

Audit Technique Guide – Political Organizations – IRC Section 527

Introduction

These examination guidelines contain technical guidelines and audit procedures for IRC Section 527 exempt organizations and IRC Section 527(f)(3) separate segregated funds. It provides methods for identifying and developing issues commonly found.

These directions are for any EO Examinations employee assigned a case, regardless of job series.

The following abbreviations appear throughout this examination guidelines section:

Abbreviation	Term
E-file	Electronically file
EIN	Employer Identification Number
FEC	Federal Election Commission
GCM	General Counsel Memorandum
IRC 527(f)(3) fund	IRC 527(f)(3) separate segregated fund
PLR	Private Letter Ruling
QSLPO	Qualified state or local political organization
RAR	Revenue agent report
TAM	Technical Advice Memorandum

These forms are frequently referenced in these guidelines:

- [Form SS-4, Application for Employer Identification Number](#)
- [Form 990, Return of Organization Exempt From Income Tax](#)
- [Form 990-EZ, Short Form Return of Organization Exempt From Income Tax](#)
- [Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations](#)
- [Form 7004, Application for Automatic Extension of Time to File Certain Business Income Tax, Information and Other Returns](#)
- Form 8871, Political Organization Notice of Section 527 Status
- [Form 8872, Political Organization Report of Contributions and Expenditures](#)

Background Information

Legislation	Effect on IRC Section S501(c)(3)
The Revenue Act of 1954	Added “participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.”
The Tax Reform Act of 1969	Created IRC Section 4945. This section imposes an excise tax on certain private foundation expenditures. This includes participation in political activities, subject to certain exceptions.
1975, Public Law (P.L.) 93-625	<ul style="list-style-type: none"> • Granted tax-exempt status to political organizations. • Created an income tax for non-exempt purpose expenditures. • Established exempt political activity funds, created by IRC Section 501(c) exempt organizations (other than IRC Section 501(c)(3)).
1987, The Budget Reconciliation Act of 1987, P. L. 100-203	Added IRC Section 4955, which imposes an excise tax on each political expenditure by an IRC Section 501(c)(3) organization.
2000, P. L. 106-230	Added four additional political organization reporting and disclosure requirements.
2002, P. L. 107-276	Amended parts of IRC Section 527, and revised political organization reporting requirements.
2015, The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 P. L. 114-41	Amended the due dates for political organization Form 1120-POL reporting requirements.

Reporting and Disclosure Requirements

On July 1, 2000, P. L. 106-230 amended IRC Section 527. This law imposes four reporting and disclosure requirements on political organizations:

- An initial notice of status.
- Periodic reports of contributions and expenditures.
- Annual income tax returns.
- Annual information returns.

On November 2, 2002, P. L. 107-276 changed the filing requirements for certain political organizations that seek IRC Section 527 tax-exempt status. The law:

- Generally reduces filing requirements of some state/local political organizations that already disclose certain information to state agencies.

- Relieves some political organizations from filing an annual income tax or information return.

P. L. 107-276 exempts various organizations from filing specific forms:

Type Of Entity:	Exempt From Filing:
Local candidate committee	Form 8871 Form 990 Form 990-EZ
State candidate committee	
Local political party committee	
State political party committee	
Qualified state political organization (see IRM 4.76.30.4 (3))	Form 8872
Qualified local political organization (see IRM 4.76.30.4 (3))	
FEC political committees	Form 990 Form 990-EZ
Caucus or association of local officials	
Caucus or association of state officials	

Public Law 107-276 also:

- Requires additional information on Form 8871 and [Form 8872](#).
- Requires the filing of an amended Form 8871 after material changes to maintain tax-exempt status.
- Increases reporting thresholds for certain [Form 990](#) filers.
- Changes the filing requirements by requiring that organizations e-file Form 8871 (as opposed to filing both in writing and electronically)
- Requires organizations to e-file any Form 8872 due after June 30, 2003, if the organization has or expects to have contributions or expenditures of more than \$50,000 during the calendar year.

The filing requirements in the chart below apply to those political organizations that both:

- Wish to be a tax-exempt political organization.
- Receive or expect to receive \$25,000 or more in gross receipts in any taxable year.

If You Are A:	You May Be Required To File:
FEC political committee, state or local candidate committee or state or local committee of a political party	Form 1120-POL
Qualified state or local political organization*	Form 8871 Form 1120-POL Form 990
Caucus or association of state or local officials*	Form 8871 Form 8872 Form 1120-POL
Any other political organization, including other federal political organizations and other state or local political organizations.	Form 8871 Form 8872 Form 1120-POL Form 990 or Form 990-EZ.
Note: An organization may be both a QSLPO and a caucus or association of state or local officials. If so, it isn't required to file Form 8872 and Form 990.	

Tax-exempt IRC Section 527 organizations must make their forms (other than [Form 1120-POL](#)) publicly available for inspection and copying at their principal place of business. The IRS also posts Form 8871 and [Form 8872](#) on its website at <https://www.irs.gov/charities-non-profits/political-organizations>.

Notice Status

Effective for taxable years after June 30, 2000, unless excepted (see exceptions on page 4), a political organization must file Form 8871 with the IRS to be tax-exempt. Until it files the form, its income (including contributions) is subject to taxation.

The organization must e-file Form 8871 within 24 hours of the political organization's establishment.

An organization must file an amended Form 8871 within 30 days of any material change (including termination). If not filed, any income (including contributions) it receives after the material change is taxable.

The organization must file a final notice upon termination.

Periodic Reports of Contributions and Expenditures

A political organization must periodically report certain contributions it receives and expenditures it makes.

Tax-exempt political organizations, other than QSLPOs, that file Form 8871 must file [Form 8872](#) to disclose this information:

- Expenditures that aggregate \$500 or more per person, per calendar year.
- Contributions that aggregate \$200 or more per person, per calendar year.

A tax-exempt political organization that doesn't disclose this data must pay a penalty. The penalty is the highest corporate tax rate (35 percent) multiplied by the sum of the contributions and expenditures not disclosed.

An organization required to file Form 8872 may choose to file it monthly or quarterly/semi-annually, but it must file it on the same basis for the entire calendar year. Due dates also vary depending on whether the reporting period falls during an even (election) or odd numbered (non-election) year.

Type Of Year	Reporting Options
Even numbered	Monthly Quarterly
Odd numbered	Monthly Semi-annually
Note: Once an organization selects an option, the organization must continue to file on that basis for the entire calendar year.	

The table below lists the due dates for each option:

Reporting Option	Due Date
Monthly (election year)	January - September: 20th day after the end of the month December: January 31st of following year (year-end report)
Monthly (non-election year)	January - November: 20th day after the end of the month December: January 31st of following year
Quarterly	15th day after the end of the quarter Last quarter: January 31st of following year (year-end report)
Semi-annually	July 31st and January 31st
<p>Note: For even numbered years filing monthly, there are no reports for October or November. The organization files pre and post general election reports.</p> <p>Note: For even numbered years filing quarterly, an organization may need to file a pre or post general election report or both.</p>	

An organization must file the first report for the first period (month/quarter/half) of the calendar year in which it accepts a contribution or makes expenditure. The report must reflect all reportable contributions accepted and expenditure made during the month.

For even numbered years, pre-election and post-general election reports may be required. A pre-election report is a [Form 8872](#) that an organization must file before any election for which the organization made a contribution or expenditure. The pre-election report must reflect all reportable contributions accepted and expenditures made through the 20th day before the election. The organization must file it by the:

- 12th day before the election.
- 15th day before the election, if it's posting the report by certified or registered mail.

An organization must file a post-election Form 8872 by the 30th day after the general election. It must reflect all reportable contributions accepted and expenditures made through the 20th day after the general election. General election, as used in establishing the due date for filing Form 8872, means:

- An election for a federal office held in even numbered years on the Tuesday after the first Monday in November.
- An election held to fill a vacancy in a federal office (in other words, a special election) intended to elect a single individual to the office at stake in a general election.

A political organization isn't required to file Form 8872 for any period of time that it's subject to income tax because it didn't file or amend a Form 8871.

Forms 8872 can be subject to penalties. The penalty is 35 percent of the contributions and expenditures to which a failure relates. The law imposes a penalty if an organization must file Form 8872 and it:

- Fails to file the form by the due date.
- Files the form but fails to report all of the information required or reports incorrect information.

For assessment of penalties on Form 8872, see [guidelines on Case Closing Procedures in subsequent sections, below](#).

Annual Returns

A political organization that has taxable income in excess of the \$100 specific deduction allowed under IRC Section 527, must file an annual income tax return on the Form 1120-POL.

For tax years beginning before 2016, Form 1120-POL was due by the 15th day of the 3rd month after the end of the political organization's taxable year. For tax years beginning after 2015, the due date for filing Form 1120-POL is the 15th day of the 4th month after the end of the organization's tax year.

Political organizations may request a six-month extension of the filing deadline by filing Form 7004. The organization must file the extension by the due date of Form 1120-POL.

A political organization that doesn't file a required Form 1120-POL timely must pay a failure to file penalty. The penalty is 5 percent of the tax due for each month (or partial month) the return is late up to a maximum of 25 percent of the tax due, unless the organization shows that the failure was due to reasonable cause.

Tax-exempt political organizations whose annual gross receipts are \$25,000 or more must file Form 990 (or Form 990-EZ), unless excepted. The exceptions to the Form 990/Form 990-EZ filing requirements are:

- Any organization excepted from the requirements to file a Form 8871.
- Any political organization that is a caucus or association or state or local officials.
- Qualified state or local political organizations only file Form 990 if they have annual gross receipts of \$100,000 or more.

A tax-exempt political organization doesn't use the three-year averaging test to determine whether it meets the \$25,000 threshold.

The table below lists the dollar thresholds for filing Form 990. Organizations below the thresholds may file Form 990-EZ.

Tax Year	Form 990 Threshold
2008	Gross receipts \geq \$1,000,000 Total assets \geq \$2,500,000
2009	Gross receipts \geq \$500,000 Total assets \geq \$1,250,000
2010 and beyond	Gross receipts \geq \$200,000 Total assets \geq \$500,000

Political organizations aren't required to submit Form 990-N.

Political Organizations

A political organization is:

- A party, committee, association, fund or other organization, (whether or not incorporated).
- Organized and operated primarily to directly or indirectly accept contributions or make expenditures for an exempt function.

Political organizations are subject to tax on income other than contributions, dues, and fund-raising income used for political campaign purposes. For all other purposes, consider them tax-exempt. IRC Section 527 also states that a newsletter fund may qualify for the same tax treatment as a political organization if it meets certain requirements. Also, IRC Section 501(c) organizations that expend any money for political activity may be subject to tax under IRC Section 527. (For an explanation of newsletter funds, see subsequent section on Political Organization Taxable Income.

On November 2, 2002, P. L. 107-276 took effect, further amending IRC Section 527. The law created an additional sub-category, the qualified state or local political organization (QSLPO).

A state or local organization may be a QSLPO, it is meets the following criteria:

- All of its political activities relate solely to state or local public office (of office in a state or local political organization).
- State law requires it to (and it does) report contributions and expenditures data to a state agency that is similar to the data otherwise reported to the IRS.
- The state agency and the organization make the reports publicly available.
- No federal candidate or office holder:
 - Controls it.
 - Materially participates in its direction.
 - Solicits contributions for it.
 - Directs any of its disbursements.

Organizational Test

To be subject to tax only as a political organization under IRC Section 527, a political committee, association, fund, or other organization must meet both:

- The organizational test of Treas. Reg. 1.527-2(a)(2).
- The operational test of Treas. Reg. 1.527-2(a)(3).

To satisfy the organizational test, the organization must have the primary purpose of carrying on exempt function activities as defined in IRC Section 527.

The organization does not need a formal charter or to be a corporation, trust, or association.

The organization must use a separate bank account to deposit and disburse political campaign. [Rev. Rul. 79-11, 1979-1 C.B. 207.](#)

When there are no formal documents, review the Form 8871 purpose statement. Consider statements of the organization's members at the time it was formed that they intend to operate the organization primarily to carry on exempt function activities. Treas. Reg. 1.527-2(a)(2).

All organizations claiming exemption under IRC Section 527 are required to obtain EINs, even if they have no employees.

Operational Test

To satisfy the operational test, the organization's primary activities must be exempt function activities as defined in IRC Section 527. The organization may engage in activities that are not exempt function income activities, but these may not be its primary activities. Treas. Reg. 1.527-2(a)(3).

IRC Section 527(e)(2) defines "exempt function" as "the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed."

Promoting the nomination of an individual for an elective public office in a primary election, or in a meeting (or caucus) of a political party is also an exempt function activity. Treas. Reg. 1.527-2(a)(1).

For tax years beginning after December 31, 1986, the exempt function of a political organization also includes making expenditures for a public office that would be allowable as a deduction under IRC Section 162(a) if incurred by the office holder.

Exempt function does not include:

- Attempts to influence legislative matters.
- Expenditures for nonpartisan activities, including voter registration drives and campaigns.

Political organizations can continue to qualify under IRC Section 527 between elections even though not supporting a particular candidate, if engaged in activities related to and supporting the selection process.

Example: An organization established for a single campaign can continue to qualify as a political organization after the election to wind up its affairs as long as its primary activities are exempt function activities.

Exempt Function Income

A political organization's receipts must meet two requirements to qualify as exempt function income. First, they must be amounts the political organization received as:

- A contribution of money or other property.
- Membership dues, fees, or assessments from a member of the political organization.
- Proceeds from a political fund-raising or entertainment event.
- Proceeds from the sale of political campaign materials that are not received in the ordinary course of any trade or business.
- Proceeds from bingo games. (IRC Section 513(f)(2)).

Second, the organization must set receipts aside in a segregated fund to be considered exempt function income. A segregated fund is a fund a political organization or individual established and maintained, separate from other assets. The fund's purpose is to receive and segregate exempt function income and earnings on that income, for use only for exempt function purposes. IRC Section 527(c)(3), Treas. Reg. 1.527-2(b)(1).

Exempt function income does not include amounts a political organization receives in exchange for:

- A promise to exercise political influence on the payer's behalf.
- Some other quid pro quo. Rev. Rul. 75-103, 1975-1 C.B. 17.

Investment income or income from a trade or business of a political organization is not exempt function income. **Example:** Renting excess office space to an unrelated organization is not exempt function income.

Exempt Function Expenditures

The term "expenditures" is defined in IRC Section 271(b)(3). The definition of expenditures inclusively lists "a payment, distribution, loan, advance, deposit, or gift, or money or anything of value and includes a contractual promise or agreement to make expenditures, whether or not legally enforceable."

Generally, these expenditures include anything that supports an individual's campaign. IRC Section 527(e)(4).

The regulations divide exempt function activities (expenditures) into "directly related expenses" and "indirect expenses" ((Treas. Reg. 1.527-2(c)(1), Treas. Reg. 1.527-2(c)(2).)

Direct expenditures include anything that supports the individual's campaign. Expenditures needed to support the directly related activities or a political organization relate indirectly to its exempt function. These expenditures are those attributed to overhead, record keeping, and fund-raising.

Travel, lodging, food, and similar expenses of a candidate and the candidate's spouse for campaign-related travel are considered to be for an exempt function.

Exempt function expenditures include those for:

- Attending a testimonial dinner to aid a campaign effort.
- Voice and speech lessons to improve a candidate's skills. Treas. Reg. 1.527-2(c)(5).

An individual does not need to be an announced candidate for the office. Whether he or she ever becomes a candidate is, in fact, not crucial. Treas. Reg. 1.527-2(c)(1).

Example: An organization supporting an individual who was "testing the waters" for a possible presidential bid qualified for treatment as an IRC Section 527 organization, even though it wasn't required to file with the FEC. PLR 8243142 (July 28, 1982).

Example: An organization maintained on behalf of a former member of the U.S. House of Representatives for a possible campaign for the U.S. Senate, although the individual didn't run for election during the period at issue and ultimately didn't run for the Senate seat. TAM 9320002 (January 14, 1993).

The activities do not need to relate to a particular candidate's or office holder's own campaign.

Example: Paying an elected legislator's expenses to attend a political party's convention as a delegate by the legislator's campaign committee from a prior election is an exempt function activity because it involves the selection process. [Rev. Rul. 79-12, 1979-1 C.B. 208](#).

Example: Paying expenses for voter research, public opinion polls, and voter canvasses on behalf of a candidate is an exempt function activity, even when the funds expended were contributed to the organization for the candidate's campaign for different office. Rev. Rul. 79-13, 1979-1 C.B. 208.

Example: Expenditures for seminars and conferences intended to generate support for candidates who have political philosophies in harmony with that of an IRC Section 527 organization are also for an exempt function. Treas. Reg. 1.527-2(c)(5)(viii).

Note: The common practice of a candidate or officeholder using funds accumulated in his/her campaign committee to contribute to other candidates for public office is an exempt function activity.

Expenditures for an election night party for political campaign workers are "an inherent part of, and the traditional public culmination of, the selection process" are exempt function expenditures. [Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 1](#).

Cash awards to campaign workers after an election are for an exempt function if the amount given each worker is reasonable, considering the exempt function services the worker rendered and the amount of other compensation, if any, already paid. [Rev. Rul. 87-119](#), 1987-2 C.B. 151, Q&A 2.

An IRC Section 527 organization's expenditures between elections to train staff members for the next election, draft party rules, implement party reform proposals, and sponsor a party convention are for an exempt function. Treas. Reg. 1.527-2(c)(5)(vii).

Under the proper circumstances, paying a salary to a candidate for the his service to the campaign committee may constitute exempt function expenditure.

Example: The candidate received payment for working over 80 hours per week for the campaign, performing services substantially similar to those he performed in his pre-campaign employment. He received a reasonable salary for those services of 37 percent of the amount he earned from his regular employment and 60 percent of the amount he would earn if elected to public office. TAM 9516006 (January 10, 1995)

Caution: When a campaign committee makes payments for the personal benefit of a candidate that the organization doesn't pay or treat as compensation, the amounts paid are not exempt function expenditures, although they are income to the candidate. Treas. Reg. 1.527-5(a)(1).

Payment of a spouse's expense in connection with a political campaign may be considered an exempt function activity if there's a relationship established between the spouse's activity and the exempt function of attempting to influence the selection, nomination, election or appointment of an individual to public office. Treas. Reg. 1.527-2(c)(5)(ii), Example (2).

An activity that is in furtherance of the process of terminating an IRC Section 527 organization's existence is an exempt function activity. Treas. Reg. 1.527-2(c)(3).

Example: For an organization established to further a single campaign, its post-campaign activities of paying campaign debts, winding up the campaign, and putting its records in order are for an exempt function.

Illegal expenditures are not exempt function expenditures even though made in connection with the selection process.

Don't consider the following types of expenditures as exempt function expenditures:

- Expenditures directly related to the appearance of IRC Section 501(c) organizations before legislative bodies in response to a written request to influence the appointment or confirmation of an individual to a public office.
- Expenditures for nonpartisan activities such as voter registration drives and "get out to vote" campaigns.

Political Organization Taxable Income

Political organizations are taxed on their non-exempt function income, nonexempt function expenditures and illegal expenditures. The organization reports this taxable income on [Form 1120-POL](#).

The most common type of political organization taxable income is investment income, including:

- Interest
- Dividends
- Rents
- Royalties
- Net gains from the sale or exchange of assets

To compute the political organization taxable income:

Use the following formula:

$$\begin{array}{r} \text{Non-exempt function income} \\ + \text{ Non-exempt function expenditures} \\ + \text{ Illegal expenditures} \\ - \text{ Deductions allowed by law} \\ - \text{ Specific deduction of \$100} \\ \hline \text{Taxable income} \end{array}$$

Note: Newsletter funds may not take the \$100 specific deduction.

Note: For a newsletter fund to be described in IRC 527(g), a fund must meet three requirements. First, an individual who holds, has been elected to or is a candidate for nomination or election to, any federal, state, or local elective public office must establish and maintain the fund. Second, the individual must establish the fund to exclusively prepare and circulate the individual's newsletter (the "organizational test"). IRC 527(g)(1), Treas. Reg. 1,527-7(a),

Expenses, depreciation, and similar items are deductible only if they satisfy both of the following requirements:

- They must qualify as deductions allowed under Chapter 1.

- They must be “directly connected” with producing political organization taxable income. Treas. Reg. 1.527-4(c)(1).

To be “directly connected” a deduction must:

- Have a proximate and primary relationship to producing taxable income.
- Be incurred in producing that income. Treas. Reg. 1.527-4(c)(2).

If an item is attributable solely to producing taxable income, allow it under IRC Section 527.

IRC Section 527 has three modifications:

- A specific deduction of \$100. IRC Section 527(c)(2)(A).
Note: Newsletter funds may not take the \$100 deduction.
- No IRC Section 172 net operating loss deductions. IRC Section 527(c)(2)(B).
- No IRC Section 241 through IRC Section 249 corporate deductions. IRC Section 527(c)(2)(C).

When the organization uses facility or personnel for both exempt function and taxable purposes, the organization allocates deductions for that use between exempt function and taxable income. This allocation must be “on a reasonable and consistent basis.” Treas. Reg. 1.527-4(c)(3).

Time spent on exempt function and taxable activities is a permitted basis for allocating salaries of personnel.

Indirect expenses are not deductible. Legislative history states, “Indirect expenses (such as general administrative expenses) are not to be allowed as deductions, since it is expected that these amounts will be relatively small and eliminating these deductions will greatly simplify tax calculations.” Rep. No. 93-1374, 93d Cong., 2d Sess. 29 (1974), 1975-1 C.B. 517, 533d.

Except for principal campaign committees, the rate of tax on taxable income of political organizations is the highest current rate specified in IRC Section 11(b).

A political organization that is a principal campaign committee of a candidate for U.S. Congress computes its tax in the same way as corporations per IRC Section 11(b). Find the formula on [Form 1120-POL](#), page 6.

Note: For IRC Section 527, a “principal campaign committee” is the political campaign committee a candidate for Congress designates as the candidate’s principal campaign committee for FECA section 302(e) (2 U.S.C. 432(e)). IRC Section 527 (h)(2)(A). Therefore, principal campaign committees of candidates for public offices other than those in the United States Congress can’t qualify for treatment as a “principal campaign committee” under IRC Section 527.

IRC Section 527(f)(3) Separate Segregated Funds

To avoid the application of tax on political expenditures an IRC Section 501(c) organization makes, the organization may create an IRC Section 527(f)(3) fund. This separate political organization's purpose is to make political expenditures.

The earnings and expenditures the segregated fund makes won't attribute to the IRC Section 501(c) organization.

For the segregated fund to qualify as a political organization, the fund's purpose must be to receive and segregate exempt function income, and earnings on this income, for use only for an exempt function or for an activity necessary to fulfill an exempt function.

If it spends more than an insubstantial amount of non-exempt function activities, do not treat the fund as a segregated fund for that year.

A segregated fund doesn't have to meet the operational test. It can be simply be a checking account, as long as it is clearly identified and established for the purpose intended. These funds are required to have their own EIN, separate from that of the parent IRC Section 501(c) organization.

An IRC Section 501(c) organization may solicit contributions or membership dues for an IRC Section 527(f) fund or organization. Don't treat the transfers of these funds to the separate organization as expenditures for an exempt purpose if:

- The IRC Section 501(c) organization makes the transfer promptly after receipt and directly to the IRC Section 527(f)(3) fund.
- A transfer is prompt if the procedure followed satisfies applicable federal and state campaign law and regulations.
- The IRC Section 501(c) organization maintains adequate records to show the amount transferred were political contributions and dues and not investment income.
- The IRC Section 501(c) organization doesn't use political contributions and dues to earn investment income.

An IRC Section 501(c) organization's exempt function expenditures include all expenditures that relate directly to the selection process, including indirect expenditures made through another organization.

However, depending on the facts and circumstances, an IRC Section 501(c) organization that takes reasonable steps when it transfers funds to an individual or organization to ensure that the transferee doesn't use the funds for an exempt function won't be absolutely liable under IRC Section 527(f), even if the transferee eventually uses the funds for political activities.

If an IRC Section 527(f)(3) fund doesn't meet the requirements for a political organization under IRC Section 527(e)(1), it is subject to tax, as a taxable organization, under general tax principles.

If a fund loses its status as an IRC Section 527(f)(3) fund under applicable federal or state law, don't treat it as a separate organization for federal tax purposes. IRC Section

527(f)(3). In that event, expenditures made from that fund subject the IRC Section 501(c) organization that maintains it to tax. IRC Section 527(f)(1).

Pre-Audit Procedures

Determine whether the organization created a formal charter or is a corporation, trust or association. Request the organizing document in the initial Information Document Request (IDR).

Obtain the EIN of the political organization. As of 2002, all political organizations are required to have identification numbers.

Verify that the EIN is unique to the financial account/political organization.

Before the initial interview determine whether the organization filed any reports at the state or federal level. For state reports, see [State Filing Requirements for Political Organizations](#) for a listing of websites for each state's political activity public records. For federal reports, check either www.fec.gov or the political organization filer database at <http://forms.irs.gov/app/pod/basicSearch/search?execution=e3s1>. Forms available on the IRS website include [Forms 990](#), Form 8871, and [Form 8872](#). Download [Form 1120-POL](#) from On-line SEIN.

An organization's reports filed should give a record of:

- Contributions received, listing the amounts, names, and addresses of contributory.
- Expenditures made, identifying the payees, address and amounts.

Using these reports, revise your initial interview accordingly. At a minimum, include the following questions:

- What are the organization's activities?
- What is the organization's primary activity?
- Who determines where to spend the money?
- Who determines how to spend the money?
- Who is involved with the organization?

Use the reports to identify large, unusual and questionable items. See [IRM 4.75.10.6.6, Review of the Return](#), for further procedures.

Follow the procedures in IRM 4.75.10.7 Initial Form 4564, Information Document Request (IDR) for preparing initial Form 4564.

Exempt Function Income

Check <http://forms.irs.gov/app/pod/basicSearch/search?execution=e3s1> for any [Form 8872](#) filed by the organization.

- If present, review the list of contributions received.
- Compile a spreadsheet of dates, contributors, and contributions received.
- Determine the total amount of contributions reported for the year.

- Identify any other sources of income reported on Form 8872.

Check the state website, listed at [State Filing Requirements for Political Organizations](#) for any information returns filed with the state.

- If present, review the list of contributions received
- Compile a spreadsheet of dates, contributors, and contributions received.
- Determine the total amount of contributions reported for the year.
- Compare the expenditures reported with the Forms 8872, if filed, to identify any discrepancies.
- Identify any other sources of income reported to the state.

If there are no reports filed with the state, check the FEC filings at www.fec.gov.

- If present, review the list of contributions received.
- Compile a spreadsheet of dates, contributors and contributions received.
- Determine the total amount of contributions reported for the year.
- Compare the expenditures reported with the Forms 8872, if filed, to identify any discrepancies.
- Identify any other sources of income reported to the FEC.

Obtain a copy of any Forms 1120-POL filed by the organization, available from [On-line SEIN](#).

- Review to see whether the organization erroneously reported any nontaxable income on the return.
- If you identify additional non-exempt income in reviewing the Forms 8872, state or FEC reports, compare to the amount reported on [Form 1120-POL](#).
- If amounts reported don't match, make a note to discuss with the organization. This discrepancy may lead to an audit report (RAR and manually complete Form 4549).

Check On-Line SEIN to see if the organization filed any Forms 990 or Form 990-EZ. The organization should report all income, taxable or otherwise. A political organization that files [Form 8872](#) is not required to disclose on Form 990 Schedule B the name and addresses of any contributor that it didn't disclose on Form 8872. It must disclose the amount of the contribution and that it paid the penalty specified under IRC Section 527(j)(1) for that contribution.

- Review the Form 990, core schedule, Part VIII for the sources of income (if filed). Review page 1 of the [Form 990-EZ](#) if filed in lieu of the [Form 990](#).
- Match the investment income reported, if any, against the amounts reported on Form 1120-POL.
- Compare the amounts reported on Form 990 as gross receipts against the amounts reported on Forms 8872, state or FEC reports.
- Identify any discrepancies in amounts reported.
- Review Part IV of the Form 990 core schedule for answers to Lines 3, 17, 18, 19, 29, and 34.
- Review Schedules C, G, and M, if attached.

Exempt Function Expenditures

Check <http://forms.irs.gov/app/pod/basicSearch/search?execution=e3s1> for any Forms 8872 the organization filed.

- Review the list of expenditures made, if present. These can include contributions to other political organizations.
- Compile spreadsheet of dates, payees, and expenditures made.
- Determine the total amount of expenditures reported for the year.
- Make notes of expenditures that don't clearly appear to be exempt in nature. Include these as interview questions and/or requests for information on these expenditures.

Check the state website, list at [State Filing Requirements for Political Organizations](#) for any information returns filed with the state.

- If present, review the list of expenditures made.
- Compile a spreadsheet of dates, payees, and expenditures made.
- Determine the total amount of expenditures reported for the year.
- Compare the expenditures reported with the Forms 8872, if filed, to identify any discrepancies.
- Make notes of expenditures that don't clearly appear to be exempt in nature. Include these as interview questions and/or requests for information on these expenditures.

If there are no reports filed with the state, check the FEC filings at www.fec.gov.

- If present, review the list of expenditures made.
- Compile a spreadsheet of dates, payees, and expenditures made.
- Determine the total amount of expenditures reported for the year.
- Compare the expenditures reported with the Forms 8872, if filed, to identify any discrepancies.
- Make notes of expenditures that don't clearly appear to be exempt in nature. Include these as interview questions and/or requests for information on these expenditures.

Obtain a copy of any Forms 1120-POL filed by the organization, available from On-line SEIN.

- The political organization may only deduct those expenses directly related to earning taxable income.

Example: The organization may not deduct the salary of its campaign director. However, if political organization hires a broker to manage its stock portfolio, it can deduct that expense from taxable dividend and capital gain income derived.

- Review Line 7 of the Form 1120-POL for any reported non-exempt function expenditures.

- Compare the expenses, if any, reported on the Form 1120-POL to those listed on Forms 8872 state or FEC reports, to identify any discrepancies.
- Identify any expenses reported on Lines 9 through 15, and discuss these with organization's officer. Determine whether there are any erroneously deducted exempt function expenditures.
- Prepare an audit report (RAR and manually completed Form 4549) if there are erroneously deducted exempt function expenditures.

Check On-line SEIN to see if the organization filed any [Forms 990](#) or [Form 990-EZ](#). The organization should report all expenses, taxable or otherwise.

- Review the Form 990, core schedule, Part IX for the expenses reported (if filed). Review page 1 of the Form 990-EZ if filed in lieu of the Form 990.
- Match the investment expenses reported, if any, against the amounts reported on Form 1120-POL.
- Compare the amounts reported on Form 990 as expenditures against the amounts reported on Form 8872, state or FEC reports.
- Identify any discrepancies in amounts reported.
- Review Part IV of the Form 990 core schedule for answers to Lines 3, 17, 18, 19, 29, and 34.
- Review Schedules C, G, and M, if attached.

IRC Section 527(f)(3) Separate Segregated Funds

When examining an IRC Section 501(c) organization (other than IRC Section 501(c)(3)), determine whether the organization has any political activities. These can include:

- Radio/television/newspaper attack/"information" advertisements
- Partisan voter guide
- Guest speakers at events
- Rallies
- Dinner Fund-raisers
- Debates
- Newspaper editorials
- Endorsements

Note: The organization may mention these activities during the initial interview, however, they'll more likely appear in web searches or amongst the organization's materials.

If there are political activities, determine whether the organization has properly established an IRC Section 527(f)(3) fund, complete with requisite EIN:

- If so, obtain permission from management to open the tax year on RCCMS.
- Consider opening subsequent and prior years of the segregated fund, contingent upon statute considerations.
- If the organization filed [Forms 1120-POL](#) for the fund, open the module on RCCMS, and issue a Letter 3606 to open the audit.

- If the organization didn't file Forms 1120-POL for the fund, open the module on RCCMS, with push code 036, alpha code EE, and issue a Letter 3606 to open the audit.

Field/Office Correspondence Audit Procedures

Interview the officers and/or managers who run the political organization.

If the organization is formally organized, review the organizing document for the purposes of the organization. If not formally organized:

- Review the Form 8871 purpose statement, if filed.
- Identify the person(s) who created the organization.
- Interview them.
- Determine if they have any records concerning the organization's formation.
- Review any documentation provided for the intentions of the creator(s).
- Apply the facts and circumstances test.

For organizations not formally chartered, determine whether there is a financial account into which the organization deposited political contributions and made political expenditures.

If available, review minutes or other records of deliberations of the activities of the organization.

Note: Be alert for any unusual comments about activities, which might raise questions as to the organization's primary activities.

Review copies of materials the organization generated. These can vary from campaign signs and flyers to recordings of radio and television advertisements, as well as websites the organization developed and operated.

Review the organization's books.

- For accounts at financial institutions, review the bank statements for deposit, interest income, expenditure, withdrawal, and transfer amounts.
- If interest accrued, compare the total to the amount reported on Form 1120-POL, [Form 990](#), or [Form 990-EZ](#).
- Match the deposits to the amounts reported on the [Form 8872](#), state or FEC reports.
- For withdrawals and transfers, ask the organization's officer(s) about the purpose and end use of the funds withdrawn/transferred. Obtain documentation supporting their statements, if available.
- Match the expenditures to the amounts reported on the Forms 8872, state or FEC reports.
- Identify Discrepancies between Form 8872 and the books. They can result in penalties of 35 percent of the amount incorrectly reported. IRC Section 527(j)(1), (Form 8278, page 2). **Note:** See earlier sections for discussion of the penalty.

- If you find interest and the organization didn't file [Form 1120-POL](#), determine whether the amount of non-exempt function income exceeded the \$100 specific deduction.
- If you identify non-exempt expenditures, withdrawals, or transfers not reported on Form 1120-POL, prepare an audit report in case the taxable income is in excess of the \$100 specific deduction.
- Before you assess tax, interview the officers to collect any additional facts to add to the fact pattern and to discuss the issue before you generate any reports.

IRC Section 527(f)(3) Separate Segregated Funds

Review the organization's own records to determine if the organization directly made any political expenditures instead of via fund. These expenditures may include:

- Checks to candidates
- Checks to committees
- Advertising & publicity
- Honorarium
- Travel expenses
- Polls, surveys, white papers
- Fund raisers
- Newsletters

Caution: Review *Big Mama Rag, Inc. v. U.S.*, 494 F. Supp. 473, D.C.D.C., 1979 (Reversed and remanded 631 F. 2d 1030, C.A.D.D., 1980) before you make any determinations that a newsletter expense is political in nature and not educational.

If the organization properly established IRC Section 527(f)(3) fund, determine whether all of the political expenditures made via the fund are for exempt purposes. For those expenditures you determine to be for non-exempt purposes or illegal expenditures, verify whether the amounts were properly reported on Form 1120-POL.

Determine whether the IRC Section 527(f)(3) fund had taxable income of its own.

- Verify the amounts against any Forms 1120-POL filed.
- If the organization didn't file Form 1120-POL and had taxable income, verify that the taxable amount meets the Form 1120-POL filing requirement threshold (\$100 specific deduction).

Determine whether transfers to the fund from the IRC Section 501(c) organization met the above requirements for IRC Section 527(f)(3) for Separate Segregated Funds.

Note: GCM 39837 held that in facts particular to the case, transfers from interest bearing checking accounts of the IRC Section 501(c)(5) and 501(c)(6) organizations to IRC Section 527(f)(3) funds were made "promptly and directly" per Treas. Reg. 1.527-6(e). In this case, dues were received daily, deposited into a general interest bearing checking account, and transferred twice a month

to its IRC Section 527(f)(3) fund within the federal and state election guidelines. Internal accounting records, allocated the amounts received between dues and PAC funds, indicating retention of the interest income in the union's coffers.

Case Closing Procedures

When the EIN is actually an SSN or an EIN of a business entity (corporation, partnership, sole proprietorship, or an IRC Section 501(c) organization), the political organization failed to establish a separate entity. Treat the income reduced by expenses as taxable to the person/entity who owns the account.

By filing an online [Form SS-4](#) at www.irs.gov, the organization can establish future exemption as a political organization for years after they filed the Forms SS-4.

Note: We find the issue of organizations not obtaining an EIN primarily in audits of related entities, such as an SB/SE audit of an individual or business, or an EO audit of an IRC Section 501(c) organization.

Complete the reviews of income and expenses outlined in earlier guidelines on exempt function income and expenditures.

Using the spreadsheets generated identify all amounts of taxable income, illegal expenditures, and non-exempt function expenditures.

Verify whether the organization reported these amounts on [Form 1120-POL](#).

If the Form 1120-POL matches your calculations, close the Form 1120-POL as a no change (unless you determined penalties apply to [Forms 8872](#)).

If the organization didn't file Form 1120-POL:

- Create a module on RCCMS for the delinquent tax period.
- Update to status 12, using push code 036, and alpha code EE.
- Create an audit report (RAR), documenting the records reviewed, the law applicable to the taxable income, and the tax computed.
- Prepare a Form 4549 manually (can't be generated by RGS) to accompany the report.
- Follow the procedures in [IRM 4.75.15](#), Closing Letters and Reports of Examination, for initial reports, formal reports and Fast Track Settlements.

If the organization filed Form 1120-POL and the amounts don't match:

- Create an audit report (RAR), documenting the records reviewed, the law applicable to the taxable income, and the tax computed.
- Prepare a Form 4549 manually (can't be generated by RGS) to accompany the report.
- Follow the procedures in [IRM 4.75.15](#) for initial reports, formal reports and Fast Track Settlements.

If you're proposing penalties for missing Forms 8872, or incorrect information on Form 8872, create a civil penalty file to be associated with the Form 1120-POL file. See earlier guidance for discussion of the penalty.

- Prepare Form 8278 to record the amount of penalty proposed. See Form 8278, page 5 for instructions to complete Form 8278.
- Prepare a Penalty Case File folder, including Form 5772, 886-A, 8278, 3198-A and 3244-A (if applicable).
- Obtain managerial approval to assess the penalty.
- Associate the Penalty Case File folder with the folder of the entity's primary return audited. **Note:** For further information on penalty case files, see [IRM 4.75.22.11](#), Information Return Penalty Case File.

IRC Section 527(f)(3) Separate Segregated Funds

For the following situations, use the IRC Section 501(c) organization's EIN, and apply the highest rate under IRC Section 11(b):

- Prepare an audit report if an IRC Section 501(c) organization made political expenditures directly from itself and not through an IRC Section 527(f)(3) fund, and if the taxable amount meets the Form 1120-POL filing requirement threshold (\$100 specific deduction).
- Prepare an audit report if an IRC Section 501(c) organization did not establish a segregated fund, made political expenditures and if:
 - the organization either didn't file Form 1120-POL or
 - filed one and the amounts don't match.However, if amounts are less than the filing requirement (\$100 specific deduction), close as a no-change with advisory.
- If the segregated fund had taxable income of its own:
 - If the organization did not file Form 1120-POL, and the taxable income exceeds the \$100 specific deduction, prepare an audit report.
 - If the organization filed Form 1120-POL and the amounts don't match, prepare an audit report.
 - If the organization didn't file Form 1120-POL and the taxable income (with non-exempt function expenditures) doesn't exceed \$100, close as a no change case with advisory.
- If transfers from an IRC Section 501(c) organization to an IRC Section 527(f) fund don't meet the requirements outlined in earlier guidelines on IRC Section 527(f)(3) Separate Segregated Funds #6 or GCM 39837, prepare an audit report.