

BEFORE THE INTERNAL REVENUE SERVICE

In the matter of Internal Revenue Code Violations by the Washington State Labor Council, AFL-CIO – EIN 91-0668471

Memorandum of Complaint

September 2, 2004

It is requested that the Internal Revenue Service investigate the tax filings of the Washington State Labor Council, AFL-CIO, for failure to report political expenditures and pay required taxes.

1.0 Introduction

The Washington State Labor Council, AFL-CIO (WSLC), represents the American Federation of Labor and Congress of Industrial Workers (AFL-CIO) in Washington State and is an association of AFL-CIO affiliates. Its state headquarters is located in Seattle, Washington and is registered with the Internal Revenue Service (IRS) as an Internal Revenue Code (IRC) §501(c)(5) tax exempt labor organization with Employee Identification Number 91-0668471. WSLC registered a political committee called “Washington State Labor Council PPP Committee” (WSLC PPP) with the Washington State Public Disclosure Commission (PDC). The political committee was also registered as an IRC §527 Political Organization in July of 2000 under the name “Washington State Committee on Political Education” (Washington State COPE) with EIN 91-0668471.¹

IRC §501(c)(5) organizations are required to annually file Form 990, *Return of Organization Exempt from Income Tax*, in which they must declare direct and indirect political expenditures. See IRC §6033. Exempt organizations that have investment income and that make direct or indirect political expenditures are treated as having political organization taxable income. IRC §527(f)(1).² Organizations having political organization

¹ Washington State COPE filed Form 8872, *Political Organization Report of Contributions and Expenditures*, from July 1, 2000, through November 25, 2002. However, it has not filed Form 8872 subsequent to that date, presumably because it is entitled to an exemption as a qualified state political organization.

² IRC §527(f)(1) provides

If an organization described in section 501(c) which is exempt from tax under section 501(a) expends any amount during the taxable year directly (or through another organization) for an exempt function (within the meaning of subsection (e)(2)), then, notwithstanding any other provision of law, there shall be included in the gross income of such organization for the taxable year, and shall be subject to tax under subsection (b) as if it constituted political organization taxable income, an amount equal to the lesser of--

- (A) the net investment income of such organization for the taxable year, or
- (B) the aggregate amount so expended during the taxable year for such an exempt function.

taxable income must file Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*. Treas. Regs. 1.6012-6.

The evidence set forth in this complaint shows that the WSLC made substantial political expenditures during periods in which they falsely declared zero political expenditures to the IRS and did not file Form 1120-POL.

2.0 Complaint

2.1 The WSLC made substantial political contributions through its political committee, but falsely reported zero political expenditures to the IRS.

WSLC submittals of Form 990 for tax years 2000, 2001, and 2002 were examined to determine if the organization properly reported its political expenditures to the IRS. (Exhibit 1). These reports encompassed the period from April 1, 2000 through March 31, 2003.

Disclosure reports filed with the PDC show that the WSLC contributed over \$360,000 of its own funds to the WSLC PPP (aka Washington State COPE) during the period from April 1, 2000 through March 31, 2003. (Exhibit 2). These funds constituted more than 74% of the committee's income. During the same period the WSLC PPP, in turn, expended approximately \$485,000. (Exhibit 3).

Instructions for Form 990 explicitly and clearly require that when a §501(c) organization transfers its own funds to a separate segregated §527(f)(3) fund for use as political expenses, the §501(c) organization must report the transferred funds as its own political expenses on Line 81 and must file a Form 1120-POL.³ Despite this requirement, the WSLC falsely reported *zero* political expenditures and did not file Form 1120-POL. See Exhibit 1.

³ IRS Instructions for Form 990 include the following directions:

Line 81 -- Expenditures for political purposes

Political organizations described in section 527 are not required to answer this question.

A political expenditure is one intended to influence the selection, nomination, election, or appointment of anyone to a Federal, state, or local public office, or office in a political organization, or the election of Presidential or Vice Presidential electors. It does not matter whether the attempt succeeds.

An expenditure includes a payment, distribution, loan, advance, deposit, or gift of money, or anything of value. It also includes a contract, promise, or agreement to make an expenditure, whether or not legally enforceable.

All section 501(c) organizations. 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).

If a section 501(c) organization establishes and maintains a section 527(f)(3) separate segregated fund, it is the fund's responsibility to file its own Form 1120-POL if the fund meets the Form 1120-POL filing requirements. Do not include the segregated fund's receipts, expenditures, and balance sheet items on the Form 990, or Form 990-EZ, of the section 501(c) organization that establishes and maintains the fund. When answering questions 81a and 81b on its Form 990, this section 501(c) organization should disregard the political expenses and Form 1120-POL filing requirement of the segregated fund.

However, when a section 501(c) organization transfers its own funds, to a separate segregated section 527(f)(3) fund for use as political expenses, the 501(c) organization must report the transferred funds as its own political expenses on its Form 990 or Form 990-EZ.

The money expended by WSLC indirectly through its political committee for political purposes is taxable to the extent of its net investment income. IRC §527(f)(1). By falsely reporting zero political expenditures, the organization failed to pay required taxes.

2.2 Funds transferred by the WSLC to its political fund were political contributions by the labor council and not contributions by members of WSLC PPP.

An IRC §501(c) organization that receives political contributions or dues from its members may avoid paying taxes on investment income if it establishes an IRC §527(f)(3) segregated fund and transfers the political contributions or dues to the segregated fund. Such transfers must be made promptly after the receipt of such amounts by the section 501(c) organization, and must be made directly to the separate segregated fund. Treas. Regs. §1.527-6(e). However, a labor organization is taxed as a political organization if it transfers funds from its general account containing both dues and other income to a separate segregated fund maintained to make political contributions. *Alaska Public Service Employees Local 71 v. Commissioner (1991) TC Memo 1991-650.*

The WSLC was identified as a source of funds on PDC disclosure reports. See Exhibit 2. Washington State law prohibits making a contribution, directly or indirectly, through another person in such a manner as to conceal the identity of the source of the contribution. RCW 42.17.120. The Administrative Code also provides that contributions made through an intermediary or conduit or transmitted by an intermediary shall identify the true and actual source of the funds. WAC 390-16-308. In the absence of evidence to the contrary, therefore, it is presumed that WSLC PPP accurately reported that WSLC was the true source of contributions attributed to it.

3.0 Recommended Enforcement Action

3.1 It is recommended that the IRS investigate the WSLC to determine the facts and circumstances of its repeated failure to report political expenditures and the extent of its tax liability.

The IRS has authority to examine WSLC books and witnesses to ascertain the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, and inquiring into any offense connected with the administration or enforcement of the internal revenue laws. IRC §7602(a)-(b). The WSLC's failure to report political expenditures and its tax liability should be so examined. It is likely that violations precede the period reviewed in this complaint. Therefore, the investigation should encompass political expenditures since inception of WSLC PPP.

3.2 It is recommended that civil penalties be pursued.

The evidence presented here shows that the WSLC has falsely reported political expenditures and has failed to file Form 1120-POL as required by law. The WSLC could be fined up to \$50,000 for each offense. IRC §6652(c)(1).

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jami Lund". The signature is fluid and cursive, with the first name "Jami" and last name "Lund" clearly distinguishable.

Jami Lund
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