

**FINAL REPORT**

**PROJECT 302**

**Political Activities Compliance Initiative**

**Introduction**

This report summarizes the 2004 Political Activity Compliance Initiative (PACI) project and the results thus far, which have been used to develop procedures for the 2006 PACI program.

The Exempt Organizations (EO) function receives information items<sup>1</sup> (referrals) of potential noncompliance by § 501(c)(3) organizations throughout the year; however, during the 2004 election year, EO management anticipated an increase in referrals alleging campaign intervention. In response to this anticipated increase, the Commissioner, TE/GE Division, requested that EO management institute the PACI project. The project was initiated in June 2004 and was a part of EO's multi-pronged strategy of guidance, publicity, accelerated case initiation, and outreach.

The objective of the project was to promote compliance with the IRC § 501(c)(3) prohibition against political campaign intervention by reviewing and addressing allegations of political intervention (PI) by tax exempt organizations on an expedited basis during the 2004 election year. This would not only deter organizations contacted under the program from continuing noncompliance, but also would serve to establish the IRS enforcement presence and reinforce the IRS education efforts. Because the primary focus was the November 2004 elections, the project covered all referrals received through November 30, 2004. When the project was initiated, several approaches, such as educational or other kinds of "soft" contacts, were considered, but an examination project was determined to be the most effective plan.

The issue of political campaign intervention by § 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;

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<sup>1</sup> An information item is a communication received by the EO function from an internal or external source relating to potential noncompliance with the tax law by an exempt organization, political organization, taxable entity, or individual.

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- 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.

### **Methodology**

PACI was a comprehensive examination program of limited-scope examinations focusing on allegations of political campaign intervention by IRC § 501(c)(3) organizations referred to the IRS. Most, though not all, PACI examinations concerned alleged intervention in the 2004 election campaign.

PACI was the first EO Examination program to focus on a category of referrals, as well as the first program to proceed in such an expeditious manner. As such, the Internal Revenue Manual (IRM) did not have procedures for processing these cases. In the usual course of operations, the Classification Unit processes referrals in receipt order. Although the procedures in draft IRM 4.75.5<sup>2</sup> required the Classification Unit to begin evaluating information items (referrals) within 60 days of receipt in the Unit, it did not set a time for completing the classification. In addition, the regularly scheduled Referral Review Committee meetings were too infrequent to meet the PACI objectives. Thus, it was necessary to develop a "fast track" case initiation process to expedite classification of the PACI referrals.

All PACI referrals were reviewed for potential examination. The examination method varied depending upon the kind of organization and the facts of the case. All church cases were conducted according to the church tax inquiry and examination procedures of IRC § 7611. Examinations of organizations other than churches were conducted by correspondence or field examination, as appropriate, depending on the circumstances of each case.

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<sup>2</sup> Published May 13, 2005.

### **Case Selection Criteria**

The Referral and Claims Classification Unit of the Office of EO Examinations (Classification Unit) used the same substantive criteria for classifying PACI cases for examination as are used for all referrals.<sup>3</sup> The standard for determining if the information warranted further IRS action is whether it supports a reasonable belief that the organization may have violated the prohibition of § 501(c)(3) that it not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. Procedurally, as with all EO referrals, PACI referrals were subject to Referral Review Committee review. These procedures were put in place in the 1990's to ensure equity and transparency and that no one individual could select organizations within certain classes for examination.

As with any case selected by the EO Classification Unit, selection of a case only signifies examination potential; it does not represent a conclusion. This is especially true for referrals concerning churches, as authority for initiating a church tax inquiry and, if necessary, a church tax examination, can be exercised only by the Director, EO Examinations.

### **The Classification Process**

All cases in this project were selected by the Classification Unit from referrals from various sources that alleged acts of political campaign intervention by § 501(c)(3) organizations.<sup>4</sup> The classification process for PACI cases followed established classification procedures<sup>5</sup> for case selection, modified as follows to meet the project's needs:

1. The project imposed short timeframes (7-10 days rather than the usual 30-90 days);
2. PACI cases were expeditiously processed as a group;
3. PACI cases identified for examination were considered priority work; Managers could not close PACI cases without action because of resource or program considerations;
4. Due to timing and resource constraints, the project eliminated the preliminary classification recommendation by the classifier to the Referral Committee; and
5. Referrals alleging political activities were reviewed on a weekly, rather than monthly, basis by a separate, ad hoc PI Referral Committee.

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<sup>3</sup> In the usual course of operations, the vast majority of, if not all, § 501(c)(3) organization examinations alleging political campaign intervention are the result of referrals.

<sup>4</sup> The Classification Unit often received multiple referrals concerning organizations. Most subsequent referrals duplicated earlier information, though it was not uncommon for a subsequent referral concerning an organization to describe a different event or provide additional information about an event described in an earlier referral.

<sup>5</sup> IRM 4.75.5, EO Examination Procedures, Information Items.

### **Applying the Criteria**

A separate, ad hoc PI Referral Review Committee was established to expedite the classification of PACI referrals in inventory as of July 25, 2004. The ad hoc PI Referral Committee was comprised of three career civil servant employees with extensive EO tax law experience. Each PI Referral Committee member independently reviewed the file contents and documented his or her recommendation. After all members had completed reviewing all the files, they jointly reviewed each case to determine the Committee recommendation. For any referral in which there was not unanimous agreement, the majority view was the recommendation of the Committee, but the dissenting view was included with the recommendation.

### **Case Groupings**

PACI cases were grouped in three categories:

1. Pre-existing cases: referrals concerning organizations that were already selected for examination for political intervention and assigned to a field group prior to the project;
2. PACI referrals: referrals in the Classification Unit inventory awaiting classification on July 25, 2004, and referrals received July 25 through November 30, 2004; and
3. Pending cases: prior year activity referrals or follow-up actions containing allegations of political intervention by § 501(c)(3) organizations pending in the Classification Unit when the PACI began.

The number of cases in each category was as follows:

#### Pre-Existing Cases

Forty-four referrals (33% of total project cases) concerned § 501(c)(3) organizations already selected for examination for political intervention and assigned to an examination group prior to the start of the project.

#### PACI Referrals

The Classification Unit considered 166 referrals concerning 127 organizations that were in its inventory on July 25, 2004, or were received between July 25 and November 30, 2004. Thirty-nine of the referrals concerned organizations that had already been the subject of one or more referrals. Sixty-eight of the 127 organizations were selected for examination. These constituted 54% of the 127 PACI Referral organizations and 52% of all PACI cases.

The Classification Unit entered each referral into its database and, unless the organization had previously been selected, considered the organization for selection. If the organization had previously been selected for examination, and

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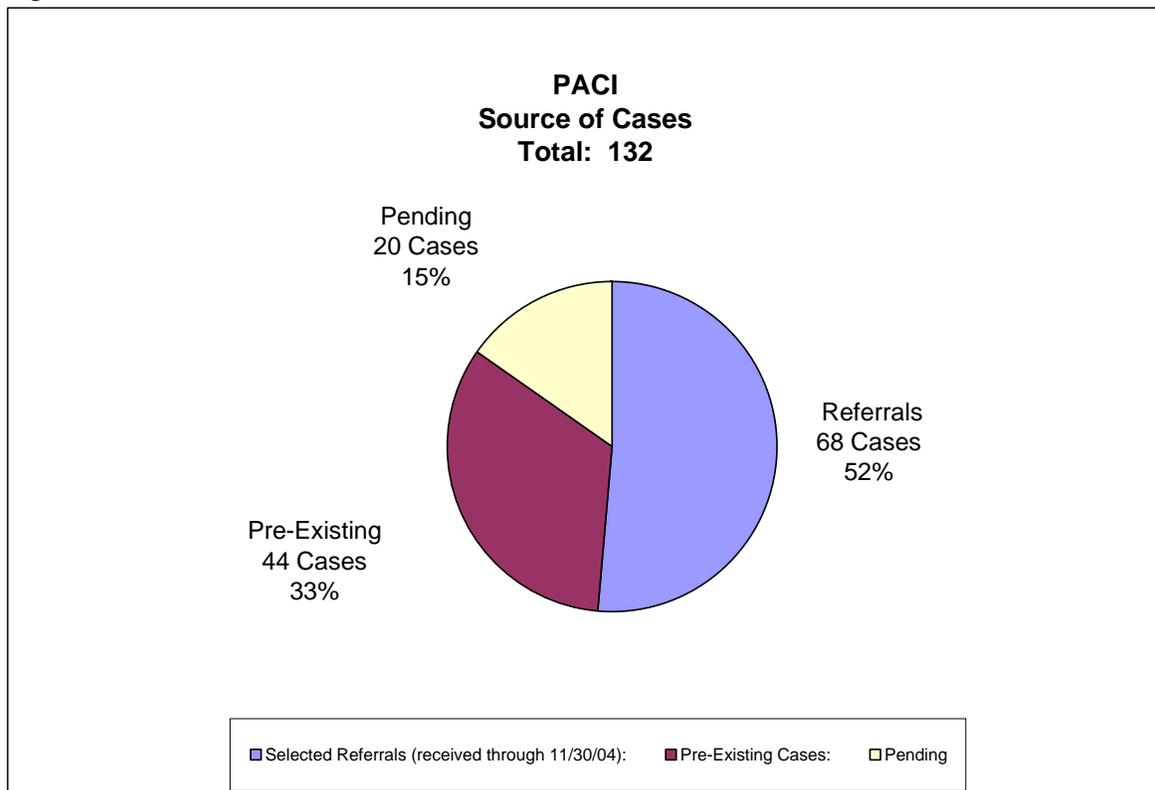
the new referral included new information, that information was associated with the existing case file. If the organization was not previously selected for examination, each subsequent referral was reviewed to determine if it presented new facts or discussed a new event. If so, the new referral was considered for examination.

### Pending Cases

Twenty cases (15% of total project cases) were the result of prior year referrals or other follow-up activities containing allegations of political intervention by § 501(c)(3) organizations that were selected for examination, but still pending in the Classification Unit when the project began in July 2004.

Figure 1 summarizes the sources of PACI cases.

Figure 1



### **Expedited Procedures**

The concept of expedited procedures originated during a June 26, 2004, conference between the Director, Exempt Organizations and management officials of EO Examinations and EO Rulings & Agreements. On July 26-30, 2004, an eight-member team met in Dallas to develop a process that would expedite classification and, if warranted, examination of referrals alleging political intervention by § 501(c)(3) organizations.

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The team developed an expedited process to screen referrals, build the case files, and submit the case files to the PI Referral Review Committee. The team also developed the initial contact letters and Information Document Request (IDR) templates to be used by the agents assigned the non-church cases. These pilot procedures were implemented immediately, pending final approval by the Director, EO Examinations. As the church tax inquiry and examination procedures of IRC §7611 preclude a simple contact letter being used for church cases, letters for these cases were developed case-by-case in coordination with TE/GE Counsel.

The contact letters and IDR templates were approved for use on September 15, 2004, and the first contact letter was sent to an organization on September 21, 2004.

The PACI Team worked on formalizing the procedures during the project, and incorporating project experience and recommendations from reviewers.

### **Description of expedited procedures**

The procedures developed by the team in July and August 2004 provided for expedited case initiation. These required that the Classification Unit process referrals alleging political intervention by § 501(c)(3) organizations as very high priority, as shown by the very ambitious time goal that referrals determined to warrant examination be assigned to an examination group within 7-10 working days of receipt of the referral.

Cases were designated as Type A, which were the non-complex, usually single issue cases, or Type B, the more complex, multiple-issue cases. The Type A cases were assigned to designated revenue agents for processing as a correspondence examination. The Type B cases were assigned to various field groups based on the location of the referred organization.

An initial contact letter, L-3934, was developed by the team for use on the non-church Type A cases, and was to be sent to the organization within 5 days of receipt of the case in the group. Because Type B cases would take longer to develop, the team prepared an initial contact letter, L-3935, to be sent for the Type B cases within 2 days of receipt of the case in the group. This was designed to alert the exempt organization about the IRS's concerns, and invite a response that might address them. A standard follow-up letter was to be sent to the organization within 10 days detailing the specific conduct/activity.

Letters 3934 and 3935 could not be used for church cases because of the constraints of IRC section 7611, which governs church inquiries and examinations. Instead, the initial procedures provided that the agent forward the inquiry letter and questions to Mandatory Review within 15 days of receipt of the case.

## **Resources**

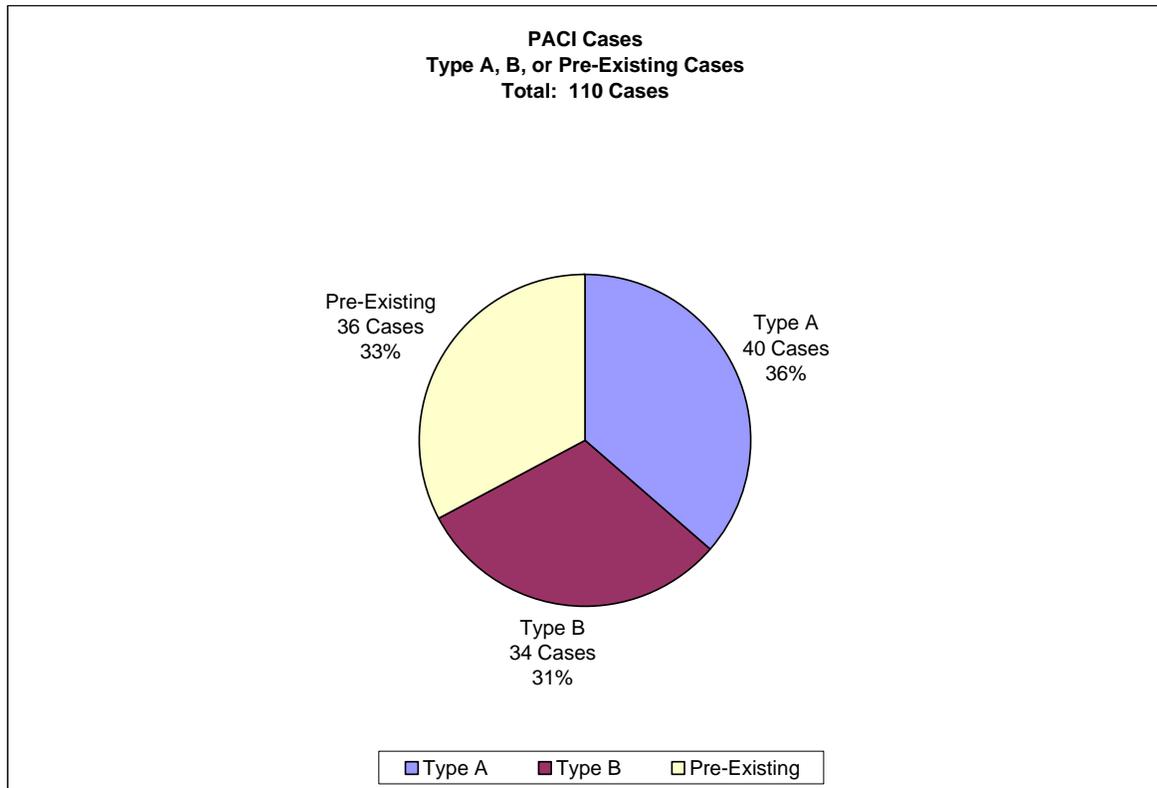
At the start of the program, there were 64 political intervention cases in inventory (see page 4 for breakdown.) Projected volume for the year was unknown, since future cases were generated by referral, making it difficult to anticipate staffing needs. Initially, Examination devoted two revenue agents full-time to the Type A cases. Type B cases were geographically disbursed to agents throughout the country who worked on them on a part-time basis. Ultimately, 43 agents, one full-time reviewer and one full-time classifier worked on the PACI project during the election period. Exact time allocated to the project has not been compiled at this point.

## **Types of Examinations Included in the Project**

Although 132 cases were forwarded to the field, twenty two cases were surveyed. A surveyed case is one that was determined by the agent and his or her manager not to merit examination. We should note that more church cases than non-church cases selected through classification were closed by survey. This is not unusual or unexpected, given the amount and intensity of review to which church tax inquiries are subject before the Director, EO Examinations can conclude that the requisite “reasonable belief” exists to support initiation of a church tax inquiry. Thus, the PACI project for the 2004 election cycle consisted of 110 examinations. Project cases were nearly equally divided between Type A, Type B, and Pre-Existing cases, as shown in Figure 2.

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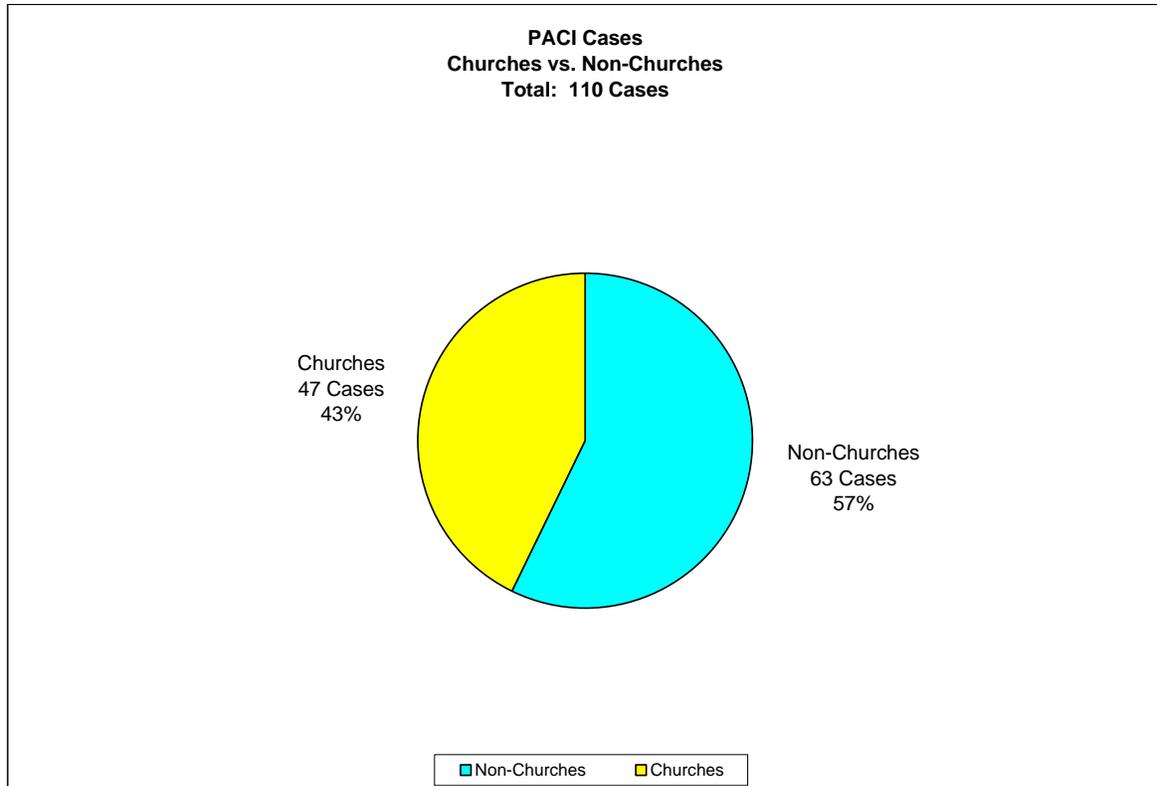
Figure 2



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As shown in Figure 3, project examinations were also nearly equally divided between churches (43%) and non-churches (57%).

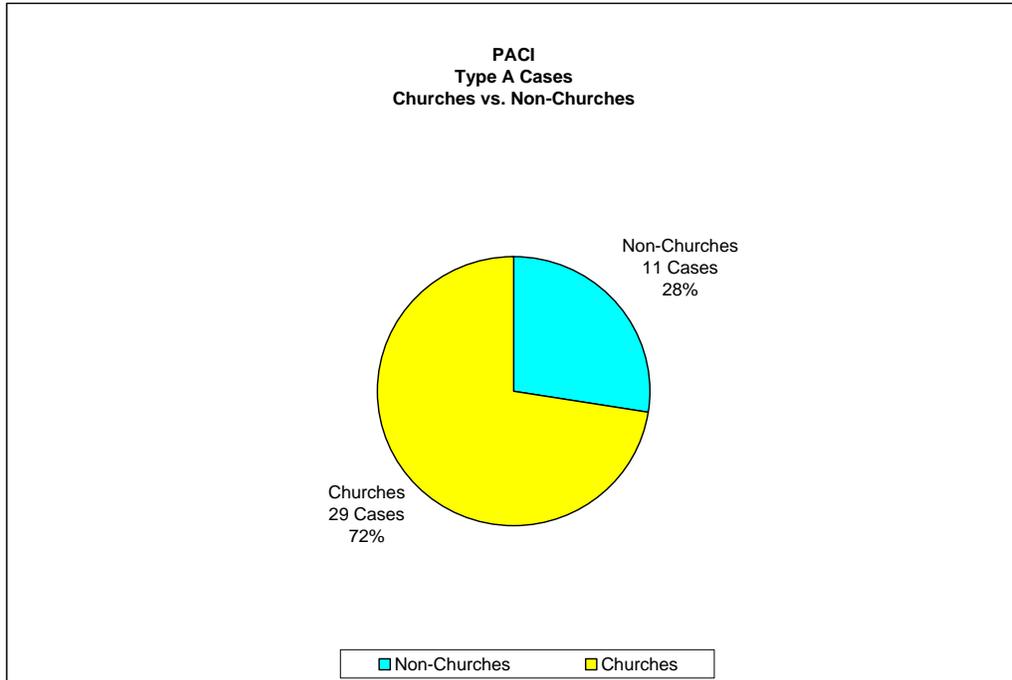
Figure 3



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Type A examinations consisted of 72% church cases and 28% non-church cases.

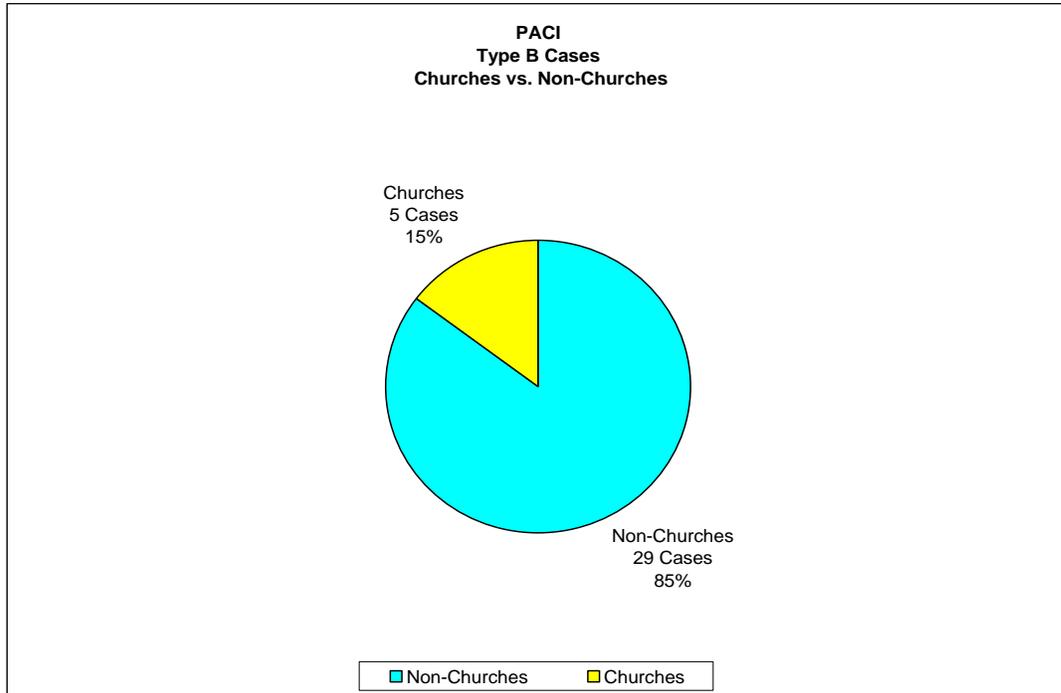
Figure 4



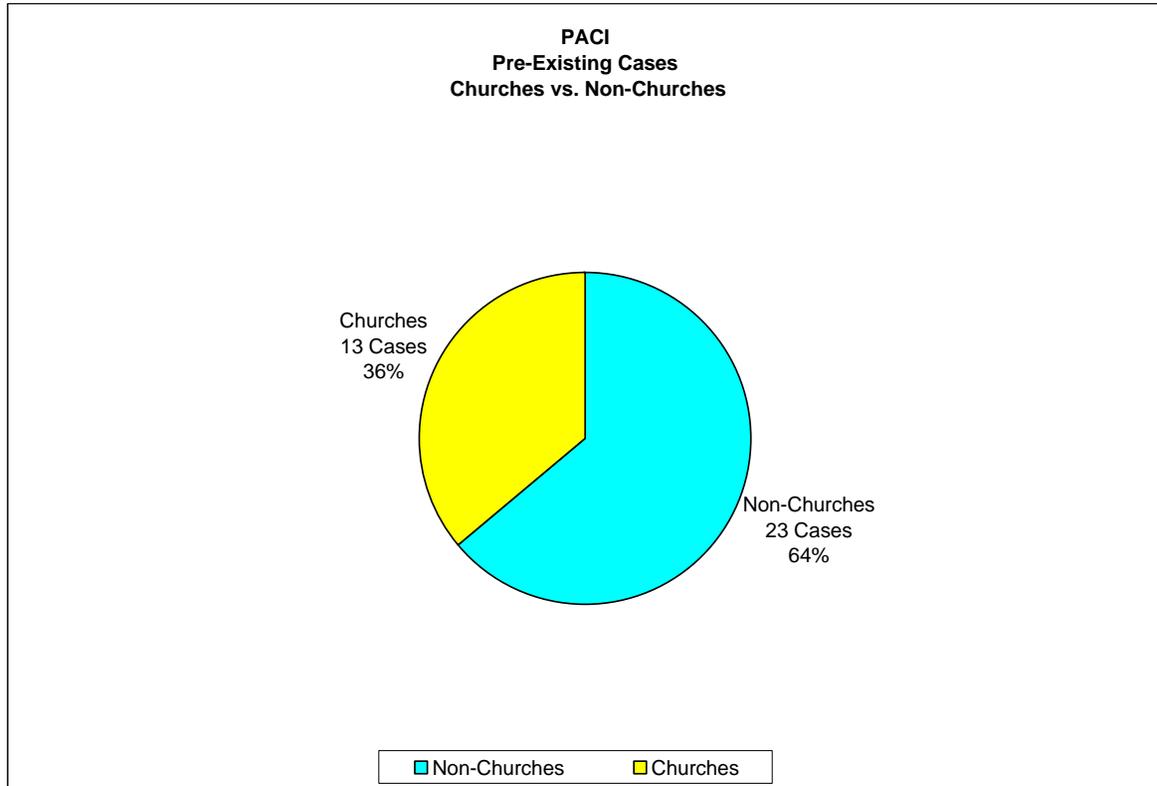
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As shown in Figure 5, Type B cases consisted of 85% non-churches and 15% churches.

Figure 5



Pre-Existing examinations consisted of 36% churches and 64% non-churches.  
Figure 6



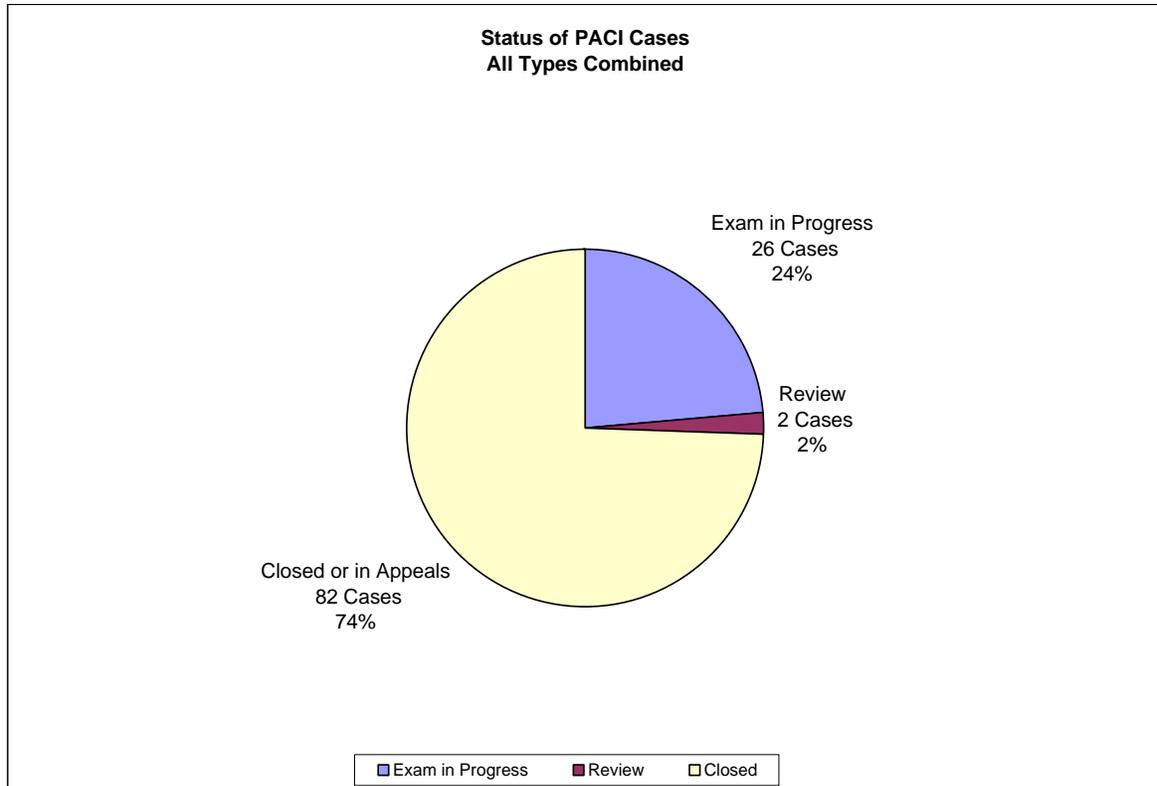
### Summary of Status of PACI Examinations

As of February 16, 2006, 82 of the 110 cases (74%) are considered closed. Two additional cases (2%) are closed from the examining group but are still in the review process. Examinations are in process and the organizations have been contacted in 26 cases (24%).

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Figure 7, below, summarizes the status of the 110 total PACI cases.

Figure 7



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Figure 7A compares the status of church examinations to the status of non-church examinations.

Figure 7A

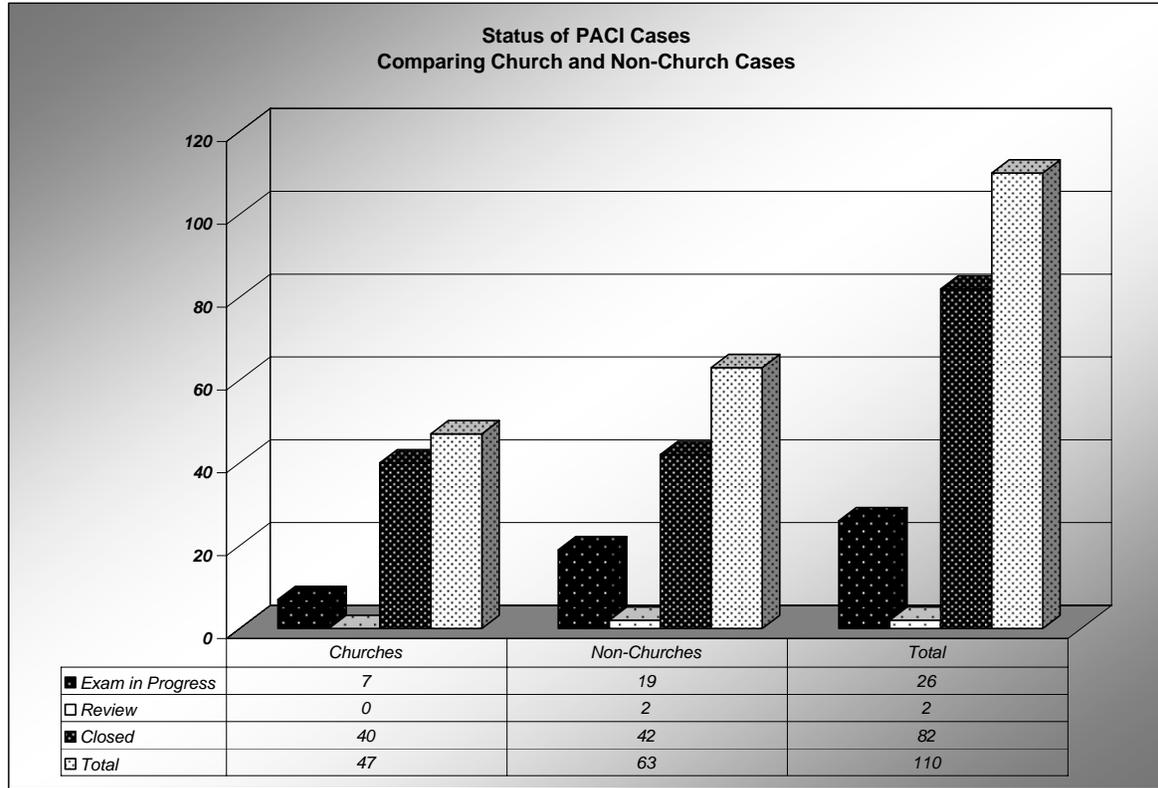
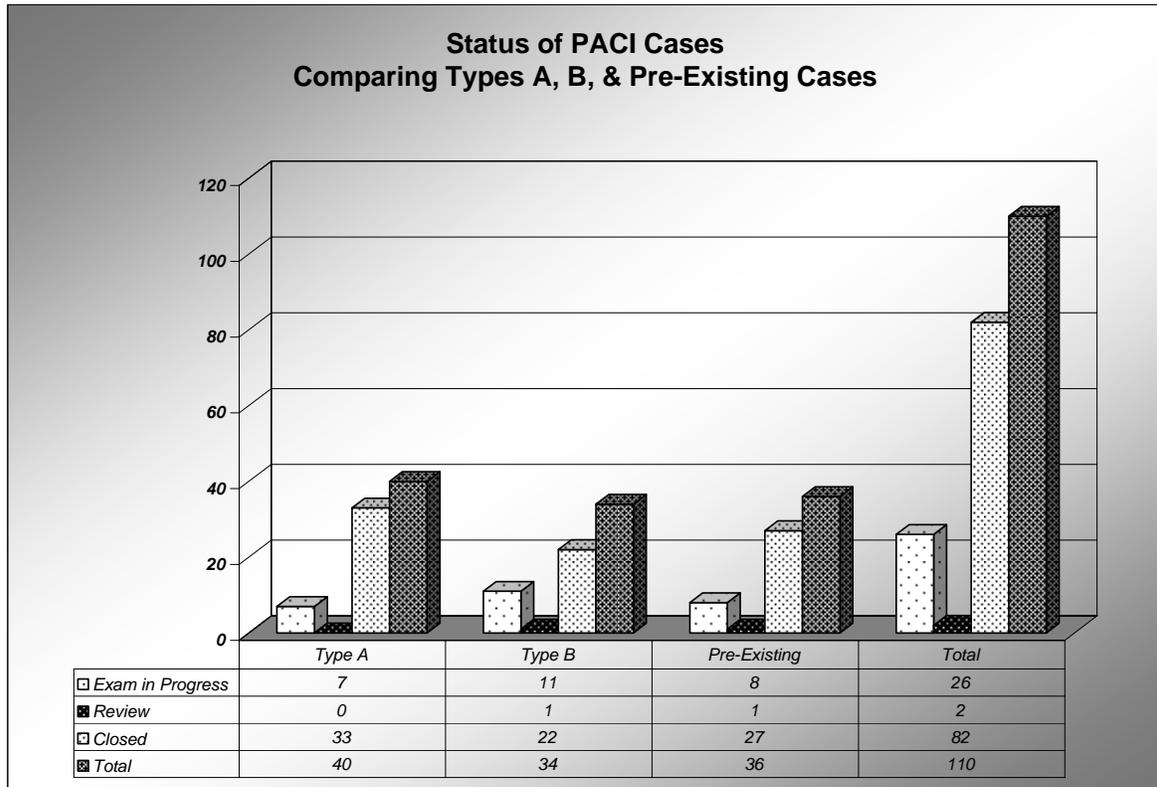


Figure 7B summarizes the status of PACI cases by type of case.



## Types of Political Campaign Intervention in 2004 Election Cycle Cases

The alleged acts of political intervention were categorized for the 82 closed cases. Some cases had more than one alleged act of intervention. For example, if an organization official appeared to endorse a candidate during the candidate’s appearance at an organization function, the referral would present two distinct issues that had to be resolved before the Service could conclusively determine whether the organization engaged in political intervention. First, the IRS would have to examine the circumstances surrounding the candidate’s appearance to determine whether it was political campaign intervention rather than an educational activity. Second, even if the candidate’s appearance, in itself, was not campaign intervention by the organization, actions or statements by organization officials may have constituted political intervention by the organization.

Following are the types of political intervention alleged and determined, to-date, in the referrals selected for examination under PACI:

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- Exempt organization distributed printed documents supporting candidates:

There were 24 alleged instances in which organizations distributed printed documents supporting candidates; in 9 of the instances, the IRS determined political intervention occurred. Examples included newsletters, church bulletins, inserts in church bulletins, letters to members, etc.

- Church official made a statement during normal services endorsing candidates:

There were 19 instances in which a church official allegedly made a statement during a service endorsing or opposing a candidate. In 12 instances, the IRS determined political intervention occurred. Project results indicated that organization officials clearly understood that express endorsements are prohibited; however, some apparently did not realize that political intervention is much broader than just express endorsements.

- Candidate spoke at an official EO function:

There were 11 alleged instances involving candidates speaking at an organization function. In 9 of the instances, the IRS determined political intervention had occurred. The majority of these allegations involved church appearances. For example, in some instances, the candidate was allowed to use the church facilities in a manner that constituted campaign intervention (*i.e.*, the appearance was not part of a candidate forum or other established policy of the organization to allow all candidates to address its membership on equal terms).

- Distribution of improper voter guides or candidate ratings:

There were 14 instances where an organization allegedly distributed an improper voter guide or candidate rating. The distribution method varied. For instance, some were made available on the organization's website; some were left on a table at the back of the church; and others were accessible through links on the organization's website. The IRS determined political intervention occurred in 4 of these instances.

- Organization posted a sign on its property endorsing a candidate:

There were 12 instances in which an organization allegedly posted a sign on its property that endorsed candidates. Generally, the referral included a picture of the sign on the organization's property. The IRS determined political intervention occurred in 9 instances.

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- Organization endorsed candidates on its website or through links on its website:

There were 15 instances in which an organization allegedly posted material on its website, or included a link on its website to website(s) that endorsed candidates. The IRS determined political intervention occurred in 7 instances.

- Verbal endorsements by a organization official:

There were 8 instances in which an official of a non-church organization allegedly endorsed a candidate verbally. These are in addition to the 19 alleged acts of political campaign intervention noted above under the category “Church official made statement during normal services endorsing a candidate.” The IRS determined political intervention occurred in 6 instances.

- Organization made a political contribution to a candidate:

The project identified 7 alleged instances in which an organization used its own funds to contribute to a campaign. This type of political intervention was easy to document, especially when the funds came from an organization’s checking account. The IRS determined political intervention in 5 instances.

- Non-candidate endorsed a candidate at an organization function:

There were 4 cases in which an organization allegedly allowed an individual, other than a candidate, to endorse a candidate during a speech at the organization’s function. Most of these instances involved well-known individuals, and most of these situations involved churches. In all 4 instances, the IRS determined political intervention.

- Other miscellaneous acts of political campaign intervention.

## Closed Case Results

As of February 16, 2006, we have closed 82 cases, 4 of which are pending in Appeals. Forty of the closed cases (49%) were churches, and 42 (51%) were non-churches.

Figure 8

Closed Cases	Church	Non-Church	Total
Type A	26	7	33
Type B	3	19	22
Pre-Existing	11	16	27
Total	40	42	82

Sixty-eight percent (68%) of the examinations resulted in no-change written advisories issued to the organization<sup>6</sup> and 22% resulted in no-change. A no-change examination results when the facts developed during the examination indicate that the organization did not intervene in a political campaign within the meaning of section 501(c)(3). See Figure 9.

We should note that the term “no-change written advisory” has a broader meaning in the context of PACI than it is usually understood to mean. In the usual course of operations, a “no-change advisory” is usually issued when an examination identifies issues or activities that are insubstantial, but, if conducted to a greater extent, could affect the organization’s exempt status. In the PACI, the term no-change advisory encompasses cases in which the organization was found to have intervened in a political campaign within the meaning of § 501(c)(3), but the following conditions existed:

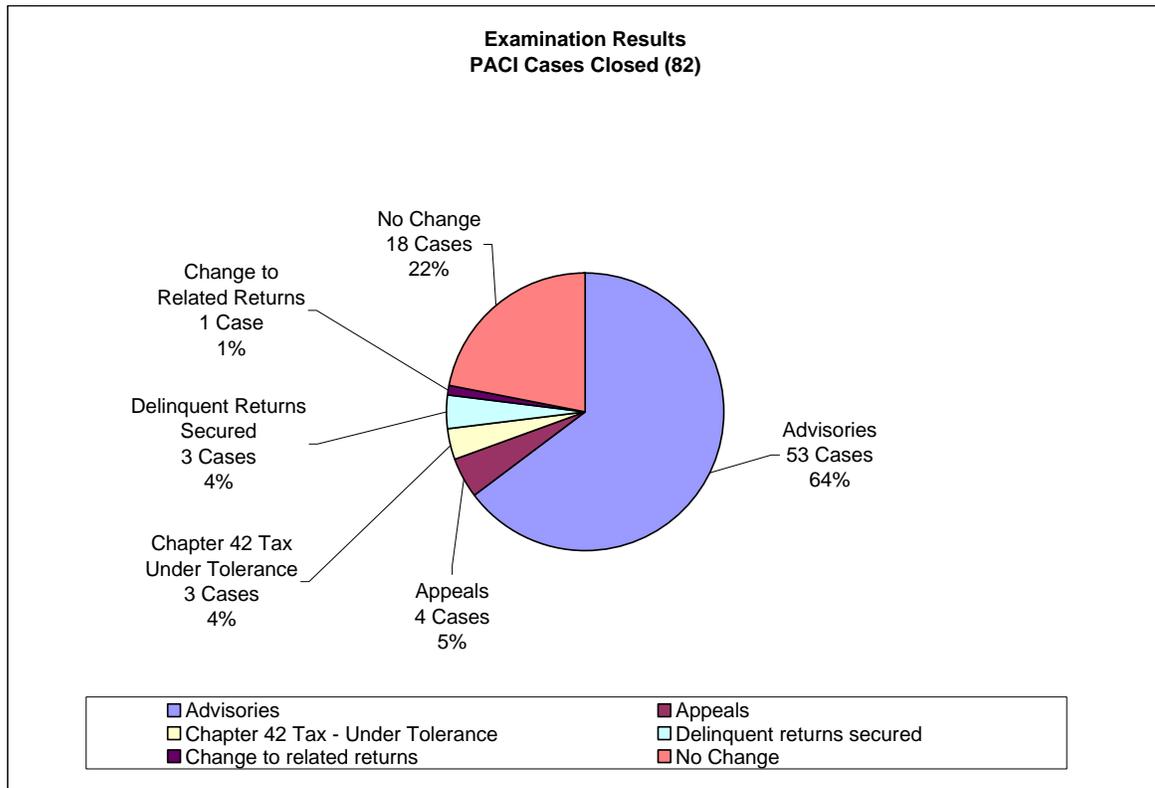
- The act of intervention was of a one-time, nonrecurring nature, or was taken in good faith reliance on advice of counsel, or was otherwise shown to be an anomaly;
- The organization corrected the intervention, including recovery of expenditures, to the extent possible, and established that it had taken steps to prevent any future political intervention within the meaning of § 501(c)(3); and
- The assessment of section 4955 tax was unavailable.

<sup>6</sup> Excise tax was assessed in one case where political intervention was found. This percentage also includes cases where the excise tax would have been assessed but the amount involved fell below internal tolerance levels.

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In these circumstances, we believe the PACI objective of promoting compliance was served with minimum burden on organizations by issuing a closing letter that stated the circumstances leading to the examination, the examination findings, and the reasons for resolving the examination without change to the organization's exempt status.

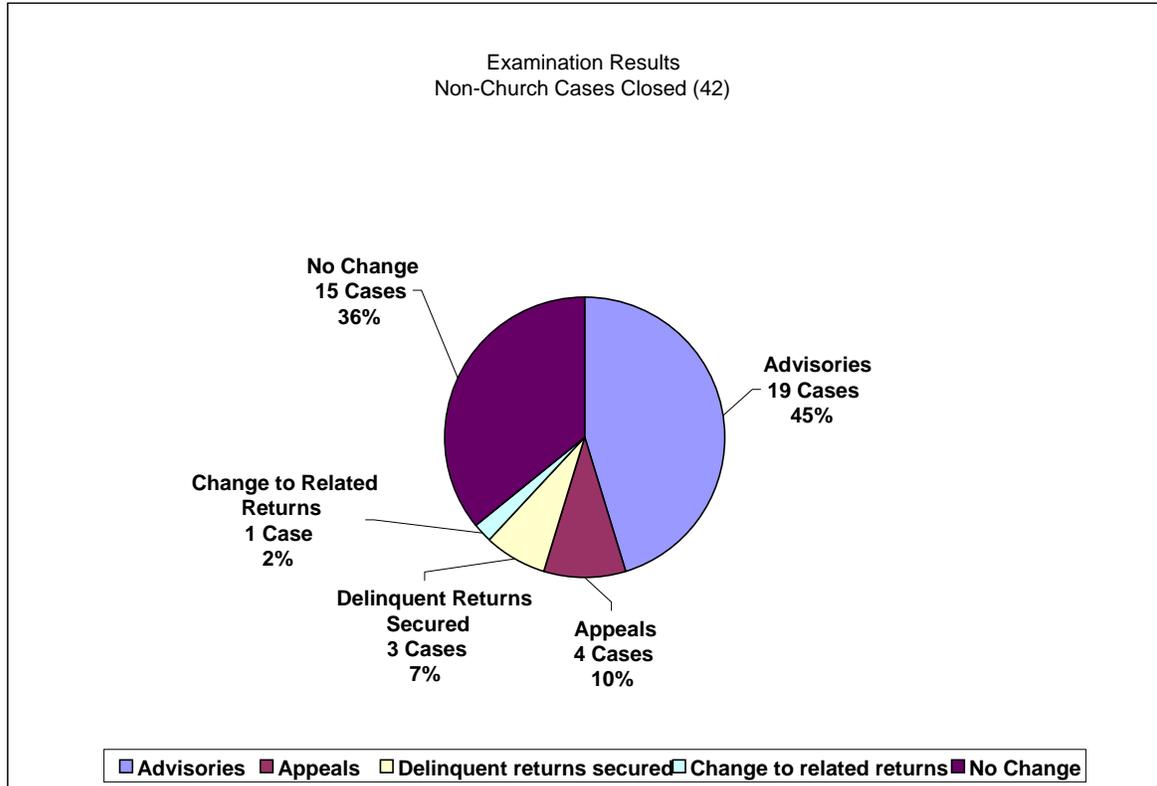
Figure 9



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As shown in Figure 9A, below, 45% of the non-church cases were closed with advisories, and 36% were closed with no change.

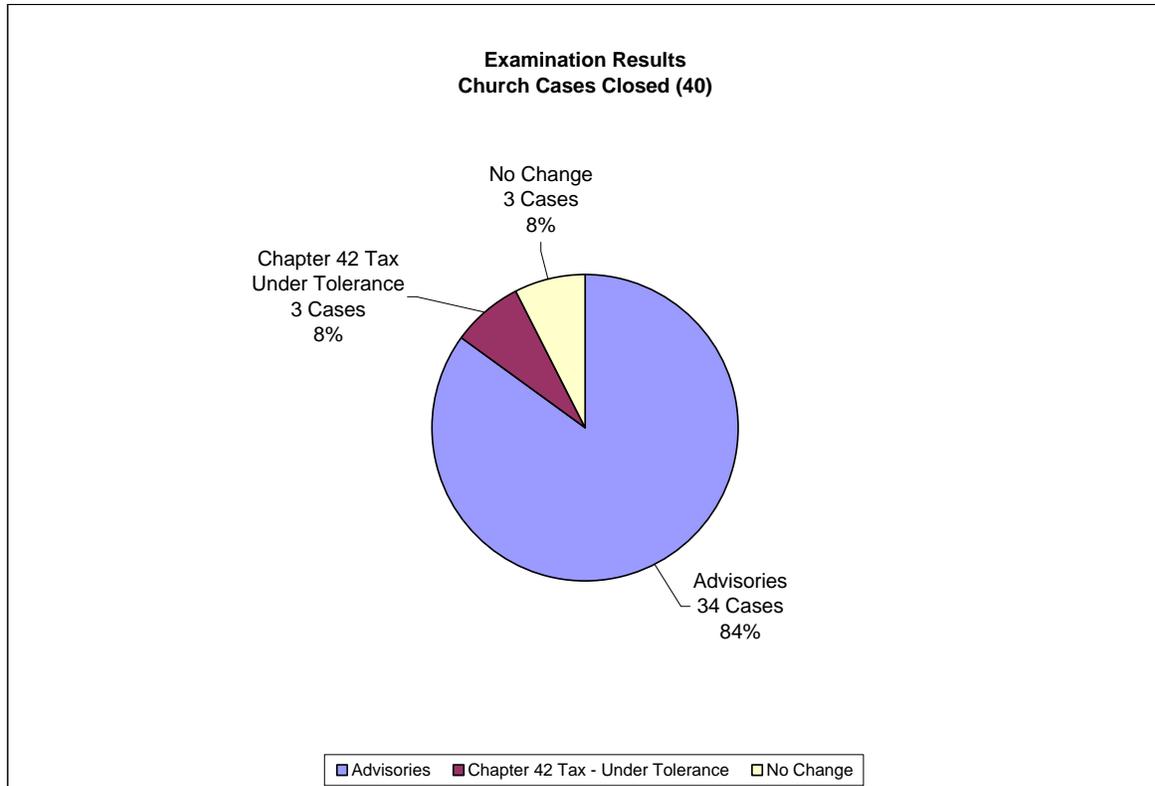
Figure 9A



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As shown in Figure 9B, eighty-four percent (84%) of church cases resulted in advisories, and 8% resulted in no change.

Figure 9B



### Lessons Learned

- We believe the decision to conduct PACI through limited-scope examinations rather than use of “soft contacts” was sound. A program employing soft contacts would have required nearly the same level of resources, but would not have been as likely to have shown positive compliance results.
- We believe the PACI approach provides additional safeguards against the possibility that bias or other improper motives will affect IRS actions, either in selecting an organization for examination or in conducting an examination.
- The PACI identified confusion with the phrase “...does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.” Especially, though not exclusively, in cases concerning churches, the phrase had been interpreted to mean that the prohibition on political

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intervention by § 501(c)(3) organizations was limited to expressly endorsing or opposing candidates. Thus, the majority of the alleged acts of campaign intervention at church services or functions were not express endorsements. In fact, the circumstances often suggested that the pastor made a conscious effort to avoid an express endorsement, yet made an indirect endorsement clearly conveying a message on behalf of, or in opposition to a candidate.

- The fact that examinations were closed “no change” did not mean that the Classification Unit erred in recommending them for examination. The examinations closed no-change generally involved acts of political intervention that were described as and appeared to be actions of the organization, but which were shown, upon examination, to be attributable to someone other than the organization, or the examination disclosed no information to contradict the organization’s explanation of the events.
- Although publicity generated by the PACI was to a large extent outside of IRS control, given the restrictions of § 6103, news articles generated by the claims of some organizations promoted awareness in the EO community of IRS compliance efforts. In addition, the report of the TIGTA PACI audit, issued in February 2005, provided the public with a third-party explanation of the program, assurance that the program was impartial, along with suggestions to the IRS for improvement.<sup>7</sup>
- Using a limited number of designated agents for PACI cases provided a solid skill base. It also made it easier to coordinate and manage “roundtable” conference calls for agents and managers to discuss technical and procedural issues. The conference calls were an effective forum for discussing problems and identifying solutions.

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<sup>7</sup> The Treasury Inspector General for Tax Administration (TIGTA) audited PACI and issued a report in February 2005. The TIGTA report concluded that:

- there were no indications that EO inappropriately handled information items reviewed by TIGTA;
- the EO Referral Committee followed a consistent process when reviewing information items, regardless of the source of the allegation or the nature of the alleged political activity;
- TIGTA did not identify any cases in which the same criteria were used to select one information item for examination and to decline a similar item for examination; and
- the information items EO selected and did not select for examination concerned organizations reflecting a variety of political views.

Although the TIGTA report concluded that there was no evidence of political bias in our classification of the information items, the report did make several recommendations, which were considered and are adopted in the new procedures.

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- Identifying cases as Type A (correspondence) and Type B (field) proved effective in applying the appropriate resources for each case.
- The Deputy Area Counsel attorney was a valuable team member, not only in developing sample letters and other materials and helping coordination with Counsel, but also in providing TE/GE personnel insight into the complexities and resource challenges Counsel faced with this project.
- Developing and using a checklist for agents to complete and electronically submit proved valuable in capturing and analyzing data from the examinations.
- Developing sample questions addressing frequently recurring scenarios to help agents prepare church tax inquiry letters, and sample advisory letters to help agents resolve the cases, were useful aids that also promoted consistent treatment of similar cases. We must emphasize, though, that sample materials must be used with care to ensure they are used appropriately.

### Going Forward

- To be effective, the project should be “up and running” by March of the election year or earlier. Given that many acts of political intervention occur in throughout the election cycle, beginning the PACI in July not only created a backlog of cases to handle at the project’s start, but limited PACI’s potential to promote compliance in the election year.
- IRS should provide advance notice that it will conduct the PACI in the Implementing Guidelines for the fiscal year, through media releases and other educational efforts it makes during the election cycle. These communication efforts also will serve to reinforce IRS educational efforts concerning the prohibition of campaign intervention.
- The timeframes for each step of the process should be ambitious but realistic. They also need to be flexible to accommodate business exigencies, but not to the extent that exceptions become the norm. For example, only 16 percent of the Type B cases met the goal of having the initial letter issued within two days of receipt. Taking into consideration managers’ and agents’ case loads and other priorities, this two-day turnaround was unrealistic if considered as a rigid standard or a performance measure. Because managers and agents must plan their calendars in advance, including scheduled field visits and taxpayer meetings, many found it impossible to begin work on a newly assigned PI case before fulfilling prior commitments.

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- Exempt Organizations should allocate sufficient resources for PACI, especially in the EO Classification Unit and Review, which are critical offices in the project.
- To ensure consistency, a PI Referral Review Committee should be designated to review all referrals for the project. Barring unforeseen circumstances, the three members should serve for the duration of the PACI. As the Committee needs to meet at least weekly, the members should all be from the Dallas, TX, area to avoid travel expenses.
- Tools (*e.g.*, contact letters, sample IDR's, IRM procedures, *etc.*) should be approved and ready for agents when the PACI begins.
- Technical training on political activity issues is essential, not only for agents, but for all employees and managers with a role in PACI cases. This is important to promote consistent treatment of technical issues, and ensure all personnel appreciate the significance of the PACI in the EO program.
- Managers and agents working "Type B" (field) examinations should have periodic "round table" conference calls to discuss technical and procedural concerns, share ideas, *etc.*
- EO Examination management needs to assign PACI field examination cases expeditiously and based on the issues raised, availability and experience of agents, and available travel resources, *etc.*
- Consideration must be given to avoid processing delays in cases, most notably church cases that are inherently difficult to expedite. In referrals concerning churches, the steps required by the IRM to ensure the IRS complies with the requirements of § 7611 - drafting of the church tax inquiry letter by the agent; review by Area Counsel; revision, as needed by the agent; review and approval by the Group Manager, Area Manager, and Area Counsel; review and approval by Mandatory Review, who forwards the file and recommendation to the Director, EO Examinations for approval and signature – require considerable time to complete, even if there are few issues and the facts are clear. When a case presents more complex or difficult issues or facts, each step takes more time to complete. Thus, to ensure church cases are timely processed without sacrificing attention to substantive issues, their process should be closely monitored. Remembering that one of the goals in PACI was to contact organizations quickly and, hopefully, in advance of any subsequent violation, it must be noted that the 7611 rules generally prevent such expeditious contact.

## Conclusions

The PACI represented a change for EO Examinations in how the issue of political intervention has been addressed. In years past IRS pursued those organizations upon the receipt of a referral but only where Examination resources were available. PACI made resources available. Many examination groups were reluctant to begin a church inquiry because of the inherent sensitivity of church examinations, difficulties in ascertaining the facts prior to opening the audit, and the complex procedures of IRC § 7611 required a significant commitment of experienced resources.

PACI more directly addressed the issue of prohibited political intervention by § 501(c)(3) organizations on an expedited basis. One goal was to ensure that organizations that had engaged in alleged political intervention activities in the 2004 elections stopped their activities as a result of a contact by the IRS. Another goal was to establish the IRS enforcement presence, which was evidenced by the publicity received on the initiative. This publicity informed the charitable community that IRS was serious about political intervention issues and that organizations that intervene in a political campaign within the meaning of § 501(c)(3) could expect an IRS contact.

One hundred and ten organizations were examined as part of the PACI program. As of February 16, 2006, 82 cases have been closed; only 18 were closed with no change. Seventy-two percent of the organizations examined were found to have intervened in a political campaign within the meaning of § 501(c)(3) and the overall change rate was seventy-eight percent. This high percentage shows that the PACI addressed a significant compliance issue.

Although the total number of organizations contacted was significant, it only represents a small percentage of the § 501(c)(3) population. Therefore, we acknowledge that we cannot measure the overall impact of the program, and it is too early to predict the long term impact on future compliance. Also, the fact that each election cycle presents new and different issues, strategies, etc., makes it likely that IRS will need to continue its efforts.

## PACI Team Recommendations

- We believe that the PACI program should be continued. The results of PACI examinations closed-to-date, in which 72% of organizations were found to have intervened in a political campaign within the meaning of § 501(c)(3), establishes that the program is an effective way to address this compliance issue. Although we may hope that the long-term compliance effect will lead to fewer instances of prohibited political intervention, making PACI unnecessary, we have no basis to assume that goal will be achieved in the immediate future.

## Project 302 – Political Activities Compliance Initiative Final Report

- We recommend that EO continue to review the program and make improvements to the process, as needed.
- We believe the general approach to resolving cases of one-time, non-recurring acts in which the organization takes steps to prevent future campaign intervention was appropriate, but should be re-evaluated in future election cycles. Additional measures may be needed if a significant number of these organizations are found to engage in political intervention in future years.
- We believe additional guidance to the agents and public would help. Areas include use of the internet and public examples of indirect candidate endorsements. In addition, legislative modifications may be necessary to ensure our ability to effectively regulate the area.
- The PACI team strongly recommends that, in future election cycles, the IRS increase its use of revocation in cases that warrant this sanction. With the significant PACI publicity and the IRS 2006 educational efforts, organizations should clearly have an understanding of the rules and the message that the IRS is serious about enforcing the prohibition.

Attachment A: Political Activity Compliance Initiative Procedures

Attachment B: Form 4564, Information Document Requests (4)

Letter 3934

Letter 3934(c)