Director, EO should clarify the instructions for Form 8872 to more clearly explain what information is required in Schedules A and B of Form 8872.

### CORRECTIVE ACTIONS

The instructions to the Form 8872 are being amended to more clearly explain what information is required based on our findings in the 2004 Section 527 Compliance Project, particularly relating to the occupation and employer information for individuals. This amendment is not expected to include any information concerning reasonable cause requirements as that must await the development of specific guidance (see response to Recommendation 3). The Director, EO will request that the amended instructions be included in the next revision of the Form.

### IMPLEMENTATION DATE

October 15, 2005.

### RESPONSIBLE OFFICIALS

Director, EO Rulings and Agreements

### CORRECTIVE ACTION MONITORING PLAN

The Director, EO Rulings and Agreements will report to the Director EO on the progress toward requesting the instruction change.

### IDENTITY OF RECOMMENDATION 2

The Director, EO should develop plans for periodically reviewing the timeliness and completeness of Forms 8871 and 8872 if implementation of the RISs related to the Forms 8871 and 8872 are delayed beyond January 1, 2006.

### CORRECTIVE ACTIONS

As noted above, we do not anticipate any delays in the implementation of the RISs. However, if implementation of the RISs is delayed, we will develop a plan for reviewing the timeliness and completeness of Forms 8871 and 8872. We will monitor the anticipated implementation of the RISs and if potential problems arise we will elevate the issue to the appropriate level within the Service and establish an appropriate action plan for reviewing the timeliness of the forms.

## Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely

---

07/26/2005 10:37 FAX 202 263 8858

003

3

### IMPLEMENTATION DATE

June 30, 2006.

### RESPONSIBLE OFFICIALS

Director, EO Rulings and Agreements

### IDENTITY OF RECOMMENDATION 3

The Director EO should ensure that taxes and penalties are assessed, as appropriate, for Section 527 political organizations that file late and incomplete Forms 8871 and 8872.

### CORRECTIVE ACTIONS

The Director EO agrees that taxes and penalties should be assessed, as appropriate, and we will take steps to address compliance in this area. To ensure appropriate assessment, the Director EO has recommended to Counsel and Treasury that Guidance on reasonable cause for 527 filings be included for consideration for next year's Treasury Guidance Plan. Because of competing priorities, TE/GE does not know whether Counsel and Treasury will concur and, therefore, cannot predict whether this item will be included.

### IMPLEMENTATION DATE

Completed.

### IDENTITY OF RECOMMENDATION 4

The Director, EO should research state laws to determine if the statutes related to the reporting of political contributions and expenditures by state and local political organizations have at least the same dollar thresholds as the requirements of Public Law 107-276 for QSLPOs. For those states whose statutes do not meet the threshold, take appropriate action to ensure Section 527 political organizations file Forms 8872, as required.

### CORRECTIVE ACTIONS

While researching all state laws individually (including monitoring them for any changes) would consume too many resources, a review of relevant state laws would be included as part of the FY 2007 project discussed in our response to Recommendation 5.

### IMPLEMENTATION DATE

September 30, 2007

### RESPONSIBLE OFFICIALS

Director, EO

### IDENTITY OF RECOMMENDATION 5

## Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely

---

..07/28/2005 10:37 FAX 202 283 8558

004

4

The Director, EO should initiate a compliance project to identify a process to address QSLPOs operating beyond the scope of their authorized activities and identify areas in which coordination with the states can be improved.

### **CORRECTIVE ACTIONS**

For FY 2006, EO has a proposed project to improve the quality of information regarding the number of QSLPOs on the public disclosure website. We believe this project needs to be completed before considering an additional project concerning QSLPOs. For FY 2007 we will propose a project to identify a process to address QSLPOs operating beyond the scope of their authorized activities and identify areas in which coordination with the states can be improved.

**IMPLEMENTATION DATE**  
September 30, 2007

**RESPONSIBLE OFFICIALS**  
Director, EO