

Political Action Committees and the IRS

By Angela Beasley Phyfer

Political Action Committees (PACs) are an important part of politics in our country. PACs are a means for corporations, *etc.* to make donations to candidates for office—something that the corporation cannot do directly. Although most PACs are thought of as either conservative or liberal—Republican or Democrat—many PACs are nonpartisan and focus on issues rather than party affiliation.

“Connected” PACs typically raise money from people employed by a corporation, political party or labor group, such as the Teamsters Union. “Unconnected” PACs raise money by targeting selected groups within our society to elect candidates from any political party that supports their agendas. An example of an unconnected PAC would be the National Rifle Association. There is also a third type of PAC, called a “leadership” PAC. Those are formed by politicians to help fund the campaigns of other politicians, often to prove their party loyalty or to further their objective of being elected to a higher office. We hear quite a bit about how PACs influence the electoral process, especially in election years. Our purpose here is not to debate the pros and cons of how these work but to make you aware of any tax-related implications of forming a PAC.

In addition to the numerous federal and state election commission filings that are required when setting up a PAC, there are filings required with the IRS. The same is true of annual filings. And, the penalty for overlooking those requirements can be quite substantial.

Formation of the PAC

PACs are classified as Section 527 organizations by the IRS.

Contributions to the PAC are not tax-exempt; however, the PAC itself may be treated as a tax-exempt organization by filing IRS Form 8871, *Political Organization Notice of Section 527 Status*. This form must be electronically filed within 24 hours of the date on which the organization was established. Additionally, Form 8871 must be filed within 30 days after the occurrence of a material change or within 30 days of termination of the PAC. A first-time user electronically submitting an initial Form 8871 will also need to print, sign and mail a Form 8453-X, *Political Organization Declaration for Electronic Filing of Notice of Section 527 Status*, to the IRS. The IRS will then mail the PAC a username and password that must be used to file an amended or final Form 8871 or to electronically file Form 8872, *Political Organization Report of Contributions and Expenditures*.

A PAC that is required to file Form 8871, but fails to do so on a timely basis, will not be treated as a tax-exempt organization for any period of time before the form is filed. In addition, the taxable income for the PAC for that period will be computed by including its exempt function income less any expenses directly connected with the production of that income. This taxable income is then taxed at the highest corporate rate.

A PAC that meets one of the following exceptions is not required to file Form 8871:

- A PAC that reasonably expects its annual gross receipts to always be less than \$25,000
- A political committee required to report under the Federal Election Campaign Act of 1971
- A political committee of a state or local candidate

- A state or local committee of a political party
- A tax-exempt organization described in Internal Revenue Code Section (“Code Sec.”) 501(c) that is treated as having political organization taxable income under Code Sec. 527(f)(1).

Annual Filing Requirements

Here is an overview of IRS forms that PACs need to be aware of:

Form 8872. Typically, PACs must use Form 8872, *Political Organization Report of Contributions and Expenditures*, to file periodic reports with the IRS disclosing their contributions and expenditures. Every 527 political organization that accepts a contribution or makes an expenditure for an exempt function during the calendar year must file Form 8872, *except* a political organization that is not required to file Form 8871, a political organization that is subject to tax on its income because it did not file or amend a Form 8871 or a qualified state or local political organization. A qualified state or local political organization is a political organization that meets the following requirements:

- The organization’s exempt functions are solely for the purpose of influencing or attempting to influence the selection, nomination, election or appointment of any individual to any state or local political office or office in a state or local political organization.
- The organization is subject to state law that requires it to report information that is similar to that required on Form 8872.
- The organization files the required reports with the state.

- The state makes such reports public and the organization makes them open to public inspection in the same manner that organizations must make Form 8872 available for public inspection.

Failure to comply with the reporting requirements of Form 8871 and Form 8872 can cause the PAC's income, including income that would otherwise be treated as exempt function income, to be subject to tax. Rev. Proc. 2007-27 [2007-1 CB 887] sets forth procedures for waiver of amounts due from a PAC that fails to comply with these reporting requirements due to reasonable cause and not willful neglect. It seems that the key consideration in establishing reasonable cause is the extent of the PAC's efforts to obtain and report the required information.

Form 990. A tax-exempt PAC will typically be required to file Form 990, *Return of Organization Exempt from Income Tax*, or Form 990-EZ, *Short Form Return of Organization Exempt from Tax*, unless it meets an exception for filing the form.

Form 1120-POL. PACs must file Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*, for any year in which they have political organization taxable income in excess of the \$100 specific deduction allowed under Code Sec. 527. Political organization taxable income is the excess of gross income for the tax year (excluding exempt function income) less deductions directly connected with earning the gross income. In figuring taxable income, a \$100 specific deduction is allowed, but the net operating loss deduction, the dividends-received deduction

and the other special deductions for corporations are not allowed.

Conclusion

PACs are very active in our political process and are typically organized to elect political candidates or to advance the outcome of a political interest or legislation. Most organizers are aware of the numerous federal and state election commission filings that are required by the PACs. However, the organizer may not be as aware of the IRS filing requirements. And, as mentioned earlier, the penalty for overlooking these requirements can be quite substantial.

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