



*Improvements Have Been Made, but
Additional Actions Could Ensure That
Section 527 Political Organizations More
Fully Disclose Financial Information*

February 4, 2010

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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.

Redaction Legend:

1 = Tax Return/Return Information



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 4, 2010

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Improvements Have Been Made, but Additional
Actions Could Ensure That Section 527 Political Organizations More
Fully Disclose Financial Information (Audit # 200910010)

This report presents the result of our review of the filing compliance of Section 527 political organizations.¹ The overall objective of this review was to determine whether the Internal Revenue Service (IRS) had taken the corrective actions needed to develop an effective program to identify and address noncompliant Section 527 organizations. This review was conducted as part of the Treasury Inspector General for Tax Administration Fiscal Year 2009 Annual Audit Plan related to the major management challenge of Tax Compliance Initiatives.

Impact on the Taxpayer

Section 527 tax-exempt political organizations² (hereafter referred to as political organizations) that desire to be tax exempt must report their contributions and expenditures to the IRS periodically. Although the Exempt Organizations (EO) function has taken action to identify noncompliant political organizations, we believe EO function management should focus on increased enforcement actions for noncompliant political organizations. With additional focus, the EO function will promote the full and accurate disclosure of political organizations' financial information, which will help the public gain an accurate understanding of political organizations' activities (e.g., tracking the flow of funds related to legislative issues and political campaigns).

¹ Internal Revenue Code Section 527 (2007).

² Political organizations include political parties; campaign committees for candidates for Federal, State, or local office; and political action committees.



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Synopsis

The IRS has taken significant actions to improve its ability to identify political organizations that do not timely notify the IRS of their existence or timely submit reports of their contributions and expenditures. However, the IRS has not fully addressed noncompliance among political organizations. For example, one out of every four Political Organization Report of Contributions and Expenditures (Form 8872) that we reviewed had incomplete or missing contributor or recipient information. While some of these filings may later be deemed acceptable, we determined the IRS is not reviewing these filings to determine if they are complete or if penalties should be assessed. Also, the IRS is not always issuing notices at the appropriate time that include all information needed by political organizations to become compliant. Lastly, the IRS is not following up on information it has requested from political organizations to verify compliance.

After our prior review completed in Fiscal Year 2005,³ the EO function focused its efforts on completing actions that would better enable it to identify noncompliant political organizations. These included establishing new electronic tax accounts to track the activity of political organizations filing Political Organization Notice of Section 527 Status (Form 8871) and Forms 8872, issuing notices to inform political organizations of untimely and missing Forms 8871 and 8872, providing more detailed instructions to political organizations that improved the completeness of Form 8872 filings, and performing a compliance project focused on the filing compliance of Qualified State or Local Political Organizations.

Although the EO function has taken action to identify noncompliant political organizations, we believe EO function management should focus on addressing noncompliance through increased enforcement actions. The assessment of taxes and penalties for incomplete filings, when appropriate, could lead to increased accountability and disclosure by political organizations. Improvement in the notice process could also assist political organizations in complying with their responsibilities.

Recommendations

We recommended that the Director, EO, Tax Exempt and Government Entities Division, 1) conduct periodic reviews to determine whether political organizations are submitting complete Forms 8872, 2) develop procedures for reviewing responses and following up on nonresponses to notices, including assessing additional tax or penalties as appropriate, 3) correct untimely and missing Form 8872 notices, and 4) revise forms and instructions for Forms 8871 and 8872 to improve compliance.

³ *Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely* (Reference Number 2005-10-125, dated August 10, 2005).



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Response

The Commissioner, Tax Exempt and Government Entities Division, generally agreed with our recommendations and provided planned actions to address them. Specifically, the EO Examination function is developing procedures for performing periodic reviews of a sample of Forms 8872 for compliance as well as procedures for reviewing reports of notices generated and notice responses. In addition, a request for changes to untimely and missing Form 8872 notices is being prepared for submission to the Modernization and Information Technology Services organization. Also, revisions to Form 8871 instructions will be completed to clarify how to report any tax due to untimely filing. The EO Rulings and Agreements function will evaluate the resources required to implement the recommended changes to Form 8872 and the Master File,⁴ and initiate changes where it is reasonable to do so.

While Tax Exempt and Government Entities Division management agreed with our findings and recommendations, they believed that our outcome measure of \$5.3 million related to 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 may be too high. Tax Exempt and Government Entities Division management responded that the EO function's examination experience related to incomplete filings of Forms 8872 suggested otherwise. Even before the publication of a safe harbor for establishing reasonable cause, nearly all Section 527 political organizations were able to demonstrate that their failure to disclose all required information was due to reasonable cause, and therefore no penalty was due under Section 527(l). Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment

Regarding the IRS' comment on the outcome measure, the \$5.3 million represents the total amount of additional tax and penalties that could be assessed for the untimely filing of Forms 8871 and 8872 (\$1.9 million) and incomplete filing of Forms 8872 (\$3.4 million). While we recognize that some of this amount may not be assessed due to reasonable cause, we could not quantify the lesser amount because the IRS has not conducted enforcement actions on these filings to determine the reasons for the noncompliance. Until appropriate enforcement action is taken on noncompliant political organizations, there is an increased risk that these organizations may continue to submit untimely and incomplete Forms 8871 and 8872 for which additional tax and penalties would be appropriate. As a result, we believe the \$5.3 million outcome measure is

⁴ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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still an accurate reflection of the amount of additional taxes and penalties that could potentially be assessed.

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 any questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.



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Abbreviations

EO	Exempt Organizations
IRS	Internal Revenue Service



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Background

Section 527 tax-exempt political organizations¹ (hereafter referred to as political organizations) are organized and operated primarily to accept contributions and make expenditures for the purpose of influencing the selection, nomination, election, or appointment of any individual to Federal, State, or local public office. Although contributions are not deductible by the contributor, political organizations that notify the Internal Revenue Service (IRS) of their existence under Section 527 of the Internal Revenue Code² may treat the contributions as tax-exempt income.³

In Calendar Year 2000, Congress believed there was a need for additional public disclosure of political organizations' financial activities. A House of Representatives Committee Report⁴ states, “. . . the Committee believes that, given the tax benefits conferred under present law . . . , the public interest is served by greater public disclosure of information relating to the political activities of such organizations, including a detailed listing of expenditures for political activities and the source of funds (i.e., contributions) used for this purpose. Public disclosure of information enables the general public to provide oversight of the political activities of these organizations.”

Congress believed that public disclosure of information enables the general public to provide oversight of the political activities of Section 527 political organizations.

To ensure information on the activities of political organizations was disclosed to the public, Congress enacted Public Law 106-230 on July 1, 2000. This law imposed new reporting and disclosure requirements on political organizations in connection with their tax-exempt status. In general, the law required that tax-exempt political organizations notify the IRS of their existence and provide periodic reports of contributions and expenditures to the IRS.

On November 2, 2002, Public Law 107-276 was enacted, amending Section 527. The law revised the filing requirements for some tax-exempt political organizations retroactive to July 1, 2000, and created a new category of political organization called a Qualified State or Local Political Organization. These organizations are required to notify the IRS of their existence, but report their contribution and expenditure information to their respective States instead of the IRS. In addition, the law required organizations meeting certain conditions to

¹ Political organizations include political parties; campaign committees for candidates for Federal, State, or local office; and political action committees.

² Internal Revenue Code Section 527 (2007).

³ Other types of tax-exempt organizations may perform limited political activities. Our focus was on Section 527 political organizations.

⁴ *Full and Fair Political Activity Disclosure Act of 2000* (House Report 106-702, dated June 27, 2000).



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electronically file a Political Organization Notice of Section 527 Status (Form 8871) and Political Organization Report of Contributions and Expenditures (Form 8872) with the IRS. The IRS posts these forms on a web site available to the public.

Political organizations inform the IRS of their establishment by filing a Form 8871. If the organization meets certain criteria, it is required to file a Form 8872 with the IRS to report the contributions it receives and expenditures it makes. The filing requirements for Form 8872 change from year to year. Organizations choose the schedule to use each year, but must follow the selected schedule for the entire calendar year. Figure 1 shows the Form 8872 filing requirements.

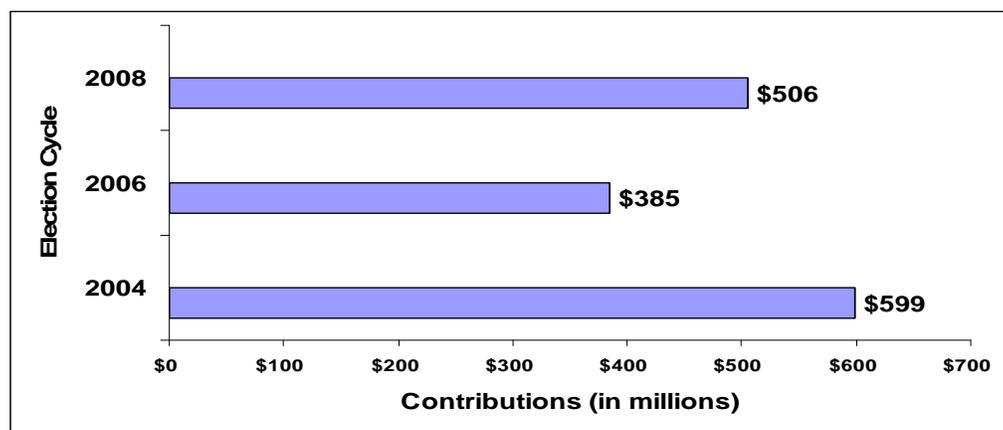
Figure 1: Form 8872 Filing Schedule

Odd-Numbered Years	Even-Numbered Years
Semi-Annually or Monthly	Monthly ⁵ or Quarterly ⁶

Source: Internal Revenue Code Section 527.

The Center for Responsive Politics⁷ reported the money raised by political organizations during the last three election cycles. As shown in Figure 2, political organizations raised more than \$500 million in the last 2 Presidential election cycles and close to \$400 million in the last Federal, non-Presidential election cycle.

Figure 2: Section 527 Political Contributions by Election Cycle (in millions)



Source: The Center for Responsive Politics. This information was not independently verified because the accuracy of these statistics did not affect the accomplishment of our audit objective.

⁵ Not required for October or November. Instead, pre- and post-general election reports are required.

⁶ Pre- and post-general election reports may be required.

⁷ The Center for Responsive Politics is a nonprofit research group tracking money in United States politics and its effect on elections and public policy.



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In two prior audit reports of political organizations,⁸ we identified areas where the IRS could improve 1) the accuracy and consistency of search results for information stored on the web site for political organizations and 2) the timeliness and completeness of political organization's public disclosure of financial information. The IRS agreed to our recommendations to provide improved instructions for completing required filings, assessing taxes and penalties for political organizations that filed late or incomplete Forms 8871 and 8872, and conducting a project to ensure the compliance of Qualified State or Local Political Organizations. The IRS did not agree with our estimated additional tax and penalty calculations because it believed most would be waived due to reasonable cause.⁹

As we were completing our current audit work, the Exempt Organizations (EO) function was developing its Fiscal Year 2010 Work Plan. Any changes that have occurred since we concluded our audit work in September 2009 are not reflected in this report. As a result, this report may not reflect the current status of the EO function's program for overseeing political organizations.

This review was performed at the Tax Exempt and Government Entities Division National Headquarters in Washington, D.C., and also included interviews of Modernization and Information Technology Services organization and Tax Exempt and Government Entities Division Business Systems Planning function personnel during the period March through September 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁸ *Improvements Are Needed to the Updated Web Site for Political Organizations to Increase the Accuracy and Consistency of Search Results for Filing Information* (Reference Number 2004-10-097, dated May 6, 2004) and *Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely* (Reference Number 2005-10-125, dated August 10, 2005).

⁹ Reasonable cause is based on all the facts and circumstances in each situation and allows the IRS to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when a taxpayer exercises ordinary business care and prudence in determining his or her tax obligations but is unable to comply with those obligations.



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Results of Review

The IRS has taken significant actions to improve its ability to identify political organizations that do not timely notify the IRS of their existence or timely submit reports of their contributions and expenditures. However, the IRS has not fully addressed noncompliance among political organizations. For example, one out of every four Forms 8872 that we reviewed had incomplete or missing contributor or recipient information. While some of these filings may later be deemed acceptable, we determined the IRS is not reviewing these filings to determine if they are complete or if penalties should be assessed. Also, the IRS is not always issuing notices at the appropriate time that include all information needed by political organizations to become compliant. Lastly, the IRS is not following up on information it has requested from political organizations to verify compliance.

After our Fiscal Year 2005 review was completed, the EO function focused its efforts on completing actions that would better enable it to identify noncompliant political organizations. These included establishing new electronic tax accounts to track the activity of political organizations filing Forms 8871 and 8872, issuing notices to inform political organizations of untimely and missing Forms 8871 and 8872, providing more detailed instructions to political organizations that improved the completeness of Form 8872 filings, and performing a compliance project focused on the filing compliance of Qualified State or Local Political Organizations.

Although the EO function has taken action to identify noncompliant political organizations, we believe EO function management should focus on addressing noncompliance through increased enforcement actions. The assessment of taxes and penalties for incomplete filings, when appropriate, could lead to increased accountability and disclosure by political organizations. Improvement in the notice process could also assist political organizations in complying with their responsibilities. With additional focus, the EO function will promote the full and accurate disclosure of political organizations' financial information, which will help the public gain an accurate understanding of political organizations' activities (e.g., tracking the flow of funds related to legislative issues and political campaigns).

The Exempt Organizations Function Has Improved Its Ability to Identify Noncompliant Political Organizations

The EO function has taken significant actions to improve its program to identify noncompliant political organizations since our last audit, including taking corrective actions to our prior recommendations. The following are some of the improvements that we noted.



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- **Creating Master File¹⁰ accounts and issuing notices** – In Calendar Year 2006, the IRS established Master File accounts for political organizations filing Forms 8871 and 8872. This allowed the EO function to systemically monitor the filing compliance of political organizations, which it could not do before. The EO function also began issuing three different notices for missing Forms 8871 and untimely or missing Forms 8872 using the information from these Master File accounts.
- **Updating Instructions for Forms 8871 and 8872** – In Calendar Year 2007, the EO function updated the instructions for Forms 8871 and 8872. Among the changes to the Form 8872 instructions were more detailed explanations for what to input in specific fields for contributions and expenditures. For example, the instructions state that organizations should input “Retired” for a contributor’s occupation if applicable or “Not Employed” in the Employer field for those contributors or recipients that are unemployed. Prior to these more detailed instructions, political organizations commonly used “Not Applicable” in these fields, which were considered incomplete entries. When “Not Applicable” is used, readers cannot fully determine who employed the contributor or recipient or the occupation of the contributor or recipient.

We determined that the changes to the Form 8872 instructions helped improve the completeness of the filings and provided the public with fuller disclosure of financial information. During our Fiscal Year 2005 audit, we reviewed 299 Forms 8872 and identified 4,382 incomplete entries for either contributions or expenditures. During this audit, we reviewed 300 Forms 8872 and identified only 1,287 incomplete entries. We concluded that this increase in compliance is partly due to the improved Form 8872 instructions, which reduced the number of entries that included the term “Not Applicable.”¹¹ Figure 3 displays the number of incomplete entries for contributions and expenditures from our prior audit and the current audit.

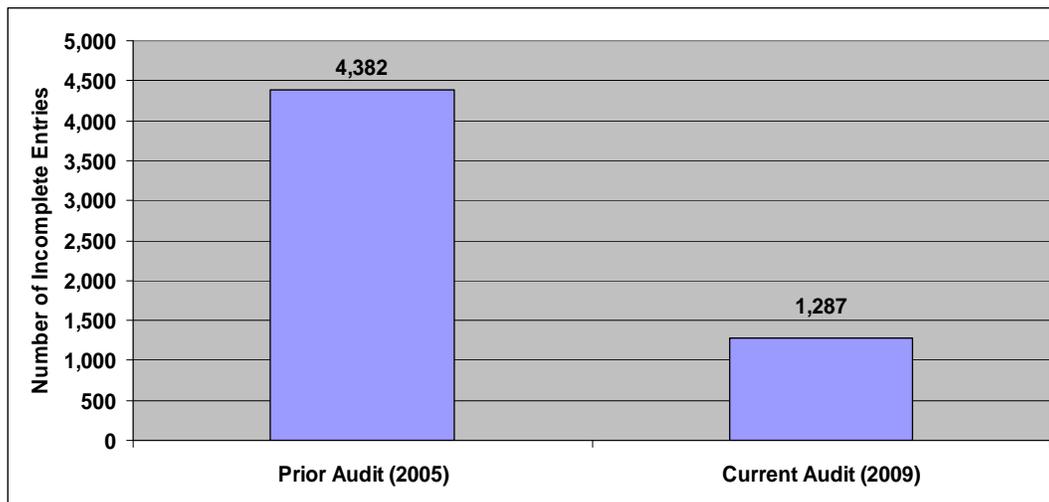
¹⁰ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

¹¹ See Appendix IV for additional details.



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Figure 3: Number of Incomplete Contribution and Expenditure Entries (Prior Audit [2005] versus Current Audit [2009])



Source: Treasury Inspector General for Tax Administration analysis of statistical samples of Form 8872 filings.

- **Providing guidance to political organizations** – As a result of a compliance project¹² performed by the EO function and the Treasury Inspector General for Tax Administration’s prior recommendation,¹³ the EO function issued a revenue procedure in Calendar Year 2007 providing guidelines for political organizations that do not have all the required information necessary to complete their Forms 8872. Revenue Procedure 2007-27 outlines six requirements for organizations to meet in order to claim “reasonable cause” for failure to report all required information about their contributors. Not meeting all six requirements may be considered willful neglect for the incomplete filings and a penalty could be assessed. Political organizations requested this guidance to help ensure their filing compliance.
- **Reviewing Qualified State or Local Political Organizations** – Based on a sample of Forms 8871 and associated State statutes that we reviewed in our Fiscal Year 2005 audit, we identified one State where the dollar threshold for reporting contributions was higher

¹² In Calendar Year 2004, the EO function performed a compliance project involving 30 Forms 8872 filings that were either incomplete or untimely. The reasonable cause criteria available at the time was used to determine if a penalty was warranted. ****1****.

¹³ The Treasury Inspector General for Tax Administration recommended that the EO function ensure taxes and penalties are assessed, as appropriate, for political organizations that file late and incomplete Forms 8871 and 8872.



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than those established under Section 527 for Qualified State or Local Political Organizations.¹⁴

As a result, we were concerned that there may be other States that have reporting requirements that are not consistent with the Internal Revenue Code, which means that political organizations in some States may not be sending financial information to the IRS as required. We recommended that the Director, EO, Tax Exempt and Government Entities Division, research State laws to determine whether the dollar thresholds for other States complied with Federal law. In response, the EO function conducted a compliance project related to the filing compliance of Qualified State or Local Political Organizations. As part of this project, research was conducted on political organization's filing requirements for seven States to determine whether they complied with Federal filing requirements. The EO function reported that all seven States complied with Section 527 filing requirements for organizations to maintain their Qualified State or Local Political Organization status. As part of our current audit, we reviewed the statutes of all 50 States and, other than the 1 State identified in our prior review, did not identify any additional States whose reporting thresholds did not comply with Federal law.

In addition to reviewing actions taken by the EO function, we reviewed statistical samples of Forms 8871 and 8872 to determine, in part, whether political organizations were timely filing these reports. Generally, organizations are timely filing their required reports. For Forms 8871, we found 97.5 percent of our sampled filings were timely. For Forms 8872, 99.4 percent of our sampled filings were timely.

Actions taken by the EO function have helped improve the IRS' ability to identify noncompliant political organizations and to notify potentially noncompliant organizations of their filing requirements. However, additional actions are necessary to fully develop an effective oversight program including necessary enforcement efforts to address noncompliance.

Additional Actions Are Necessary to Address Noncompliance of Political Organizations and Create an Effective Oversight Program

Although the EO function has developed tools for identifying noncompliance of political organizations that do not publicly disclose financial information as required, additional actions are necessary to develop a complete oversight program that includes enforcement efforts, when necessary, to address noncompliance. Specifically, the IRS does not:

- Review reports containing political organizations' contributions and expenses to determine whether they are complete and if penalties should be assessed.

¹⁴ Political organizations can declare Qualified State or Local Political Organization status if they meet certain requirements and file their financial information with the applicable State. Each State has its own filing requirements for political organizations separate from Section 527.



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- Ensure notices are issued correctly and contain referenced information. In some instances, notices for failing to file Forms 8872 are being issued for tax periods the political organizations are not required to file for and, in other cases, are not being issued when they are required.
- Review political organizations' responses to notices and follow up with political organizations that do not respond to notices.

In addition, we have identified actions the IRS could take to improve compliance without long-term resource commitments. These include clarifying instructions to forms and automatically penalizing political organizations for intentionally withholding required information about contributions and expenses.

The IRS is not reviewing electronically submitted Forms 8872 for completeness

The EO function is not able to systemically review Forms 8872 to determine whether political organizations are including complete contribution and expenditure information. Only summary dollar totals for all contributions and expenditures included on a particular filing are available on the Master File accounts of political organizations, so a manual review of each Form 8872 would be required to determine whether it is complete. As a result, the IRS cannot issue notices to inform political organizations of incomplete filings.

In 77 (26 percent) of 300 cases we reviewed, some required contribution and expenditure information was missing on the Forms 8872.¹⁵ Some of these filings may later be deemed acceptable due to compliance with the provisions of Revenue Procedure 2007-27. Missing information usually involved a contributor or recipient's employer and/or occupation. We project an estimated 320 Forms 8872 were filed in Calendar Year 2008 that did not include all required information. As a result, more than \$9.8 million in contributions and expenditures¹⁶ were estimated to be reported with incomplete information. We estimate more than \$3.4 million in penalties may be due for these incomplete filings.

The IRS has the legal authority to impose a 35 percent penalty if a political organization fails to file Form 8872 by the due date or if it does not provide all the required information. Section 527 requires political organizations to report the name, address, and if an individual, the employer and occupation for all its contributors and recipients. The penalty is 35 percent of the total amount of contributions and expenditures not properly reported. The penalty can be waived if the political organization establishes reasonable cause that the untimely or incomplete filing was not due to willful neglect.

¹⁵ We did not consider entries with terms like "Information Requested" as incomplete based upon Revenue Procedure 2007-27. In addition, because organizations are not required to disclose contributions totaling less than \$200 in the aggregate to date for the year from the same contributor and expenditures less than \$500 to the same recipient, we did not consider entries incomplete if they fell below these thresholds.

¹⁶ See Appendix IV for additional details.



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Revenue Procedure 2007-27 provides criteria for determining whether a political organization can claim reasonable cause for not providing all the required contributor information on its Forms 8872. This guidance provides political organizations with a way to establish that their failure to disclose required information was due to reasonable cause and not due to willful neglect. As mentioned previously, Revenue Procedure 2007-27 was issued as a result of an EO function compliance project and a Treasury Inspector General for Tax Administration audit recommendation. The EO function has not repeated this compliance project using this new guidance, and compliance characteristics may have changed since the last compliance project. EO function management informed us that after our prior review, they wanted to make incremental improvements to the program. Initial efforts have focused on creating Master File accounts and issuing notices.

Without complete contribution and expenditure information, the public cannot gain an accurate understanding of a political organization's financial position, track the flow of funds related to legislative issues and political campaigns, or determine the level of a political organization's support from contributors in specific occupations or that work for specific employers. Incomplete Forms 8872 do not provide the public with all the necessary information to determine who is giving funds to the political organization and how the organization is using those funds. This information helps potential contributors determine whether they want to support a particular political organization.

Notices are not always being issued correctly

The EO function developed notices for three different noncompliance issues: missing Forms 8871, untimely filed Forms 8872, and missing Forms 8872. We identified three concerns with the issuance of the missing or untimely filed Form 8872 notices that would unnecessarily increase taxpayer burden or not inform political organizations about missing filings.

1. **Some organizations are receiving a missing Form 8872 notice for a tax period prior to their creation date.** The computer program used to generate the missing Form 8872 notice does not take into consideration the creation date of the organization when determining whether a notice should be issued. For example, a political organization is created in May 2008 and files its Form 8871 with the IRS. The organization files its first required Form 8872 for the second quarter ending June 2008. However, a notice is subsequently issued to the organization for a missing Form 8872 that covers the first quarter ending March 2008. Since the organization was not created until May 2008, a first quarter Form 8872 was not required. We estimate that 362 missing Form 8872 notices were issued in Calendar Year 2008 to political organizations that were not required to file, thereby increasing taxpayer burden.¹⁷

¹⁷ See Appendix IV for additional details.



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2. **Some political organizations may not be receiving a notice for failure to file a required Form 8872.** Political organizations that choose to file on a monthly basis during a nonelection year will not receive a missing Form 8872 notice for forms not filed for October and November. In addition, organizations that did not file a Form 8872 for the last quarter of Calendar Year 2008 also did not receive a missing Form 8872 notice. IRS officials stated that this could be occurring because computer codes needed to identify what reporting time period is being used by political organizations are reset at the beginning of the calendar year, prior to the generation of the notices. During our case reviews, we identified 22 organizations that did not file and did not receive a missing Form 8872 notice for the last quarter of Calendar Year 2008 as required.¹⁸ By not sending out these notices, the IRS is not ensuring political organizations comply with the Internal Revenue Code.
3. **Notices for untimely or missing Forms 8872 did not identify the relevant tax period.** The body of the notices for untimely and missing Forms 8872 refers to “the above referenced period.” However, the IRS does not inform the taxpayer which Form 8872 was untimely or missing on the notice. We found several examples of responses to notices issued in Calendar Year 2008 where taxpayers commented that the notice does not inform them which filing was untimely. For example, *****1*****. Similarly, *****1*****. The IRS was not reviewing these responses and, therefore, was not aware of this issue. From Calendar Year 2006 through Calendar Year 2008, the IRS had issued more than 2,950 untimely and missing Forms 8872 notices without the related tax period information, thereby creating additional taxpayer burden.¹⁹

The IRS is not reviewing political organizations’ responses to notices or following up when political organizations do not respond to notices

Notices are issued for missing Forms 8871 and 8872 and untimely Forms 8872. However, the EO function does not fully use these tools to enforce compliance. Political organizations are asked to reply to notices and provide a reasonable cause explanation for filing their Forms 8872 untimely, or not filing their Forms 8871 or 8872 at all. However, the EO function is not reviewing these responses and determining whether the reasonable cause explanations are acceptable. Organizations that do not provide acceptable reasonable cause explanations should be reporting any contributions received during the untimely period for Forms 8871 as income or be assessed penalties for the untimely or missing Forms 8872. In addition, we identified 24 organizations that received 91 notices for untimely and/or missing Forms 8872 during Calendar Year 2008. Organizations that received multiple notices for untimely or missing filings could be considered willfully neglecting their filing responsibilities and warrant penalties being

¹⁸ See Appendix IV for additional details.

¹⁹ See Appendix IV for additional details.



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assessed. Further, the EO function is not taking any followup action if political organizations simply do not respond to these notices.

The IRS has the legal authority to assess taxes and penalties if a political organization fails to file Forms 8871 or 8872 by the due date or if it does not provide all the required information on the Form 8872. The tax or penalty can be waived if the political organization establishes reasonable cause that the untimely or incomplete filing was not due to willful neglect.

Procedures for making reasonable cause determinations based upon Forms 8871 and 8872 notice responses were not in place. However, we identified some procedures for the processing of notice responses. EO Entity function employees at the Ogden Submission Processing Center reviewed the responses and updated Master File accounts as needed. For example, an organization could have claimed Qualified State or Local Political Organization status as its reason for not filing a Form 8872. The EO Entity function would have updated the filing requirements on the organization's Master File account to reflect this change. However, we did not locate any EO function procedures for making a reasonable cause determination based upon the explanations in the notice responses provided by the political organizations. In addition, there are no procedures for following up with political organizations that do not respond to the notices.

Although notices are being issued, the EO function has not followed through and enforced compliance when necessary due to a lack of procedures. As a result, this enforcement tool is not being used to its fullest extent. Without providing consequences for untimely or missing filings, the EO function may not be fully encouraging political organizations to voluntarily comply with their filing responsibilities. In fact, political organizations may become more noncompliant if they do not respond to these notices and the IRS does not follow up. Although Form 8872 filings were generally timely (99.4 percent), we estimate that more than \$434,000 in penalties could have been assessed from untimely filings in Calendar Year 2008.²⁰

The IRS could improve compliance by making changes that do not involve long-term resource commitments

The IRS could take some additional steps to help political organizations better comply with their Forms 8871 and 8872 reporting requirements and assess additional taxes and penalties, as appropriate. We identified two opportunities to increase compliance efforts that would not involve the commitment of long-term resources.

1. **Clarifying Form 8871 Instructions** – Generally, political organizations are filing their Forms 8871 timely. However, we identified 5 of 203 cases in our sample (from a universe of 1,985 filings) with untimely filed Forms 8871 that received contributions prior to filing Form 8871 and did not file a U.S. Income Tax Return for Certain Political Organizations

²⁰ See Appendix IV for additional details.



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(Form 1120-POL). We estimate that \$1.4 million in additional taxes could have been collected from political organizations in 2008.²¹

Section 527 requires political organizations that do not file their Forms 8871 timely to include in their taxable income any exempt function income received during the untimely period. However, the Form 8871 instructions are unclear on where to report the taxable income earned during the untimely period. The instructions state, “In addition, the taxable income of the organization for that period . . . will be computed by including its exempt function income.” More detailed Form 8871 instructions on where to report this taxable income (on the Form 1120-POL) would help political organizations voluntarily comply with their filing requirements. Although this change would involve an initial outlay of resources to revise the instructions, there would be no long-term resource commitment.

2. **Automatically Penalizing “Withheld” Entries** – Political organizations are intentionally withholding required information regarding their contributions and expenditures from Forms 8872. As discussed earlier, the IRS would have to manually review Forms 8872 to identify most incomplete filings. However, changes to the Form could help improve the identification of a specific incomplete entry that should be automatically assessed penalties (reasonable cause criteria does not apply). Political organizations can choose not to disclose information for individual contributors and recipients. Form 8872 instructions state to include the total dollar amount associated with all of these transactions in a single generic “withheld” entry - one related to contributions and another related to expenditures. The instructions also state that this amount is subject to a 35 percent penalty for failure to provide all the information required.

The EO function does not have a systemic mechanism to identify and penalize these entries. The IRS’ computer system only captures summary dollar totals for all contributions and expenditures on a Form 8872 and not the individual entry information. Therefore, only a manual review of the Form 8872 could identify “withheld” entries. By requiring political organizations to report the total amount of contributions and expenditures where information was “withheld” on the first page of Form 8872, the EO function could ensure that this type of incomplete entry is properly penalized. Penalizing these entries could also encourage political organizations to more fully disclose contributions and expenditures in the future. We estimate that 46 Forms 8872 included a “withheld” entry in Calendar Year 2008 with a projected total of more than \$932,300 in incomplete contributions and expenditures. Approximately \$326,300 in penalties should have been assessed.²² Although this would involve an initial outlay of resources to make the necessary changes, there would be no long-term resource commitment.

²¹ See Appendix IV for additional details.

²² This figure is included in the overall estimated penalty amount and not claimed as a separate outcome. See Appendix IV for additional details.



Improvements Have Been Made, but Additional Actions Could Ensure That Section 527 Political Organizations More Fully Disclose Financial Information

Recommendations

To develop a more effective program for identifying and addressing potentially noncompliant political organizations, the Director, EO, Tax Exempt and Government Entities Division, should:

Recommendation 1: Conduct periodic compliance projects to determine whether political organizations are submitting complete Forms 8872 or meeting the relief provisions of Revenue Procedure 2007-27 and assess penalties as appropriate.

Management's Response: IRS management agreed with the recommendation and is developing procedures for EO Examination staff to periodically review a sample of Forms 8872 for compliance. However, they believed that our outcome measure of \$5.3 million related to additional tax and penalties for political organizations that either received contributions before filing Form 8871 with the IRS or filed an incomplete or late Form 8872 with the IRS may be too high. Even before the publication of a safe harbor for establishing reasonable cause, nearly all political organizations were able to demonstrate that their failure to disclose all required information was due to reasonable cause, and therefore no penalty was due.

Office of Audit Comment: Regarding the IRS' comment on the outcome measure, the \$5.3 million represents the total amount of additional tax and penalties that could be assessed for the untimely filing of Forms 8871 and 8872 (\$1.9 million) and incomplete filing of Forms 8872 (\$3.4 million). While we recognize that some of this amount may not be assessed due to reasonable cause, we could not quantify the lesser amount because the IRS has not conducted enforcement actions on these filings to determine the reasons for the noncompliance. Until appropriate enforcement action is taken on noncompliant political organizations, there is an increased risk that these organizations may continue to submit untimely and incomplete Forms 8871 and 8872 for which additional tax and penalties would be appropriate. As a result, we believe the \$5.3 million outcome measure is still an accurate reflection of the amount of additional taxes and penalties that could potentially be assessed.

Recommendation 2: Develop procedures for reviewing responses and following up on nonresponses to notices, including:

- a) Determining whether the reasonable cause explanations provided by political organizations in response to notices are sufficient.
- b) Considering whether organizations have received multiple notices, indicating possible willful neglect.
- c) Following up with political organizations that do not respond to notices.
- d) Assessing additional tax or penalties, as appropriate.



Improvements Have Been Made, but Additional Actions Could Ensure That Section 527 Political Organizations More Fully Disclose Financial Information

Management's Response: IRS management agreed with the recommendation and is developing procedures for EO Examination function staff to review reports of notices generated and responses received and take appropriate action.

Recommendation 3: Correct untimely and missing Form 8872 notices by:

- a) Requesting that programming issues be corrected which allow missing Form 8872 notices to be issued for time periods prior to an organization's creation.
- b) Requesting that programming issues be corrected which cause missing Form 8872 notices not to be issued for certain time periods throughout the year.
- c) Initiating a notice change request for the untimely and missing Form 8872 notices to add the tax period of the related report to the notices.

Management's Response: IRS management agreed with the recommendation and is preparing a request to submit to the Modernization and Information Technology Services organization to make the recommended changes.

Recommendation 4: Revise forms and instructions for Forms 8871 and 8872 by:

- a) Updating the Form 8871 instructions to include clear guidance on where to report taxable income resulting from filing untimely.
- b) Initiating a form change for the Form 8872 to:
 - Add summary dollar information to the first page of the Form for all "withheld" entries reported for contributions and expenditures not fully disclosed.
 - Request a programming change to capture this new summary information on the Master File and automatically assess a 35 percent penalty for any "withheld" amounts included on the first page of the Form.
 - Update Form 8872 instructions to include an explanation for completing this new item on the front page of the Form.
 - Update the Political Organization Filing and Disclosure²³ programming for the electronic filing of Forms 8872 to include this new information on the front page of the Form.

Management's Response: IRS management generally agreed with the recommendation and will revise the Form 8871 instructions to clarify how to report any taxes due to untimely filing. In addition, IRS management will evaluate the resources required to implement the recommended changes to Form 8872 and the Master File, and initiate changes where it is feasible to do so.

²³ This is the web site used to file and search for information from political organizations' Forms 8871 and 8872.



Improvements Have Been Made, but Additional Actions Could Ensure That Section 527 Political Organizations More Fully Disclose Financial Information

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to determine whether the IRS had taken the corrective actions needed to develop an effective program to identify and address noncompliant Section 527 organizations.¹ To accomplish our objective, we:

- I. Assessed any improvements made to the instructions for filing Political Organization Report of Contributions and Expenditures (Form 8872).
 - A. Interviewed EO function management to identify any changes to the filing instructions for Forms 8872.
 - B. Reviewed Form 8872 instructions to determine whether clarification had been added for required information for Itemized Contributions (Schedule A) and Itemized Expenditures (Schedule B).
- II. Identified any changes made in the EO function's efforts to ensure filing compliance of Section 527 political organizations.
 - A. Interviewed EO function management to identify any changes to how the IRS identifies and addresses filing noncompliance by Section 527 political organizations. We ascertained how responses or nonresponses to notices were handled. We also reviewed notice responses to identify any issues raised by political organizations and, for any issues identified, determined the volume of notices involved.
 - B. Reviewed programming change requests for Political Organization Notice of Section 527 Status (Form 8871) and Form 8872 and compared them to the resulting program changes to ensure the requests were implemented.
 - C. Requested a Business Master File² extract to identify all nonfiled Forms 8871 for the period January 1, 2008, through December 31, 2008. We validated a judgmental sample of 10 records to ensure the data met our criteria. Based upon this validation, we concluded that the data extract met our criteria and could be used to complete our audit tests.
 - D. Determined whether Section 527 political organizations were receiving notices (i.e., Form 8872 Late Notice (249B) or Form 8872 Not Filed Notice (249C)) for late

¹ Internal Revenue Code Section 527 (2007).

² The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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- and nonfiled Forms 8872. We validated a judgmental sample of 10 records to ensure the data met our criteria. Based upon this validation, we concluded that the data extract met our criteria and could be used to complete our audit tests.
- E. Determined the status of any new guidance issued internally or by the Department of the Treasury to aid the EO function in overseeing Section 527 political organizations.
- III. Determined whether political organizations filed timely and complete Forms 8871 and 8872.
- A. Downloaded filing data from the IRS Political Organization Filing and Disclosure web site for Forms 8871 and 8872 electronically filed. We validated the data from this download to ensure the reliability for our selection of statistical samples to review. We validated a judgmental sample of 30 records (15 of each form type) to ensure we received accurate information. Based upon this validation, we concluded that the data download could be relied upon to select our statistical samples for our case reviews.
 - B. Selected a statistically valid sample of 203 Forms 8871 from a universe of 1,985 electronically filed Forms 8871 during the period January 1, 2008, through December 31, 2008, from the download obtained in Step III.A. and reviewed the cases for timeliness of filings.
 - C. Selected a statistically valid sample of 300 Forms 8872 from a universe of 2,777 electronically filed Forms 8872 during the period January 1, 2008, through December 31, 2008, from the download obtained in Step III.A. and reviewed the cases for completeness and timeliness of filings.
 - D. Computed outcome measures resulting from untimely or incomplete filings of Forms 8871 and 8872 during the time period of our review.³
- IV. Determined the effectiveness of any actions taken to ensure filing compliance by Qualified State or Local Political Organizations.
- A. Obtained the results of compliance projects initiated to address the filing compliance of Qualified State or Local Political Organizations.
 - B. Researched the filing thresholds of each State for Qualified State or Local Political Organizations to determine which States have a higher threshold than required by Federal law.

³ See Appendix IV for additional details.



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Internal controls methodology

Internal controls relate to management’s plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: Tax Exempt and Government Entities Division policies, procedures, and practices for planning, managing, and monitoring the filings of political organizations. We evaluated these controls by interviewing personnel and reviewing statistical samples of Forms 8871 and 8872.



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Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations Programs)
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Thomas F. Seidell, Audit Manager
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Andrew J. Burns, Senior Auditor
William Simmons, Senior Auditor
David M. Bueter, Auditor
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Martha Stewart, Information Technology Specialist



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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 Internal Control OS:CFO:CPIC:IC
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities
Division SE:T:CL



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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$5.3 million in additional tax and penalties for Section 527 political organizations that met either of the following conditions: 1) received contributions before filing their Political Organization Notice of Section 527 Status (Form 8871) with the IRS or 2) filed an untimely or incomplete Political Organization Report of Contributions and Expenditures (Form 8872) with the IRS¹ (see page 7).

Methodology Used to Measure the Reported Benefit:

We selected two statistically valid samples and projected the results. The first statistical sample consisted of 203 Forms 8871 electronically filed between January 1, 2008, and December 31, 2008, that we randomly selected from a Political Organization Filing and Disclosure download. The second statistical sample consisted of 300 Forms 8872 electronically filed between January 1, 2008, and December 31, 2008, that were randomly selected from the same download. We stratified this sample by the total amounts of contributions and expenditures reported into 3 strata – low (total contributions and expenditures less than \$400,000), medium (total contributions and expenditures from \$400,000 to less than \$4 million), and high (total contributions and expenditures equal to and more than \$4 million). Figure 1 shows the size of each universe and sample.

¹ This figure includes the estimated penalty amount of \$326,300 related to the incomplete “withheld” entries.



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Figure 1: Statistical Sampling Data

Sample	Strata	Size of Universe	Sample Size
Sample 1 (Forms 8871)		1,985	203
Sample 2 (Forms 8872)	Strata 1 (low)	2,454	125
	Strata 2 (medium)	273	125
	Strata 3 (high)	50	50

Source: Treasury Inspector General for Tax Administration sampling plan.

We estimated these political organizations may owe \$5.3 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 95 percent confidence level, an actual error rate of 2.5 percent, and a precision rate of +/- 2 percent, estimated 49 political organizations filed Form 8871 untimely and may be subject to approximately \$1.4 million in tax in Calendar Year 2008. The estimated number of political organizations filing an untimely Form 8871 was calculated by multiplying the universe of Forms 8871 by the percentage of untimely Forms 8871 in our sample ($1,985 * .0246 = 49$). The \$1.4 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 ($\$730.05 * 1,985 = \$1,449,149.25$).
2. Projected the results of Sample 2 (by strata) to each universe and, based on a 95 percent confidence level, an actual error rate of 1.4 percent, and a precision rate of +/- 1.9 percent, estimated 39 political organizations that filed untimely Forms 8872 may be subject to more than \$434,000 in penalties in Calendar Year 2008. 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 ($2,777 * .0141 = 39$). The weighted percentage is the sum of the proportions of each strata to the overall universe multiplied by the proportions of untimely Forms 8872 in each strata. The estimated amount of penalties that 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 ($\$156.40 * 2,777 = \$434,322.80$). The average weighted penalty is the sum of the proportions of each strata to the overall universe multiplied by the average dollar value of contributions and expenditures related to the untimely Forms 8872 in each strata.
3. Projected the results of Sample 2 (by strata) to each universe and, based on a 95 percent confidence level, an actual error rate of 11.5 percent, and a precision rate of +/- 4 percent, estimated 320 political organizations that filed incomplete Forms 8872 may be subject to more than \$3.4 million in penalties based on an estimated \$9.8 million in incomplete entries



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during Calendar Year 2008. 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 ($2,777 * .1153 = 320$). The weighted percentage is the sum of the proportions of each strata to the overall universe multiplied by the proportions of incomplete Forms 8872 in each strata. The estimated amount of penalties that political organizations may be subject to for the incomplete filing of Forms 8872 was calculated by multiplying the average weighted penalty dollars for incomplete Forms 8872 by the universe of Forms 8872 ($\$1,236.63 * 2,777 = \$3,434,121.50$). The average weighted penalty is the sum of the proportions of each strata to the overall universe multiplied by the average dollar value of contributions and expenditures related to the incomplete Forms 8872 in each strata.

4. The overall total of \$5.3 million in taxes and penalties was calculated by adding the amounts due from the untimely filing of Forms 8871, untimely filing of Forms 8872, and incomplete filing of Forms 8872 ($\$1,449,149.25 + \$434,322.80 + \$3,434,121.50 = \$5,317,593.55$).

Type and Value of Outcome Measure:

- Taxpayer Burden – Actual; 2,954 taxpayers who received an untimely or missing Form 8872 notice without the relevant tax period from Calendar Year 2006 through Calendar Year 2008 (see page 7).

Methodology Used to Measure the Reported Benefit:

We reviewed notice responses and identified that some political organizations commented on the lack of a relevant tax period on the untimely and missing Form 8872 notices. We obtained reports of issued notice volumes for Calendar Years 2006 through Calendar Year 2008 and totaled the number of notices issued: 2006 – 524 untimely and 272 missing Forms 8872 notices were issued for a total of 796 notices; 2007 – 213 untimely and 482 missing Forms 8872 notices were issued for a total of 695 notices; and 2008 – 330 untimely and 1,133 missing Forms 8872 notices were issued for a total of 1,463 notices ($796 + 695 + 1,463 = 2,954$).

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 362 taxpayers who may have received a missing Form 8872 notice for a tax period they are not required to file a Form 8872 in Calendar Year 2008 (see page 7).

Methodology Used to Measure the Reported Benefit:

We selected a statistically valid sample of 203 Forms 8871 filed in Calendar Year 2008 from a universe of 1,985 filings. During our case reviews, we determined that a missing Form 8872 notice had been issued to 37 political organizations for tax periods prior to their establishment. We projected with 95 percent confidence, an actual error rate of 18.2 percent, and



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a precision rate of +/- 5 percent that 362 political organizations received an unnecessary missing Form 8872 notice ($37/203 * 1,985 = 362$).

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 22 taxpayers did not receive a missing Form 8872 notice for the last quarter of 2008 as required (see page 7).

Methodology Used to Measure the Reported Benefit:

We reviewed a statistically valid sample of 203 Forms 8871 filed in Calendar Year 2008 from a universe of 1,985 filings. During our case reviews, we determined that 22 political organizations did not file their Form 8872 for the quarter ending December 2008, but did not receive a missing Form 8872 notice for this tax period.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 3,095 fewer entries were incomplete due in part to a prior Treasury Inspector General for Tax Administration recommendation (see page 4).

Methodology Used to Measure the Reported Benefit:

In a prior review,² the Treasury Inspector General for Tax Administration recommended that the Director, EO, Tax Exempt and Government Entities Division, clarify the instructions for Form 8872 to more clearly explain what information is required in Schedules A and B of Form 8872. In Calendar Year 2007, the IRS issued updated Form 8872 instructions that provided more detailed guidance on how to complete the Form. We compared the number of incomplete entries identified in our previous review (4,382) to the number of incomplete entries identified in this review (1,287) and determined that the previous recommendation aided political organizations in filing more complete Forms 8872 ($4,382 - 1,287 = 3,095$).

² *Additional Actions Are Needed to Ensure Section 527 Political Organizations Publicly Disclose Their Activities Timely and Completely* (Reference Number 2005-10-125, dated August 10, 2005).



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Appendix V

Management's Response to the Draft Report



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

RECEIVED
JAN 19 2010
BY: PAS

JAN 19 2010

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *Sarah Ingram* Commissioner, Tax Exempt and Government Entities Division

SUBJECT: Response to Draft Audit Report – Improvements Have Been Made, but Additional Actions Could Ensure That Section 527 Political Organizations More Fully Disclose Financial Information (Audit # 200910010)

This responds to your draft audit report concerning efforts by the Internal Revenue Service to ensure compliance by section 527 political organizations.

Your report highlights the improvements we have made in our ability to identify non-compliance by section 527 political organizations. For example, your sampling showed that section 527 political organizations are now filing 97.5% and 99.4 % of required Forms 8871 and 8872, respectively. You also note areas where we could make further improvements.

We are in general agreement with all of your recommendations. However, with respect to recommendation 4 b, which concerns improvements to Form 8872, we must evaluate the cost and feasibility of the recommended changes before we can commit to making the recommended changes.

Our specific response to your recommendations appears on the attachment.

You also asked us to comment on your estimate of your recommendations' measurable benefits on tax administration. We concur with items 2 through 5. Concerning item 1, however, we believe your estimate of \$5.3 million in additional tax and penalty may be too high. You estimate that over \$3.4 million in penalties may be due as a result of incomplete filings of Form 8872, *Political Organization Report of Contributions and Expenditures*. Our examination experience suggests otherwise. Even before we published a safe harbor for establishing reasonable cause, nearly all section 527 political organizations were able to demonstrate that their failure to disclose all required information was due to reasonable cause, and therefore no penalty was due under section 527(l).



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If you have any questions, please contact Judith Kindell, Senior Technical Advisor, at (202) 283-8964.

Attachment



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Attachment

Recommendation 1

The Director, Exempt Organizations, should conduct periodic compliance projects to determine whether political organizations are submitting complete Forms 8872 or meeting the relief provisions of Revenue Procedure 2007-27 and assess penalties as appropriate.

Corrective Action

We agree with this recommendation. We are developing procedures for examination staff to periodically review a sample of submitted Forms 8872 for compliance.

Implementation Date

December 31, 2010

Responsible Official

Nanette M. Downing, Acting Director, EO Examinations

Recommendation 2

The Director, Exempt Organizations, should develop procedures for reviewing responses and following up on nonresponses to notices, including:

- a) Determining whether the reasonable cause explanations provided by political organizations in response to notices are sufficient.
- b) Considering whether organizations have received multiple notices, indicating possible willful neglect.
- c) Following up with political organizations that do not respond to notices.
- d) Assessing additional tax or penalties, as appropriate.

Corrective Action

We agree with this recommendation. We are developing procedures for examination staff to review the reports concerning notices generated and the responses received and handle them appropriately.

Implementation Date

December 31, 2010

Responsible Official

Nanette M. Downing, Acting Director, EO Examinations



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Recommendation 3

The Director, Exempt Organizations, should correct untimely and missing Form 8872 notices by:

- a) Requesting that programming issues be corrected which allow missing Form 8872 notices to be issued for time periods prior to an organization's creation.
- b) Requesting that programming issues be corrected which cause missing Form 8872 notices not to be issued for certain time periods throughout the year.
- c) Initiating a notice change request for the untimely and missing Form 8872 notices to add the tax period of the related report to the notices.

Corrective Action

We agree with this recommendation. We are preparing and will submit a request to MITS for these changes to be implemented in January 2011.

Implementation Date

March 1, 2010

Responsible Official

Marian Bodart, Director, Business Systems Planning

Recommendation 4

The Director, Exempt Organizations, should revise forms and instructions for Forms 8871 and 8872 by:

- a) Updating the Form 8871 instructions to include clear guidance on where to report taxable income resulting from filing untimely.
- b) Initiating a form change for the Form 8872 to:
 - Add summary dollar information to the first page of the Form for all "withheld" entries reported for contributions and expenditures not fully disclosed.
 - Request a programming change to capture this new summary information on the Master File and automatically assess a 35 percent penalty for any "withheld" amounts included on the first page of the Form.
 - Update Form 8872 instructions to include an explanation for completing this new item on the front page of the Form.
 - Update the Political Organization Filing and Disclosure¹ programming for the electronic filing of Forms 8872 to include this new information on the front page of the Form.

¹ This is the web site used to file and search for information from political organizations' Forms 8871 and 8872.



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Corrective Action

We agree that these recommendations would improve our ability to identify non-compliance. We will revise the instructions for the Form 8871 to clarify how to report any tax due to untimely filing. We will evaluate the resources required to implement the recommended changes to Form 8872 and the Master File, and initiate changes where it is feasible to do so.

Implementation Date

December 31, 2010

Responsible Official

Robert S. Choi, Director, EO Rulings & Agreements