

## **2006 Political Activities Compliance Initiative**

On February 22, 2006, the IRS issued its report on the Political Activities Compliance Initiative for election year 2004 (2004 PACI). The report noted that, in nearly three quarters of the cases reviewed, improper political intervention by section 501(c)(3) organizations was substantiated. In the face of such a high level of non-compliance, the IRS launched the Political Activities Compliance Initiative for election year 2006 (2006 PACI), which included expedited timeframes for classification and case assignment and established a group of referral classifiers dedicated to PACI cases, all directed at providing swift notice to organizations with the hope of stopping political intervention as quickly as possible. At the same time, the IRS initiated the Political Contribution Sub-Project (2006 PACI-PC) in 2006. PACI-PC maximizes enforcement resources by using internet research to identify instances of direct campaign contributions by section 501(c)(3) organizations to candidates for public office and political organizations that support them.

### **Summary**

This report provides 2006 PACI information and statistics and compares them to the results of the 2004 PACI<sup>1</sup>. Because only a few 2006 PACI cases have closed thus far, we do not address the attributes of closed cases at this time.

- In 2004, the IRS received 166 referrals alleging political campaign intervention by section 501(c)(3) organizations, resulting in 110 organizations selected for examination.
- In 2006, the number of referrals received increased to 237; but, the number of referrals selected for examination remained relatively consistent at 100.
- In both 2004 and 2006, referrals alleging violations by churches and non-churches were almost evenly split, as were the referrals ultimately selected for examination.
- Similar levels and types of allegations of prohibited political intervention occurred in both 2004 and 2006.
- The 2006 PACI-PC sub-project identified 269 apparent cases of direct contributions, totaling \$343,963, from section 501(c)(3) organizations to political candidates.
- Initial IRS contact in 2006 PACI-PC cases resulted in charities receiving over \$121,000 in refunds of political contributions.

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<sup>1</sup> The 2004 PACI covered a six month period which included the Presidential election; the 2006 PACI covered a nine month non-presidential election period.

## 2006 POLITICAL ACTIVITIES COMPLIANCE INITIATIVE

### Methodology

2006 PACI utilized expedited, limited-scope examinations to address referrals alleging political campaign intervention by section 501(c)(3) organizations. The examination method varied depending on the type of organization and the facts of the case. All church examinations were conducted as field examinations and followed the church tax inquiry and examination procedures of IRC section 7611. Examinations of non-church organizations were conducted by correspondence or field examination.

### Classification

The 2006 PACI procedures further expedited the 2004 “fast track” process for evaluating referrals alleging potential prohibited political activity by section 501(c)(3) organizations. This process enabled the IRS to intercede quickly in instances of alleged prohibited political activity and to educate the organizations to prevent potential future violations.

Upon receipt of a referral, the PACI Referral Committee, comprised of three career civil servant employees with extensive EO tax law experience, determined whether the information supported a reasonable belief that the organization may have violated the political campaign prohibition of section 501(c)(3) and, therefore, warranted further IRS action. The Referral Committee then categorized the referrals into three groups: Type A--single issue/non-complex; Type B--multiple issue/complex; and Type C--egregious/repetitive alleged violations.

The procedures set ambitious time goals for processing referrals. Referrals were to be categorized and assigned to the field, and contact was to be made with the taxpayer organization within 16 to 65 days of the IRS receipt of the referral, depending upon the referral category (Type A, B, or C) and whether the organization was a church.

The chart below shows the average time, from receipt of the referral to notice to the taxpayer, for the different case types.

2006 PACI	Number of Cases	Goal in Days	Average Timeframe
Churches Types A & B	40	65	79.6
Churches Type C	0	50	0
Non-churches Types A & B	53	29	34.8
Non-churches Type C	4	16	26

## Referrals

In 2006, the IRS received 237 referrals alleging prohibited political campaign intervention by section 501(c)(3) organizations, as compared to 166 in 2004. Although the number of referrals received in 2006 exceeded those filed in 2004 by 81, the number of referrals actually selected for examination in 2006 was less than the number selected in 2004. In our view, the IRS public awareness program contributed to the rise in the number of referrals we received; whereas, the experience we gained through the 2004 PACI resulted in fewer 2006 referrals selected for examination.

In both 2004 and 2006, referrals alleging violations by churches and non-churches were almost evenly split, as were the referrals ultimately selected for examination.

The chart below compares the number of referrals received with the number of organizations selected for examination for 2004 and 2006. When comparing these figures, note that the time period for the 2004 PACI (six months) differs from the 2006 PACI (nine months).

	<b>2004</b>	<b>2006</b>
<b>Referrals Received</b>	166	237
<b>Selected for Examination</b>	110 (66%)	100 (42%)
• <b>Churches</b>	47 (43%)	44 (44%)
• <b>Non-churches</b>	63 (57%)	56 (56%)

### **Allegations of Political Campaign Intervention**

As the following chart illustrates, the number and types of political campaign intervention alleged in the referrals selected for examination in 2004 and 2006 was similar.

<b>Allegations</b>	<b>2004 Totals</b>	<b>2006 Totals</b>
1. Exempt organization distributed printed documents supporting candidates.	<b>24</b>	<b>14</b>
2. Church official made a statement during normal services endorsing candidates.	<b>19</b>	<b>13</b>
3. Candidate spoke at an official EO function.	<b>11</b>	<b>16</b>
4. Organization distributed improper voter guides or candidate ratings.	<b>14</b>	<b>7</b>
5. Organization posted a sign on its property endorsing a candidate.	<b>12</b>	<b>15</b>
6. Organization endorsed candidates on its website or through links on its website.	<b>15</b>	<b>11</b>
7. Organization official verbally endorsed a candidate.	<b>8</b>	<b>5</b>
8. Organization made a political contribution to a candidate.	<b>7</b>	<b>11</b>
9. Organization allowed a non-candidate to endorse a candidate during a speech at the organization's function.	<b>4</b>	<b>2</b>
10. Organization's facilities used for political campaign intervention.		<b>6</b>

### Status of Cases

As of March 30, 2007, five 2004 PACI and 60 2006 PACI cases remain open. The chart below shows the disposition of the closed cases.

### Closed Cases

Disposition of Cases	2004			2006		
	Churches	Non-churches	% of closed cases	Churches	Non-churches	% of closed cases
Final revocations	0	5*	4%	0	0	0
Proposed revocations	0	2	2%	0	0	0
Political intervention substantiated: written advisory issued	42	27	66%	4	22	65%
Non-political intervention violations	0	6	6%	0	0	0
Political intervention not substantiated upon exam	4	19	22%	10	4	35%
<b>Total</b>	<b>46</b>	<b>59</b>		<b>14</b>	<b>26</b>	

\*One case was revoked not due to political intervention, but for other operational issues.

### Review of Operations (ROO)

During 2006, EO implemented a follow-up process whereby the Review of Operations (ROO) would conduct quarterly internet research on organizations that had received written advisories for isolated incidents of political intervention to detect whether subsequent political intervention occurred. The 2006 review of the organizations identified in the 2004 PACI found no instances of repeat political intervention. While additional experience will be instructive, these results indicate that the written advisory, combined with the ROO follow-up, are important to the PACI process and are effective tools to promote compliance.

## **POLITICAL CONTRIBUTIONS SUB-PROJECT – 2006 PACI-PC**

Candidates and political organizations that support candidates file reports of contributions and expenditures with state campaign finance offices. PACI-PC researches those reports to identify campaign contributions made by section 501(c)(3) organizations.

### **Methodology**

EO conducted research of various state campaign finance report databases. The review focused on contributions reported in 2003, 2004, and 2005, the most recent information available. The research identified contributions from what initially appeared to be exempt organizations.

EO then verified that the non-church organizations were actually section 501(c)(3) organizations, and eliminated all church and non-church organizations whose contributions were in support of, or opposition to, ballot initiatives, rather than candidates.

Ultimately, 269 apparent cases of direct contributions to candidates were identified for this project. The organizations were divided into two categories, based on the amount of the contributions and whether the organization was a church. The Exempt Organizations Compliance Area (EOCA) conducted correspondence examinations of the non-church organizations that made small contributions to individual candidates. Churches and organizations that made larger contributions were referred for field examination.

	<b>Non-Churches</b>		<b>Churches</b>	
	<b>Number of Organizations</b>	<b>Amount of Contributions</b>	<b>Number of Organizations</b>	<b>Amount of Contributions</b>
<b>Correspondence Exams</b>	126	\$65,257	0	0
<b>Field Exams</b>	56	\$234,555	87	\$44,151
<b>Totals</b>	182	\$299,812	87	\$44,151

### Status of Project Cases

When reviewing cases, we consider all available remedies, including issuing written advisories, imposing excise taxes and, in the most egregious cases, revocation.

Of the 269 2006 PACI-PC cases, the examinations thus far have resulted in the charities recovering refunds of prohibited contributions totaling approximately \$121,098 from political campaigns. In addition, the IRS has received multiple Forms 4720, Return of Certain Excise Taxes Under Chapter 41 and 42 of the Internal Revenue Code and Forms 1120-POL, U.S. Income Tax Return for Certain Political Organizations, reporting taxes under section 4955 relating to more than \$23,000 in political contributions.

To date, 92 of the 2006 PACI-PC cases are closed. Political contributions were substantiated, and written advisories were issued, in 65 of the cases. In 21 cases, political intervention was not substantiated, largely due to inaccurate information on state campaign finance databases.

#### Open Cases: 177 (66%)

Status of Cases	Churches	Non-churches	Total	Percentage
Assigned but no taxpayer contact	26	7	33	19%
Exam in progress	47	26	73	41%
Exam completed; going thru internal review	13	58	71	40%
Totals	86	91	177	100%

#### Closed Cases: 92 (34%)

Disposition of Cases	Churches	Non-churches	Total	Percentage
Political intervention not substantiated upon exam	0	21	21	23%
Non-political intervention violations	0	1	1	1%
Surveyed cases <sup>2</sup>	1	4	5	5%
Political intervention substantiated; written advisory issued	0	65	65	71%
Totals	1	91	92	100%

Organizations identified through the 2006 PACI-PC process as having made contributions directly to candidates will be monitored for evidence of future political campaign intervention by the Review of Operations. In addition, the PACI-PC will be an on-going program to address this serious area of non-compliance.

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<sup>2</sup> Prior to contact with the taxpayer, the revenue agent and/or manager determined that the case did not merit examination.