

# Political Activities Compliance Initiative

## Executive Summary

February 22, 2006

### Background

Two elements define the IRS concern about political intervention and the charitable tax-exempt sector. The first is the law which pointedly prohibits such activity. With the enactment of the Revenue Act of 1954, Congress barred section 501(c)(3) tax-exempt organizations (including churches) from political campaign intervention by adding language to the Internal Revenue Code that disqualifies them from exemption if they “participate in, or intervene in (including the publicizing or distributing of statements), any political campaign on behalf of any candidate for political office.” In 1987, Congress amended section 501(c)(3) to clarify that the prohibition on political campaign intervention applies to activities “in opposition to,” as well as on behalf of, any candidate for public office.

The second is the dramatic increase in the amount of money financing campaigns. The level of funds going into the campaign area from organizations regulated by the Federal Election Commission has increased significantly. For the 2003-2004 election cycle, the FEC reported that over \$10 billion was spent, more than double the \$4 billion spent during the 1999-2000 election cycle (the last election cycle that included a presidential election).

Similar dramatic increases were reported in the receipts and expenditures by section 527 political organizations reporting to the IRS. In the last six months of the 2004 election cycle, these organizations, which typically are involved in election-related issue advocacy not regulated under the stricter FEC rules, reported over \$300 million in expenditures, more than double the \$150 million in expenditures reported in the comparable period in the 2000 cycle.

Although charities are precluded from intervening in political campaigns, the IRS has seen a growth in the number and variety of allegations of such behavior by section 501(c)(3) organizations during election cycles. The increase in allegations, coupled with the dramatic increases in money spent during political campaigns, has raised concerns about whether prohibited funding and activity are emerging in section 501(c)(3) organizations.

If left unaddressed, the potential for charities, including churches, being used as arms of political campaigns and parties will erode the public’s confidence in these institutions. Nevertheless, enforcement of the prohibition against political campaign intervention by section 501(c)(3) organizations presents unique challenges for the IRS:

- The activities that give rise to questions of political campaign intervention also raise legitimate concerns regarding freedom of speech and religious expression;
- The Code contains no bright line test for evaluating political intervention; it requires careful balancing of all of the facts and circumstances;

- The questionable activities are public and occur within the compressed period of time of the election cycle. Keeping in mind that there are over one million 501(c)(3) organizations, media reports on the activities of a small representation of those organizations can, rightly or wrongly, create an impression of widespread noncompliance; and
- The activities that must be evaluated for potential campaign intervention can be difficult to document, because they often involve events and statements that may not be recorded or otherwise captured.

If the IRS determines prohibited political intervention has occurred, it faces additional challenges:

- The existing sanctions are limited to assessing penalties based on the amount spent on the intervention, which is often de minimis, or revocation, which may not be in the public interest; and
- The disclosure restrictions of IRC section 6103 limit IRS's ability to discuss its enforcement actions.

Because of strong indications of increasing political activity in the tax exempt area, the IRS augmented its efforts in this area in 2004. The Service adopted a two-part approach. First, the IRS expanded its educational efforts to remind section 501(c)(3) organizations about the prohibition on political activities and the consequences of engaging in such activities. The Service conveyed this message through press releases, speeches, workshops, IRS Nationwide Tax Forums, and in a letter to national political parties. Second, the Service initiated the Political Activities Compliance Initiative to respond in a faster, targeted fashion to specific credible allegations of political campaign intervention.

As part of the initiative a "fast track" process was implemented for evaluating reports and allegations (referrals) of potential prohibited political activity by section 501(c)(3) organizations and for starting examinations, where appropriate. The fast track process enabled the IRS to meet the main objectives of the initiative--to intercede quickly in instances of alleged prohibited political activity, address allegations of noncompliance in a manner that was balanced and even-handed, educate the exempt organizations, and prevent potential future violations of the law by those contacted.

### **Processing Referrals and Conducting Examinations**

The cases came to the IRS from many sources. As part of the fast track process, the initiative team developed procedures for expediting the review of these referrals. Each week, a committee of three career employees reviewed referrals and decided whether they merited examination. Each member conducted a thorough technical review of the referral information to determine whether there was a "reasonable belief" that the organization may have engaged in political campaign activity prohibited by section 501(c)(3), when considered

fairly and in light of any other reliable information. An organization was selected for examination only if at least two members agreed that the referral met the “reasonable belief” criterion. All decisions were documented.

The IRS reviewed 166 new referrals as part of the initiative. Sixty-eight of those were selected for examination. Additionally, 64 organizations were already in process for this issue when the project began. Thus, 132 organizations were included in the project for examination. Each case was designated either as non-complex, usually meaning it was a single-issue case that could be handled as a correspondence examination; or more complex, meaning it was a multi-issue case that was to be handled as a field examination.

Fewer than half of the organizations ultimately contacted were churches. All of the church cases went through the specific procedures of IRC section 7611, which require a church tax inquiry prior to the opening of a church tax examination. Under this section of the law, the approval of the Director, EO Examinations is required before the initiation of any contact with a church.

The attached full report explains the selection and examination process in detail and describes various obstacles the IRS faced. As discussed below, the IRS is seeking to remove those obstacles for the coming election cycle.

## **Examination Results**

As indicated above, of the original cases, 132 were assigned to the field for examination. Twenty-two of those cases were closed after additional review conducted in preparation for the examinations indicated they did not merit further use of IRS resources. Of the remaining 110 cases, as of the date of this report, 82 examinations have been completed and the cases are closed.

- In three of the 82 cases, the IRS not only substantiated that prohibited political campaign activity occurred, but that the activity warranted, and the Service proposed, revocation of the organization’s exempt status.
- In 55 of the cases, the IRS issued written advisories indicating the Service’s view that prohibited campaign activity had occurred, but that revocation was not recommended. In one case, the Service assessed excise tax. A written advisory is issued when the Service believes the organization engaged in prohibited campaign activity, but the activity appeared to be a one-time, isolated violation, and the organization corrected the violation where possible (e.g., recovered the funds spent on the activity), and, in most cases, took affirmative steps to ensure it would not violate the prohibition in the future. The written advisory states the facts of the case and the applicable law. It also includes a warning that the organization risks possible revocation of tax-exempt status should it become involved in political activities in the future.

- In 5 cases, the IRS found non-political intervention violations (including delinquent returns).
- In 18 cases, the IRS found that the organization did not engage in prohibited political campaign activity.

Twenty eight cases remain open:

- With respect to two of these cases, the examinations are completed but, as with all initiative cases, the files are being reviewed in Examination's Mandatory Review branch to ensure consistency and correctness.
- Twenty-six cases remain in process.

A one-page statistical summary of the cases is attached.

A review of the files indicates some of the more common types of prohibited political activities alleged and found to date through the course of the examinations. Although taxpayer privacy rights preclude us from discussing specific instances, cases included miscellaneous alleged violations ranging from allowing candidates to put up signs at organization facilities to voter registration drives conducted in a way that favors or opposes certain candidates. Violations alleged and determined include:

- Charities, including churches, distributing diverse printed materials that encouraged their members to vote for a preferred candidate (24 alleged; 9 determined),
- Religious leaders using the pulpit to endorse or oppose a particular candidate (19 alleged; 12 determined),
- Charities, including churches, criticizing or supporting a candidate on their website or through links to another website (15 alleged; 7 determined),
- Charities, including churches, disseminating improper voter guides or candidate ratings (14 alleged; 4 determined),
- Charities, including churches, placing signs on their property that show they support a particular candidate (12 alleged; 9 determined),
- Charities, including churches, giving improperly preferential treatment to certain candidates by permitting them to speak at functions (11 alleged; 9 determined), and
- Charities, including churches, making cash contributions to a candidate's political campaign (7 alleged; 5 determined).

The attached full report provides additional information about the examination results and describes other allegations of prohibited political activities engaged in by section 501(c)(3) organizations.

## **Conclusions**

The IRS found that nearly three quarters of the organizations examined under the initiative had engaged in prohibited political activities. As a result, the Service will continue the initiative for future election periods, and as noted above, will focus on both education and enforcement.

The updated initiative procedures reflect what the IRS learned during the 2004 election cycle and the adoption of certain recommendations made by Treasury Inspector General for Tax Administration (TIGTA). TIGTA reviewed the 2004 Initiative in response to public complaints questioning whether IRS methods of selecting cases for examination reflected a political bias or a response to political direction. The TIGTA report concluded that there was no evidence of political bias or direction, but did make several recommendations for improving the process.

Heading into the 2006 election cycle, the Service will:

- Distribute expanded educational material based on findings from the 2004 election cycle and make it widely available early in the coming election cycle,
- Start the project earlier in the election year to ensure consistent and timely referral selections and examinations,
- Publicize the project in advance so there is no surprise to organizations, and
- Augment the dedicated and trained team to assure prompt handling of project cases.

Creating new educational materials is critical for any future success in preventing political intervention by section 501(c)(3) organizations. Fact Sheet FS 2006-17 dated February 23, 2006, represents the Service's latest effort to educate organizations on the issues found in these cases and provides assistance on how organizations can comply into the future.

Attachment: Summary of Results, 2004 Political Activity Compliance Initiative