

BEFORE THE INTERNAL REVENUE SERVICE
RE: Washington Education Association, EIN 91-0460645

COMPLAINT

I. BACKGROUND

The Evergreen Freedom Foundation (EFF) requests that the Internal Revenue Service (IRS) investigate the conduct and tax filings of the Washington Education Association (WEA).

Under Internal Revenue Code (IRC) § 501(c)(5), tax exempt labor organizations, including the WEA, are required to fully disclose the extent of the organization's political expenditures to the public, union members, non-member agency fee payers and the IRS. Moreover, political expenditures are taxable to the labor organization unless they are segregated from the organization's general operations and conducted through a separate segregated fund. IRC 527(f). The evidence set forth in this complaint indicates that the WEA is spending substantial general operating funds on taxable political activities, which it has not reported on at least its last four tax returns.

II. COMPLAINT

A. The Full Extent of the WEA's Political Expenditures is not Reported.

As a tax exempt organization, the WEA is required to file a Form 990 information tax return. *See* IRC § 6003. The instructions accompanying Form 990 explicitly require that certain political expenditures must be reported by exempt organizations. (Instructions for Form 990, Exhibit 1, pp. 26-27):

Line 81 – Expenditures for political purposes

. . . 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. Section 501(c) organizations must file Form 1120-POL if their political expenditures and their net investment income both exceed \$100 for the year. They may be liable for a tax under section 527.

. . . 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.

Since at least its 1995-1996 filing, the WEA has reported that it made no such political expenditures on its Form 990 tax returns. (Exhibits 3, 4, 5, and 6; WEA 1995-1996, 1996-1997, 1997-1998, and 1998-1999 Form 990s) A labor organization, such as the WEA, is permitted to engage directly in political activity, as defined by IRC 527(e) (*see also* Instructions to Line 81, *supra*), if all such political expenditures and activities are fully accounted for and reported to the IRS as taxable income. IRC § 501(b)

Political expenditures as defined above also may be engaged in without generating income tax liability if the WEA establishes a "separate segregated fund," (also known as a political action committee (PAC)), as provided in IRC 527(f). PACs, however, are subject to strict income and expenditure reporting rules requiring full disclosure of their political activities. While the WEA operates a PAC, the evidence presented in this complaint indicates that the WEA's political expenditures and activities extend beyond its reported PAC activities and, therefore, beyond the zero dollars it has reported on its last several federal tax returns. (Exhibits 7-12)

1. 501(c)(5) Tax Exempt Organizations are Permitted to Make Political Expenditures Provided Such Expenditures Conform with Specific Statutory Criteria.

IRC 527(f) segregated funds (PACs) serve three functions: 1) PACs provide full disclosure of the nature and extent of a labor organization's participation in the political process; 2) the segregation of funds permits the IRS to monitor the political activity of labor organizations and 3) a separate and full accounting of resources dedicated to political activities allows the union's members, and nonmembers compelled to pay fees to the union, to understand more fully how their dues and fees are used.

Activities that are permitted for a PAC, but taxable for a labor organization, include "all activities that are directly related to and support the process of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to public office or office in a political organization . . ." 26 C.F.R. 1.527-2(c)(1). Whether an expenditure is for a political activity depends upon all the facts and circumstances. *Id.*

While the WEA's official political organization, WEA-PAC, appears to meet applicable separate segregated fund standards (WEA-PAC Notice of Section 527 Status, Exhibit 2) the evidence set forth in this complaint indicates that the WEA's political activities extend beyond those reported by its PAC and have not been reported as taxable income to the IRS.

2. The WEA Does Not Report Its Extensive Political Activity on IRS Forms 990 and 1120-POL.

As stated previously, IRC 501(c)(5) organizations engaging in political activity are required to disclose fully and make public the organization's non-PAC political expenditures on IRS Form 990. Detailed disclosures of these political expenditures must be filed with the IRS on a Form 1120-POL. (See Exhibit 1, Form 990 Reporting Instructions, p .27.) Such expenditures are taxable to the organization. IRC 527(f)

Overhead and operating expenses are reportable political expenditures. The cost of soliciting contributions for a separate segregated fund (PAC) must also be reported. *See* 26 CFR 1.527-2(c). Washington state law requires lobbyist employers, such as the WEA, and political action committees, such as WEA-PAC, to file periodic reports of their political expenditures. Washington state's definition of "political expenditure" is similar to that set forth in Exhibit 1. Such expenditures include

a payment, contribution, subscription, distribution, loan, advance, deposit, or gift of money or anything of value, and includes a contract, promise, or agreement, whether or not legally enforceable, to make an expenditure. The term "expenditure" also includes a promise to pay, a payment, or a transfer of anything of value in exchange for goods, services, property, facilities, or anything of value for the purpose of assisting, benefiting, or honoring any public official or candidate, or assisting in furthering or opposing any election campaign

RCW § 42.17.020(19).¹ In contrast to WEA's claim to the IRS that it spent no money on politics, WEA has admitted substantial political expenditures on its state campaign finance reports. (Exhibits 7-12) WEA's affiliated political committee, WEA-PAC, has also reported substantial political expenditures made from WEA to WEA-PAC. These expenditures should have been reported by WEA.

1996

For example, WEA-PAC's 1996 Schedule Bs² (Exhibits 7-9) show that WEA heavily subsidizes the operations of WEA-PAC. From January to October of 1996, WEA paid \$64,346.38 for WEA-PAC's administrative costs. (Exhibit 7, p. 2) In October/November, WEA expended an additional \$7,575.24 (Exhibit 8, p. 5 - expenditures made to Initiative Committee subtracted) and in December, an additional \$4,080.24. (Exhibit 9 pp. 3-4). Thus, WEA made over \$76,000 of unreported political expenditures.

1997

¹ The noteworthy difference between the Internal Revenue Code's definition of "political expenditure" and Washington State's definition of "political expenditure" is that Washington includes expenditures made to ballot proposition committees. As a result, this complaint excludes expenditures expressly made to ballot proposition committees.

² In Washington State, political committees are required to file summary reports of their receipts and expenditures. Schedule B shows in-kind contributions received by the political committee. Wash. Admin. Code § 390-16-41.

WEA's 1997 L3³ (Exhibit 10) shows that WEA expended \$64,191.43 on WEA-PAC during 1997. WEA's expenditures for WEA-PAC's operating costs and administrative expenses are subject to reporting requirements and to taxation. IRC § 527 and 26 CFR 1.527-2.

1998

WEA-PAC's 1998 Schedule Bs show the following monthly expenditures made by WEA to finance WEA-PAC or promote candidates for public office. (Exhibit 11).

- January 1998 - \$7,157.16
- February 1998 - \$5,826.96
- March 1998 - \$6,575.06
- April 1998 - \$6,447.23
- May 1998 - \$9,867.87
- June 1998 - \$6,757.36
- July/August 1998 - \$8,252.65
- August/September 1998 - \$6,099.58
- September/October 1998 - \$9,246.21
- October/November 1998 - \$7,752.37
- December 1998 - \$8,393.36

1999

WEA's 1999 L3 shows that WEA expended \$110,307.71 on WEA-PAC. (Exhibit 12, p. 5) All of this should have been reported by WEA on its 990's, but WEA has consistently reported no political expenditures. (*See* Instructions for Form 990, Exhibit 1).

B. IRS Jurisdiction and Enforcement Authority

IRC § 6001 requires every person liable for any tax imposed by the tax code, including exempt organizations such as the WEA, to "keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary [of the Treasury] may from time to time prescribe." Exempt organizations are required to file an annual return

stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. . . .

IRC § 6033(a)(1).

³ L3 reports must be filed by organizations which employ a lobbyist. The L3 report summarizes political contributions and expenditures made by the lobbyist employer during the previous year. Wash. Rev. Code § 42.17.180 and Wash. Admin. Code § 390-20-110.

Failure to comply with the IRC's reporting and record-keeping requirements subject an exempt organization to civil and criminal penalties under the Internal Revenue Code. *See* IRC §§ 6652 (Failure to file certain information returns); 6662 (Imposition of accuracy-related penalty); 7201 (Attempt to evade or defeat tax); 7203 (Willful failure to file return, supply information, or pay tax); 7206 (Fraud and false statements); and 7207 (Fraudulent returns, statements or other documents). Moreover, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under penalty of perjury. IRC § 6065. While it is the taxpayer's obligation to comply with the IRC, it is the duty of the IRS to enforce the Internal Revenue Code.

For the purpose of ascertaining the correctness of any tax return, the IRS is authorized:

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry; (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and (3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

IRC § 7602 (a)(1)-(3).

The evidence presented in this complaint indicates that the WEA has failed to comply with its duties to fully report its political expenditures, and therefore, its taxable income. Since at least its 1995-1996 form, the WEA has used tax exempt funds for taxable political purposes.

3. The IRS Must Determine Whether the WEA is Subject to Civil and Criminal Penalties.

An exempt organization's failure to include any of the information required to be shown on a Form 990, or to provide correct information, exposes the organization to penalties pursuant to IRC §§ 6652 and 6662. IRC 6652 provides that an exempt organization the size of the WEA may be fined up to \$50,000 for each tax year for which the organization has failed to comply with its general reporting obligations. The evidence indicates that the WEA has failed to report the full extent of its political expenditures on its Form 990 tax returns for 1995-1996, 1996-1997, 1997-1998, and 1998-1999. Moreover, the WEA's failure to account fully for its political expenditures may be ongoing, implicating future tax return filings. (Exhibit 13, p.14 shows \$137,785.70 expended by WEA to support WEA-PAC during 2000. WEA's 990, which EFF has not yet been able to obtain, should report at least that amount, or WEA has committed an additional violation of the Internal Revenue Code.)

Moreover, the IRS must determine whether the WEA has engaged in a willful attempt to violate its reporting and tax obligations, so that the following additional penalties would apply:

Any person who willfully attempts in any manner to evade or defeat any tax imposed by

[the IRC] or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

IRC § 7201. IRC § 7203 also provides that any person (or organization) required to pay any tax, or required to file a tax return and maintain records as required by law, shall be fined not more than \$100,000, or imprisoned not more than 1 year, or both, in the event that those obligations are not fulfilled.

In addition, subject to IRC § 7207

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 \$10,000 (\$50,000 in the case of a corporation), or imprisoned not more than 1 year, or both.

The IRS must consider whether these civil and criminal provisions have been violated and whether appropriate referrals should be made to law enforcement agencies.

III. Conclusion

IRS enforcement of the IRC enables the public, WEA members and non-member fee payers to receive accurate and complete information about the WEA's political activities. The evidence presented in this complaint indicates that for several years the WEA has failed to disclose the full extent of its political activities and expenditures as required by the Internal Revenue Code. As a result, the WEA appears to have submitted inaccurate tax returns that understate its taxable income.

Accordingly, the IRS should conduct a comprehensive functional and financial investigation to determine the full extent of the WEA's political activities and expenditures. The IRS should assess income taxes on tax exempt resources used for political purposes and impose appropriate fines and penalties.

Respectfully submitted,

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