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VIA PRIORITY MAIL

**Complaint: American Federation of State County and Municipal Employees (AFSCME)
(EIN# 53-0237789).**

Landmark Legal Foundation (“Landmark”) requests that the Internal Revenue Service (“IRS” or “the Service”) investigate the conduct and tax filings of the American Federation of State County and Municipal Employees (“AFSCME”).

Summary

Internal Revenue Code (“IRC” or “Code”) § 501(c)(5) tax exempt labor organizations, including AFSCME, are required to disclose fully to the public, union members, non-union fee payers and the IRS the extent of the organization’s political activities and expenditures. Moreover, certain political activities and expenditures made in furtherance of such activities are taxable to those organizations unless they are segregated from general operating revenue and conducted through a separate segregated fund. IRC § 527(f)(1) (2010).

In contravention of statutory and regulatory requirements, AFSCME appears to have failed to pay taxes on expenditures made for activities directly related to the selection, nomination and/or election of candidates for local, state, and/or federal office. Despite acknowledging such expenditures on its 2008 Form 990 tax return, AFSCME appears to have ignored its obligation to file the additional IRS Form 1120-POL return, which is utilized to pay accrued taxes for political activity. The Service should initiate an immediate investigation of this failure to declare and pay required taxes.

Specifically, on its 2008 tax return, AFSCME acknowledges engaging in “direct or indirect political campaign activities on behalf of or in opposition to candidates for public office.” (Exhibit 1, AFSCME 2008 990, Line #4.) On its accompanying “Schedule C” disclosure form, AFSCME reports \$18,343,215 in “political expenditures.” AFSCME provides the following explanation:

The organization supports state and local political parties and various candidates for nonfederal public office. (Exhibit 2, Part I-A, Line 1, AFSCME 2008 990 “Schedule C.”)

Additionally, AFSCME reports \$13,341,443 in expenditures made “for section 527 exempt function activities.” (Exhibit 2, Part I-C, Line 1, AFSCME 2008 990 “Schedule C.”) Such expenditures should have been reported on – and appropriate income taxes paid with – a Form 1120-POL. See 26 CFR § 1.6012-6(b) (2010).

As explained further below, the amount expended for section 527 exempt function activities is subject to taxation. However, it appears AFSCME failed to pay taxes on these expenditures.

It is incumbent upon the Service to immediately investigate the extent to which AFSCME has attempted to avoid its tax liability. Moreover, the IRS should investigate whether AFSCME has violated IRC provisions pertaining to fraud, tax evasion and/or corrupt interference with administration of Internal Revenue laws. Where appropriate, the Service should assess penalties, and issue sanctions, including revocation of AFSCME’s tax-exempt status.

Relevant Law

Unions – or “labor organizations” – are generally exempt from paying income taxes to the federal government. IRC § 501(c)(5) (2010). This exception does not apply, however, to the revenues a labor organization spends on certain types of political activity. Political activity, or “exempt function” activity is defined as:

...[T]he 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. IRC § 527(e)(2) (2010).

If an organization expends any amount of general treasury revenue on exempt function activity, these amounts shall be included in the organization's gross income and shall be subject to taxation. IRC § 527(f)(1) (2010). When a labor organization engages in these types of activities it must report such activity as an itemized expenditure on Schedule C of its 990 income tax return.

On Schedule C, organizations are required to specifically distinguish between “**direct and indirect political campaign activities**” and “**exempt function activities.**” Part I-A of Schedule C requires an entity to identify the amount it expended on “political expenditures.” “Political expenditures” are defined as expenditures made “for political campaign activities which includes **all** activities that support or oppose candidates for elective federal, state or local public office.” See, IRS TE/GE Division, Office Of Exempt Organizations, 990 Redesign Glossary (emphasis added).

Part I-C requires an organization to report amounts expended for “**exempt function activities.**”¹ When an entity engages in “exempt function” activities, it must pay taxes. To illustrate, when a labor organization receives a dollar in dues from one of its members, and places that dollar in its general treasury, then no tax is owed to the IRS. If the labor organization then takes the dollar from its general treasury and uses it for an exempt function activity, then that dollar becomes taxable income and the expenditures must be reported. IRC § 527(f)(1) (2010), 26 CFR § 1.527-6(a) (2010).

These expenditures are reported on Line 1, Part I-C, Schedule C on an organization's tax return. An entity that makes any such expenditures is required to also file a Form 1120 POL, and, if appropriate, pay the existing tax liability. 26 CFR § 1.6012-6(b) (2010). Line 4, Part I-C, Schedule C further requires an organization to indicate whether it filed the Form 1120 POL.

There are certain expenditures related to political campaigns that are not considered “exempt.” These types of expenditures fall within a safe harbor provision of the law and do not result in a taxable event. A labor organization is permitted to expend general treasury funds without incurring tax liability on activities that are considered “nonpartisan.” Specifically, the applicable “safe harbor” provision of § 1.527 states:

Expenditures **for nonpartisan activities** by an organization to which [this section applies] are not expenditures for an exempt function. Nonpartisan activities include voter registration and get-out the vote campaigns. To be nonpartisan voter registration and get-out-the-vote campaigns must not be specifically identified by the organization with any candidate or political party. 26 CFR § 1.527-6(b)(5) (2011).

¹ It is crucial to keep these confusing terms clear. All exempt function expenditures are political expenditures but not all political expenditures are exempt function expenditures. As discussed in this Complaint, there are a number of safe harbor provisions where an outlay can be related to politics, but not qualify as an exempt function expenditure.

Service regulations further provide an exception from taxation for activities allowed under the Federal Election Campaign Act (“FECA”). 26 CFR 1.527-6(b)(3) (2011). Specifically, § 44b(b)(2) of the FECA pertains to the following activities: (1) internal communications with members and their families; (2) nonpartisan registration and get-out-the-vote campaigns and; (3) the establishment, administration, and solicitation of contributions to separate segregated funds. 2 U.S.C. 441b(b)(2) (2010).

Finally, “indirect expenses” – defined as those expenses associated with overhead and record keeping that are necessary to support direct function activities – are not subject to taxation. 26 CFR 1.527-6(b)(2) and 1.527-2(c)(2) (2011).

In summary, when an organization expends general treasury funds for exempt function expenditures, it incurs tax liability and must use a Form 1120-POL to pay the accrued taxes. An entity can spend general treasury fund on certain activities that may be considered “political” and avoid taxation if those funds are used to support any of the activities that fall into the above referenced safe harbor provisions.

AFSCME’s 2008 Tax Returns Indicate Expenditures of Taxable, Exempt Function Activity.

On Schedule C of its 2008 tax return, AFSCME reports that it expended \$13,341,443 “for section 527 exempt function activities.” Despite making these expenditures, AFSCME states that it did not file a Form 1120-POL. Thus, it appears AFSCME failed to comply with its obligation to report taxable activity and possibly avoided the tax liability it incurred by spending over \$13 million on taxable political activities.

A labor union who acknowledges expending funds for exempt function activities must file a Form 1120-POL and pay the requisite tax. Service regulations and accompanying instructions are clear. A labor organization “shall make a return of income within the time provided, if a tax is imposed on such an organization.” 26 CFR 1.6012-6(a) (2010). The regulations continue, “The return required by an organization or fund upon which a tax is imposed shall be made on Form 1120-POL.” 26 CFR 1.6012-6(b) (2010).

These requirements are stated on the Service’s 1120-POL instructions, “an exempt organization that is not a political organization must file Form 1120-POL if it is treated as having political organization taxable income under section 527(f)(1).” Instructions, Form 1120-POL. On the Form 1120-POL, an organization must complete Line 17, where it identifies the amounts of net investment income and the aggregate amount expended for an exempt function.

The IRS Must Determine Whether AFSCME Is Subject To Civil And Criminal Penalties.

An exempt organization’s failure to include any of the information required on a Form 990, or to provide correct information, exposes the organization to potential civil penalties. IRC § 6652(c) and § 6662 (2010). An organization the size of AFSCME can be fined up to \$50,000

for each tax year for which the organization has failed to report the full extent of its exempt function expenditures. Id.

Additional penalties may be assessed for inaccurate reporting on an organization's tax return. Where an underpayment of taxes results from an exempt organization's "negligence or disregard of rules or regulations," the organization is subject to a penalty in an amount equal to 20 percent of the portion of the underpayment. IRC § 6662(a) (2010). "Negligence" includes any failure to make a reasonable attempt to comply with the provisions of [the IRC]" and the term "disregard" includes "any careless, reckless, or intentional disregard." IRC § 6662(c) (2010).

Moreover, the IRS must determine whether AFSCME has engaged in a willful attempt in any manner to, "evade or defeat any tax imposed by [the IRC] or the payment thereof... in addition to other penalties provided by law, [AFSCME] may be guilty of a felony and, upon conviction thereof, shall be fined not more than \$500,000..." IRC § 7201 (2010).

AFSCME's tax returns are verified as to their truthfulness by the organization's designated officer or agent in accordance with IRC § 6033(a)(1) (2010). The Service must determine whether AFSCME officials engaged in fraud. Accordingly,

Any person who willfully delivers or discloses to the Secretary any list, return, account, statement, or other document, known by him to be fraudulent or to be false as to any material matter, shall be fined not more than... \$50,000 [in the case of a corporation such as AFSCME], or imprisoned not more than 1 year, or both. IRC § 7206 (2010).

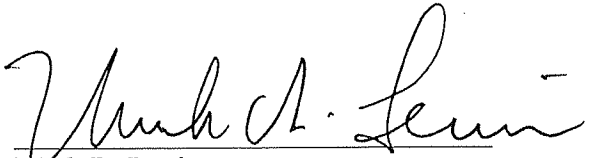
Finally, the Service must also determine whether officials within AFSCME engaged in "corrupt interference" with the administration of Internal Revenue laws. If individuals engaged in any action which served to obstruct or impede the administration of revenue laws, said individuals can be fined up to \$5,000, or imprisoned up to three years, or both. IRC § 7212 (2010), see also *United States v. Kelly*, 147 F.3d 172 (2nd Cir., 1992).

Conclusion

While AFSCME acknowledges making over \$13 million in "exempt function" expenditures, it did not file a Form 1120-POL. It, apparently, did not pay the taxes that accrued. The avoidance of these taxes constitutes a violation of IRS regulations and possible violation of civil and criminal provisions of the Internal Revenue Code. Such conduct subjects AFSCME to penalties and sanctions including civil and criminal penalties. It is incumbent upon the Service to investigate this failure immediately and, if appropriate, issue appropriate penalties, including revocation of AFSCME's tax-exempt status. Furthermore, the Service must consider whether any of the above referenced criminal provisions have been violated and whether appropriate referrals should be made to law enforcement agencies.

Respectfully submitted,

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