



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DEPUTY AREA COUNSEL
CC:TEGE:NEMA

FROM: Assistant Chief, EO Branch 1
CC:TEGE:EOEG

SUBJECT:

This Field Service Advice responds to your request for assistance regarding your ongoing audit of this organization for the years _____ Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

DISCLOSURE STATEMENT

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official tax administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND

Organization =

ISSUES

Is the Organization an exempt political organization, within the meaning of § 527 of the Internal Revenue Code?

CONCLUSIONS

Yes. Section 527 is not an elective provision. An organization is a political organization, as defined in § 527(e)(1) (a "section 527 organization"), if it is a party, committee, association, fund, or other organization organized and operated primarily for the purpose of accepting contributions or making expenditures for the functions described in § 527(e)(2)—generally, influencing the selection, nomination, election, or appointment of candidates for public or party office.

With respect to the "organizational test," we conclude that the test, as it applies to section 527 organizations, is less strict than the organizational test for public charities under § 501(c)(3) of the Code and § 1.501(c)(3)-1(b) of the Income Tax Regulations. In particular, when, as in the present case, the purposes of the organization as set out in its articles of organization are broad, and ambiguous with respect to whether the primary purpose of the organization is to achieve its goals through the means described in § 527(e)(2), it is permissible to consider other evidence and evaluate all the facts and circumstances—including oral and other written statements, as well as the actual operation of the organization—in order to determine the organization's primary purpose. Applying this approach, we conclude that the Organization was organized as well as operated as a "political organization," within the meaning of § 527.

FACTS

For purposes of this memorandum, we have made the following factual conclusions:

1. The Organization was engaged primarily in activities that meet the definition of political intervention under IRC Section 501(c)(4). Primarily, the Organization directly or indirectly participated or intervened in political campaigns

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on behalf of or in opposition to candidates for public office, during the years at issue.

2. The same activities which gave rise to the denial of exempt status under § 501(c)(4), also indicate that the Organization was operated primarily for the purpose and functions described in § 527(e).

LAW AND ANALYSIS

Section 527(a) provides that a political organization is subject to income taxation only to the extent provided in § 527.¹ Section 527(e)(1) defines a "political organization" as a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.

Under § 527(e)(2), the term "exempt function" means 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.²

Section 527 is not an elective provision. Neither the statute nor the regulations provide for an organization either to elect into or elect out of § 527. There is no mandatory application process, although an organization may obtain a private letter ruling as to its status if it chooses to do so. Whether an organization is governed by § 527 is determined by whether it is in fact organized and operated in the manner described in § 527(e).

1. Operational Test

Considering first the "operational test," the Service has determined that the Organization is not exempt under § 501(c)(4). In order for an organization to be exempt under § 501(c)(4), it must be primarily engaged in promoting in some way the common good and general welfare of the people of the community.

¹ Generally, a section 527 organization is exempt from tax on contributions, dues, and fundraising proceeds used for its exempt (political) functions; however, it is taxed on net investment income and income from activities in the ordinary course of a trade or business, if any.

² The term "exempt function" also includes the making of expenditures relating to such an office which, if incurred by the individual, would be allowable as a deduction under § 162(a).

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§ 1.501(c)(4)-1(a)(2)(i). For this purpose, the promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. § 1.501(c)(4)-1(a)(2)(ii).

A determination that an organization is not exempt under § 501(c)(4) does not necessarily mean that the organization is a political organization within the meaning of § 527. However, in this case, the Service's denial of exemption was based on the following determination:

The emphasis throughout the materials submitted by the [Organization] is on electing people to local, state and national office in order to impact legislation and policy as insiders. The overwhelming majority of the evidence in the administrative record, and thus the facts and circumstances in this case, denotes an organization that is intent upon intervening in political campaigns at all levels of government. The organizational structure of the [Organization] allows it to implement its policies as more and more are elected to office. While lobbying is usually mentioned in the speeches and literature, and we recognize that lobbying activities are being pursued, those activities are not the primary activity of the organization. An analysis of all of the facts and circumstances contained in the administrative file, including the utilization of the

, leads us to the conclusion that the primary activities of the [Organization] constitute political intervention.

PDL, pp. 32-33.

Although the proposed denial letter focuses on the disqualification of the Organization from § 501(c)(4) status, the facts described and summarized in the letter also indicate that the Organization was operated primarily for the purpose and functions described in § 527(e).

2. Organizational Test

The only remaining question, therefore, is whether the Organization was organized primarily for the purpose described in § 527(e). In order to determine the relevant standard, it is useful to contrast the organizational requirements under § 527 with those that apply under § 501(c)(3).

Section 501(c)(3), in a manner similar to § 527 and other exemption provisions in the Code, provides that to be exempt, the organization must be "organized and operated" for the specified exempt purpose or purposes. This has led to the establishment, in case law as well as under the regulations, of separate "organizational" and "operational" tests, both of which must be met in order for the organization to be exempt. See § 1.501(c)(3)-1(a), (b), and (c).

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In the context of § 501(c)(3), the organizational requirement for public charities and other organizations described in that provision has been interpreted and administered fairly strictly. In part, this follows from the statutory requirement that a section 501(c)(3) organization must be organized (and operated) "exclusively" for the stated exempt purposes.³

Thus, for example, the regulations setting out the organizational test for exemption under § 501(c)(3) are relatively long and detailed, with an emphasis on satisfying certain formalities. See § 1.501(c)(3)-1(b). To meet the test, the organization's articles must be explicit as to its purposes, and must not empower it to carry on substantial activities which are not in furtherance of its stated exempt purposes. See § 1.501(c)(3)-1(b)(1)(i), (iii), and (v). The statement of purposes must not be overly broad or general. See Rev. Rul. 60-193, 1960-1 C.B. 195.⁴ Finally, § 1.501(c)(3)-1(b)(iv) expressly provides that neither actual operations, nor statements or other evidence concerning the intent of the members, will cure a defect in the articles:

In no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such organization are created are broader than the purposes specified in section 501(c)(3). The fact that the actual operations of such an organization have been exclusively in furtherance of one or more exempt purposes shall not be sufficient to permit the organization to meet the organizational test. Similarly, such an organization will not meet the organizational test as a result of statements or other evidence that the members thereof intend to operate only in furtherance of one or more exempt purposes.

Despite this emphasis on strict application of formal requirements, even in the § 501(c)(3) context some courts, in appropriate cases, have shown a certain latitude in permitting evidence outside the "four corners" of an organization's articles. See, e.g., Colorado State Chiropractic Society v. Commissioner, 93 T.C. 487, 495 (1989), quoting Peoples Translation Service v. Commissioner, 72 T.C. 42, 48 (1979), acq., 1981-2 C.B. 2:

It is well settled that:

³ This is true even though the term "exclusively" has not been given a literal interpretation, and certain insubstantial nonexempt purposes are permissible.

⁴ Rev. Rul. 60-193 has been modified, but not on this point. See Rev. Rul. 66-258, 1966-2 C.B. 213, modified and superseded, Rev. Rul. 76-456, 1976-2 C.B. 151.

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The issue of "organized" ... is primarily a question of fact not to be determined merely by an examination of the certificate of incorporation but by the actual objects motivating the organization and the subsequent conduct of the organization.

Taxation with Representation v. United States, 585 F.2d 1219, 1222 (4th Cir. 1978); Samuel Friedland Foundation v. United States, 144 F. Supp. 74, 85 (D. N.J. 1956).⁵

Turning to § 527, it is clear that while § 527, like § 501(c)(3), contains an organizational requirement—and the regulations mirror the basic two-test structure of the § 501(c)(3) regulations, see § 1.527-2(a)—a less formal, more flexible approach is intended.

In contrast to the more lengthy § 501(c)(3) regulations, for example, the organizational test is discussed in only one paragraph of the § 527 regulations, § 1.527-2(a)(2), which provides, in full:

A political organization meets the organizational test if its articles of organization provide that the primary purpose of the organization is to carry on one or more exempt functions. A political organization is not required to be formally chartered or established as a corporation, trust, or association. If an organization has no formal articles of organization, consideration is given to statements of the members of the organization at the time the organization is formed that they intend to operate the organization primarily to carry on one or more exempt functions.

Note, in particular, the treatment of members' statements, in contrast to the treatment of such statements in § 1.501(c)(3)-1(b)(iv), quoted above.

The less formal approach of the § 527 regulations is consistent with the structure of the statute, which only requires that the organization be organized and operated "primarily," rather than "exclusively," for an exempt purpose, and which applies to a broad range of entities.⁶

⁵ While the Service may not have adopted the broad approach reflected in the cited statements, the statements indicate the possibility that, even in the § 501(c)(3) context, extrinsic evidence may be relevant when an organization's articles are ambiguous.

⁶ The Service has ruled, for example, that a candidate's separate bank account can qualify as a "political organization" under § 527. Rev. Rul. 79-11, 1979-1 C.B. 207. This less formal approach reflects legislative intent. See, e.g., S. Rep. No. 1357, 93rd Cong., 2d Sess. 26; 1975-1 C.B. 517, 532 ("A qualified organization may be formally established under articles of incorporation, a charter, etc.; however, it is also anticipated that such an organization may be established informally."). See also M. Cerny, The Tax Treatment of Political Organizations, 71 Tax Notes 651, 653 (Tax Analysts, 1996) ("In effect, section 527 organizations are defined primarily by their activities, not by their structures.").

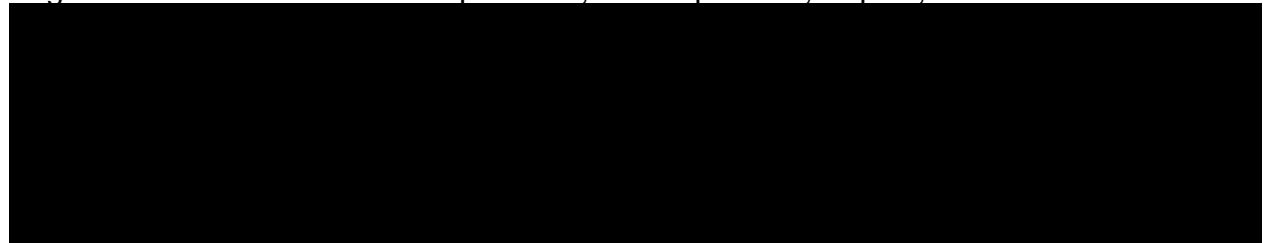
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Given this evidence as to the structure and purpose of § 527 and the corresponding regulations, we believe that an approach similar to that taken, in the § 501(c)(3) context, by courts in cases like Colorado State Chiropractic—regardless of whether such an approach is appropriate under § 501(c)(3)—is appropriate in applying the organizational test under § 527.

In particular, when the purposes as stated in an organization's articles of incorporation are broad, and ambiguous with respect to the means whereby the organization intends to achieve those purposes, we do not believe that this fact necessarily causes the organization to “fail” the organizational test in § 1.527-2(a)(2). Rather, all the facts and circumstances—including any relevant evidence, appropriately weighted according to its probative value—may be taken into account in determining whether the organization was in fact established for the primary purpose of carrying out the exempt political functions in § 527(e). As in the case of an organization that lacks formal articles, consideration may be given to statements of the members of the organization at the time the organization is formed. See § 1.527-2(a)(2). In addition, however, in order to resolve an ambiguity we believe it is also acceptable to look beyond such contemporaneous statements and take into account other relevant evidence, including documents and oral statements reflecting the “actual objects motivating the organization,” whether contemporaneous or not, as well as the “subsequent conduct of the organization.” Cf. Taxation with Representation, quoted above.⁷

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Applying the approach outlined above to the present case, we first look to the Organization's articles of incorporation, which provide, in part, as follows:



⁷ We recognize that, by its terms, § 1.527-2(a)(2) only mentions the use of evidence such as member statements when, unlike the present case, there are no formal articles of incorporation or organization. However, in our view this does not preclude consideration of such evidence in order to resolve ambiguity in the articles—a situation not explicitly covered by the regulation. Since it is unnecessary to the resolution of the present case, we express no opinion concerning a situation in which the purposes of the organization, as stated in its articles, are contrary to its purposes as reflected in other statements or in its actual operations.

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[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] the Organization was organized as well as operated primarily for the purpose and functions described in § 527(e) and is, therefore, an exempt "political organization" subject to § 527.

Please call if you have any further questions.

NANCY ORTMAYER KUHN
Assistant Chief, EO Branch 1
CC:TEGE:EOEG