A principal method that corporations use to engage in campaign activity is the political action committee ("PAC"). The corporation forms a PAC composed of corporate officers, who are appointed to the PAC by the corporation’s board of directors. The PAC solicits contributions from employees, and decides which candidates will receive contributions from the PAC. The New York State Election Law does not specifically provide for PACs, and the Handbook of Instructions For Campaign Financial Disclosure 2003 (the “Handbook”), published by the New York State Board of Elections (the “Board”), recognizes this statutory lacuna. The Handbook provides, “[A]lthough not defined in the New York State Election Law, a PAC is considered to be any political committee that supports candidates or other political committees by making contributions only; i.e., PACs do not make direct expenditures on behalf of Candidates.”¹ The New York State Election Law defines a political committee as any corporation aiding or promoting, and any committee, political club, or combination of one or more persons operating or cooperating to aid or take part in the election or defeat of a candidate for public office.² Thus, there is no required form of legal entity for a New York PAC.

The recognition of PACs by New York law is important because corporations that engage in campaign activity often form one PAC for federal candidates, and a separate PAC for state candidates. Under regulations promulgated by the Federal Election Commission (“FEC”) pursuant to the Federal Election Campaign Act of 1971, as amended (“FECA”), when a PAC’s funds are kept in one account that supports both federal and state candidates, all funds received by that account are subject to FECA’s contribution limits, prohibitions, and solicitation restrictions.³ To avoid federal rules that are often more restrictive than state rules, corporations form two PACs with separate accounts. Although a state PAC avoids the tight reins of most of FECA, it does not entirely escape FECA’s sprawling net, nor, more importantly, does it escape the tortuous minefield of the detailed reporting and disclosure obligations of the Internal Revenue Code of 1986, as amended (the “Code”). In addition, the requirement of the New York State Election Law that a PAC have an in-state depository often makes it impractical for a corporation’s federal PAC also to serve as a New York PAC.

LIMITATIONS ON CONTRIBUTIONS

The maximum contributions that a corporation and its employees can make to a PAC are as follows. A corporation can contribute up to $5,000 in a calendar year for all candidates and committees, and an individual can contribute up to $150,000 in a calendar year for all candidates and committees.⁴ These amounts are not indexed for the consumer price index.⁵ There are no controlled group rules requiring aggregation of members of the same controlled group of corporations to be treated as one corporation. Each corporation has its own $5,000 limit as long as it uses its own funds to make contributions.⁶ For example, a corporation’s PAC can receive

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$5,000 per year from the corporation. If the corporation makes contributions directly to candidates, these contributions reduce the $5,000. If a corporation contributes $3,000 directly to candidates, it can contribute $2,000 to its PAC.

The maximum contributions that a PAC can make to each candidate or the candidate’s authorized committee are as follows. Each primary and general election has its own limit. For state-wide office, such as Governor, Lieutenant Governor, Comptroller, and Attorney General, a contributor can contribute for the primary an amount equal to the total number of enrolled voters in the candidate’s party in the state multiplied by .005. This formula is capped at $16,200, and has a floor of $5,400.\(^7\) For the general election, a contributor can contribute up to $33,900.\(^8\)

For New York State Senate, a contributor can contribute up to $5,400 for the primary, and $8,500 for the general election.\(^9\) For New York State Assembly, a contributor can contribute up to $3,400 for the primary, and $3,400 for the general election.\(^10\)

For the New York City offices of Mayor, Public Advocate, and Comptroller, a contributor can contribute for the primary an amount equal to the total number of enrolled voters in a candidate’s party in the city multiplied by .05. This formula is capped at $16,200, and has a floor of $5,400. For the general election, a contributor can contribute up to $33,900.\(^11\)

These amounts are indexed for the consumer price index for all urban consumers published by the United States Bureau of Labor Statistics, and the adjustments are made at the beginning of each fourth calendar year beginning in 1995.\(^12\) The foregoing amounts are the limits as adjusted for 2003.

Candidates who participate in the New York City Campaign Finance Program are subject to further limitations. For example, a candidate cannot accept contributions from a PAC unless the PAC has registered with the New York City Campaign Finance Board.\(^13\)

Each limit is for an election cycle, which is either two or four years, and begins in January following the last election for the office. If the maximum contribution for a candidate exceeds $5,000, a corporation is still restricted to $5,000 in a calendar year, but the corporation can give for each year of the election cycle the lesser of its $5,000 limit, and the candidate’s limit.\(^14\)

**CORPORATION’S PAYMENT OF PAC ADMINISTRATIVE EXPENSES AS CORPORATE CONTRIBUTION**

In determining the amount of corporate contributions, the amounts that the corporation spends in the PAC’s formation and administration, such as the expenses of soliciting and distributing contributions, and the percentage of officers’ salaries allocable to PAC administration, are counted toward the $5,000 annual limitation.\(^15\) This rule is the opposite of the federal rule, which is that the corporation’s payment of administrative expenses is not a contribution.\(^16\) If a corporation uses an outside accounting firm to prepare the IRS and New York filings, or consults with outside counsel on how to handle a suspect contribution, the professional fees can exceed $5,000. In this situation, the PAC would be responsible from its funds for payment of the amount over $5,000. Accordingly, the corporation and PAC should prepare an annual budget, and in determining the funds available for contributions to candidates,
take into account reasonably anticipated administrative expenses to be paid by the corporation and PAC, and a reserve for unanticipated expenses to be paid by the PAC.

The corporation’s payment of PAC administrative expenses is disallowed as a deduction by the corporation for federal income tax purposes. The percentage of the salaries of officers and employees allocable to time spent on PAC administration is also disallowed as a deduction. This disallowance also applies to the New York corporate franchise tax, which imposes tax on a corporation’s entire net income. Entire net income is “presumably the same” as the entire taxable income that the corporation is required to report to the United States. Furthermore when the PAC reimburses the corporation for payment of administrative expenses and salaries so that the corporation does not exceed its $5,000 annual limitation, the reimbursement is taxable income to the corporation without any offsetting deduction.

The treatment of the corporation’s payment of administrative expenses as a contribution raises the issues of whether indemnification payments by the corporation to corporate officers for claims arising from or related to an officer’s service to the PAC, and payment by the corporation of premiums for liability insurance covering corporate officers for these claims, are contributions subject to the $5,000 annual limitation.

Accordingly, corporate officers should make sure that each of the corporation and the PAC, in the appropriate instruments and agreements, e.g., the corporation’s bylaws and the PAC’s bylaws, jointly and severally agree to indemnify the officers to the fullest extent permitted by law, and to advance all expenses covered by the indemnification with the officer’s agreement to repay the advances if he or she is subsequently found not to be entitled to indemnification. The governing state corporation statute may also limit the corporation’s and PAC’s right to indemnify the officer for penalties, especially criminal ones. A contractual agreement by the corporation to indemnify is important to address the argument that the statutory indemnification provisions do not apply to an officer’s service to a PAC. Corporation statutes often contain a nonexclusivity clause that the statutory indemnification provisions are not exclusive of indemnification rights under bylaws and an agreement. Finally, since the PAC is funded almost exclusively from employee contributions, it is unlikely to have the same economic wherewithal as the corporation to satisfy the indemnification obligation.

In addition, since the corporation’s and the PAC’s indemnification is taxable income to the officer, and the officer does not have an offsetting deduction for payment of a penalty, a full indemnification must include a gross-up so that after the officer pays the federal, state, and local employment, income, and payroll taxes on the grossed-up indemnification, the officer is left with sufficient cash to pay the penalty.
In light of the restrictions on corporate indemnification, directors’ and officers’ insurance plays an important role in limiting the officers’ personal exposure for service to the PAC. These restrictions raise the issue of whether insurance is permissible. The corporation and its officers can reasonably take the position that it is for two reasons. First, the criminal penalty for violation of the prohibition on corporate political contributions applies to any officer, director, stockholder, attorney, or agent of any corporation who participates in, aids, abets, advises, or consents to any violation by the corporation. An insurer does not participate in, aid, abet, advise, or consent to any violation by the corporation.

Second, state corporation statutes often permit the purchase of insurance to cover liabilities for which a prohibition on indemnification applies. For example, the Delaware statute provides that a corporation can purchase insurance for a current or former director, officer, employee, or agent against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person’s status as such, regardless of whether the corporation would have the power to indemnify under the corporate indemnification statute.

As another example, the New York statute provides that a corporation can purchase insurance to indemnify directors and officers in instances in which they may not otherwise be indemnified under Article 7 of the New York Business Corporation Law as long as the insurance contract provides, in a manner acceptable to the superintendent of insurance, for a retention amount and coinsurance. In addition, no insurance can provide for any payment, other than cost of defense, (a) if a judgment or other final adjudication adverse to the insured director or officer establishes that his or her acts of active and deliberate dishonesty were material to the cause of action so adjudicated, or that he or she personally gained a financial profit or other advantage to which he or she was not legally entitled, or (b) in relation to any risk the insurance of which is prohibited under the insurance law of New York. Finally, the New York statute provides that it is the public policy of the state to spread the risk of corporate management, notwithstanding any other general or special law of New York or of any other jurisdiction including the federal government.

With respect to whether the corporation’s payment of premiums for directors’ and officers’ insurance is a contribution, the corporation and its officers can reasonably take the position that if the policy covers the officer for service to the PAC for no additional premium, and the officer would have been covered by the policy regardless of his or her service to the PAC, there is no contribution. If there is an additional premium, in light of the risk that the corporation’s payment of the additional premium is a contribution, the PAC or officer may wish to pay it. The officer’s payment of the additional premium should come within his or her $150,000 annual contribution limitation. Since a person can make a contribution only in his or her name, the officer should issue a check payable to the insurer, rather than reimburse the corporation or PAC for its payment.

CONTRIBUTIONS TO PAC FROM EMPLOYEE PAYROLL DEDUCTIONS

An employer-sponsored PAC can collect contributions from employees through payroll deductions as long as the payroll deduction authorization is signed by the employee, and specifically states the employee’s full name and address, the amount of any deduction, and the frequency with which any deduction is made. The authorization must be provided to the PAC’s...
treasurer, and the treasurer must retain the authorization as part of the PAC’s records. In addition, the employer must comply with the New York wage withholding statute, which provides that no employer shall make any deduction from an employee’s wages, except deductions which “are expressly authorized in writing by the employee and are for the benefit of the employee; provided that such authorization is kept on file on the employer’s premises. Such authorized deductions shall be limited to payments for insurance premiums, pension or health and welfare benefits, contributions to charitable organizations, payments for United States bonds, payments for dues or assessments to a labor organization, and similar payments for the benefit of the employee.” The regulations of the New York Department of Labor provide that “similar payments for the benefit of the employee” cannot exceed, in the aggregate, ten percent of the gross wages due the employee for a payroll period.

Effective September 19, 2002, an employer that fails to pay the wages of employees as provided in Article 6 of the New York Labor Law forfeits five hundred dollars for each failure. The Commissioner of Labor recovers the forfeited amount in a civil action. Effective November 1, 2002, every employer that does not pay the wages of all its employees in accordance with the provisions of Chapter 31, and the officers and agents of any corporation who knowingly permit the corporation to violate Chapter 31 by failing to pay the wages of any of its employees in accordance with the provisions thereof, are guilty for the first offense of a misdemeanor. Upon conviction of the first offense, the violator shall be fined not less than five hundred nor more than twenty thousand dollars, or imprisoned for not more than one year. If any second or subsequent offense occurs within six years of the date of conviction of a prior offense, the violator is guilty of a felony and for each offense shall be fined not less than five hundred nor more than twenty thousand dollars, or imprisoned for not more than one year plus one day, or punished by both fine and imprisonment.

The requirement of the New York wage withholding statute that the deduction be “for the benefit of the employee” counsels that the employer apply the antireprisal provisions of the FECA regulations governing federal PACs. Under these regulations, employers cannot use or threaten physical force, job discrimination, or financial reprisals, and PAC contributions cannot be a condition of employment. Reverse check offs in which amounts are automatically deducted from payroll checks unless the employee requests otherwise are prohibited. In addition, the employer must advise employees at the time of the solicitation of the PAC’s political purposes, and of the employee’s right to refuse to contribute without any reprisal. The employer must also advise employees that it will not favor or disadvantage anyone by reason of the amount of his or her contribution, or decision not to contribute. The employer can provide guidelines for contributions as long as it only suggests amounts. An employee may contribute more or less than the guidelines.

STATEMENT AS TO NONDEDUCTIBILITY OF CONTRIBUTIONS FOR FEDERAL INCOME TAX PURPOSES

A PAC must place on each solicitation an express statement in a conspicuous and easily recognizable format that contributions to the PAC are not deductible as charitable contributions for federal income tax purposes. This requirement applies to solicitations for contributions, as well as for attendance at testimonials and other fundraising events. This requirement does not apply to PACs whose annual gross receipts do not normally exceed $100,000. In Notice 88-
120, 1988-2 C.B. 454, the IRS provided a safe harbor statement, which for solicitations by mail, leaflet, or advertisement in a print medium, must satisfy the following requirements:

(a) The solicitation includes whichever of the following statements the PAC chooses: “Contributions or gifts to [name of PAC] are not deductible as charitable contributions for Federal income tax purposes,” “Contributions or gifts to [name of PAC] are not tax deductible,” or “Contributions or gifts to [name of PAC] are not tax deductible as charitable contributions;”

(b) The statement is in at least the same size type as the primary message;

(c) The statement is included on the message side of any card or tear-off section that the employee returns with the contribution; and

(d) The statement is either the first sentence in a paragraph, or is itself a paragraph.

Notice 88-120 also provides that in determining whether an organization has annual gross receipts that do not normally exceed $100,000, the IRS will generally follow the rules of Treas. Reg. §1.6033-2(g) and Rev. Proc. 83-23, 1983-1 C.B. 687. Under these rules, a PAC must include the statement on all solicitations made more than thirty days after reaching $300,000 in gross receipts in a three-year period. For example, if on July 1 of the third year (for a calendar year PAC) a PAC has $300,000 in total gross receipts for the prior two years and the first six months of the third year, it must include the statement on all solicitations no later than August 1.

The PAC is subject to a penalty for failure to include statement of $1,000 for each day on which the failure occurs, subject to an annual cap of $10,000.44 The cap does not apply to intentional violations, which are subject to a penalty of the greater of the $1,000 penalty, and fifty percent of the aggregate cost of the solicitations that occurred on the day the failure occurred.45 No penalty is imposed if the failure is due to reasonable cause.46 Each day on which a failure occurs means the day that a solicitation is mailed, distributed, or published.47 For example, if a PAC mails 500 noncomplying solicitations on March 30, and fifty noncomplying solicitations on April 5, as long as the violation is not intentional, the penalty is $1,000 each day for two days for a total of $2,000.48

FECA PROHIBITIONS ON CONTRIBUTIONS BY FOREIGN NATIONALS

Under FECA, and FEC regulations effective January 1, 2003, a PAC cannot knowingly solicit or accept contributions from a foreign national in connection with any federal, state, or local election.49 Under the FEC regulations, a foreign national cannot direct, control, or participate in the decision making process of any person, such as a corporation, labor organization, or political committee, regarding such person’s federal or nonfederal election-related activities.50 A foreign national is defined as a foreign principal under 22 U.S.C. §611(b), or an individual who is not a citizen of the United States and who is not lawfully admitted for permanent residence.51 Thus, foreign citizens who are present in the United States on nonimmigrant visas, such as B-1 business visitors, H-1B workers in specialty occupations, and L-1A executives or managers of multinational corporations, cannot contribute to a PAC. Foreign citizens who are lawfully admitted for permanent residence, otherwise known as green card holders, can contribute. The permanent resident should be present in the United States when he
or she makes the contribution because under 22 U.S.C. §611(b)(2) persons “outside the United States,” unless they are United States citizens, are foreign principals.

A foreign national is also defined as “a partnership, association, corporation, organization or other combination of persons organized under the laws of or having its principal place of business in a foreign country.” Thus, a foreign corporation cannot form a PAC. A United States subsidiary of a foreign parent can form a PAC as long as the PAC does not solicit foreign nationals, and no foreign national participates in the PAC’s decision-making process. The foreign parent cannot provide the funds or reimburse the United States subsidiary for contributions. A United States subsidiary of a foreign parent must be able to show through reasonable accounting methods that it had sufficient United States profits to cover its contributions. A joint-venture formed in the United States in which a foreign corporation holds an interest can form a PAC, and a United States incorporated trade association with foreign corporate members can form a PAC. Finally, the FEC on July 8, 2003 released an updated brochure entitled, “Foreign Nationals,” which is available at www.fec.gov/pages/brochures/foreign.htm.

Under the new FEC regulations, for purposes of the prohibition on knowingly soliciting or accepting contributions from foreign nationals, knowingly means that a person must (a) have actual knowledge that the source of funds is a foreign national; (b) be aware of facts that would lead a reasonable person to conclude that there is a substantial probability that the source of funds is a foreign national; or (c) be aware of facts that would lead a reasonable person to inquire whether the source of funds is a foreign national, but the person failed to conduct a reasonable inquiry. Pertinent facts include, but are not limited to (a) the contributor uses a foreign passport or passport number for identification; (b) the contributor provides a foreign address; (c) the contributor makes a contribution with a check or other written instrument drawn on a foreign bank, or by a wire transfer from a foreign bank; or (d) the contributor resides abroad. A person is deemed to have conducted a reasonable inquiry if he or she seeks and obtains copies of current and valid U.S. passport papers for U.S. citizens who are contributors described in the preceding sentence. A person cannot rely on the safe harbor if he or she has actual knowledge that the source of funds is a foreign national.

A violation of FECA is subject to a civil penalty not to exceed the greater of $5,000, and an amount equal to the impermissible contribution. If the violation is knowing and willful, the civil penalty cannot exceed the greater of $10,000, and an amount equal to 200% of the impermissible contribution. Under the Bipartisan Campaign Reform Act of 2002, a knowing and willful criminal violation of making, receiving, or reporting any contribution aggregating $25,000 or more during a calendar year is subject to felony prosecution and imprisonment of five years, a fine, or both. A knowing and willful criminal violation aggregating $2,000 but less than $25,000 during a calendar year is subject to misdemeanor prosecution and imprisonment of one year, a fine, or both. The felony fine is up to $250,000 for individuals, and $500,000 for entities. The misdemeanor fine is up to $100,000 for individuals, and $200,000 for entities.
NEW YORK REGISTRATION REPORT

A PAC must file Form CF-02, Committee Designation and Depository, prior to soliciting, accepting, and making contributions, and within five days after the selection of its treasurer and depository. The depository must be a banking organization authorized to do business in New York, and be physically located in New York. The PAC must provide on Form CF-02 its name, the treasurer’s name, the treasurer’s residential, mailing, and e-mail addresses, the treasurer’s residential and business telephone numbers, the name and address of the PAC’s depository, ballot proposals supported or opposed, names and original signatures of persons other than the treasurer authorized to sign checks, and the original signature of the treasurer and date signed. The treasurer may provide his or her social security number, but there is no penalty for not providing it. The PAC does not have to provide the names of candidates supported or opposed. Any change in the information, other than the year of election, requires the PAC to file an amended Form CF-02 within two days of the change.

NEW YORK DISCLOSURE REPORTS

PACs must file periodic disclosure reports of contributions and expenditures. The reports are filed on July 15th and January 15th. A PAC must file a report on the first reporting period following its filing of the designation of treasurer and depository. For example, if a new PAC is formed in March, its first report is the July periodic report. For each year, the July report is the first report, and the following January report is the final report.

In addition, a PAC must file three reports for each primary and general election. There is a 33-day pre-election report and an 11-day pre-election report for each election, a 10-day post-election report for primary elections, and a 27-day post-election report for general elections. A PAC must continue to file periodic reports until it can terminate, which is when it has no assets or liabilities. In addition, any contribution to the PAC that exceeds $1,000 and is received after the cut-off date for the 11-day pre-election report but before election day must be reported within twenty-four hours of receipt.

The reports are filed on Form CF-01, Financial Disclosure Statement. A PAC uses Schedule A to report all monetary contributions from individuals to the PAC, and for contributions greater than $99 the PAC must provide the contributor’s complete name and address, the check number and amount, and the total of previous contributions received from the contributor in the calendar year. A PAC uses Schedule B to report all monetary contributions from corporations to the PAC, and for contributions greater than $99 the PAC must provide the same information as for individual contributors. A PAC uses Schedule F to report all political contributions from the PAC to candidates and other political committees, and for each expenditure greater than $49.99 the PAC must provide the date paid and check number, the amount of the expenditure, the payee’s complete name and address, and the purpose of the expenditure.
Finally, PACs must file the Status of Contributions Schedule annually. The purpose of this schedule is to review the last report filed and determine the cumulative, to date amounts of all contributions for the campaign cycle.

PLACE AND METHOD OF FILING NEW YORK REPORTS

PACs that contribute to candidates for Governor, Lieutenant Governor, Comptroller, Attorney General, State Senate, and State Assembly file their reports with the Board. PACs that support these candidates and local candidates must also file with each County Board with jurisdiction over the local candidate. PACs that raise or spend, or expect to raise or spend, more than $1,000 in any calendar year must file the reports with the Board electronically by diskette or e-mail. The most recent version of the computer software for electronic filing, as well as instructions for its installation and use, are available from the Board at www.elections.state.ny.us/finance/fdismenu.htm. Assistance for electronic filing is available from the Board by phone at 518-473-4803, or by e-mail at efshelp@elections.state.ny.us. Filers can use the electronic software to create paper reports for filing with the County Boards.  

PENALTIES FOR VIOLATIONS OF NEW YORK STATE ELECTION LAW

Any person who fails to file a required report is subject to a civil penalty not in excess of $500. This penalty applies for each filing. Penalties for a PAC’s failure to file are the treasurer’s liability, rather than the PAC’s. The penalty is recoverable in a special proceeding or civil action brought by the Board, or governing County Board of Elections, that seeks a money judgment against the treasurer. In addition, any person who knowingly and willfully fails to file a report within ten days after the due date is guilty of a misdemeanor.

Any person who knowingly and willfully contributes, accepts, or aids or participates in the acceptance of a contribution in an amount exceeding the maximum permissible amount is guilty of a misdemeanor. In addition, any director, officer, or stockholder of a corporation who participates in, aids, abets, or advises or consents to the corporation’s violation of the prohibition on corporate political contributions is guilty of a misdemeanor. Furthermore, any person who solicits or knowingly receives any money or property in violation of the prohibition on corporate political contributions is guilty of misdemeanor. Finally, any person who, while acting on behalf of a political committee, knowingly and willfully makes expenditures in connection with the nomination for election, or election, of any candidate, or solicits any person to make any such expenditures, for the purpose of evading the contribution limitations, is guilty of a class E felony.

Any offense that is defined to be a misdemeanor without specification of the classification thereof or sentence thereof is deemed to be a class A misdemeanor. A class A misdemeanor is subject to a sentence of imprisonment of up to one year, and fine not to exceed $1,000. If a person gained money or property through the commission of a misdemeanor, the court, in lieu of the foregoing fine, may impose a fine not to exceed double the amount of the defendant’s gain from the commission of the crime. Gain means the amount of money or the value of property derived from the commission of the crime, less the amount of money or the value of property returned to the victim or seized by or surrendered to the authority prior to the time sentence is imposed.
A class E felony is subject to an indeterminate sentence of imprisonment of three to four years,88 or a definite sentence of imprisonment of one year or less,89 and a fine not to exceed the greater of $5,000, and double the amount of the defendant’s gain from the commission of the crime.90

IRS REPORTING AND DISCLOSURE OBLIGATIONS

The IRS reporting and disclosure obligations for a New York PAC are found in Code Sections 527, 6012, and 6033. The IRS recently explained a state PAC’s obligations in Rev. Rul. 2003-49, 2003-20 I.R.B. 903, which was published in the May 19, 2003 issue of the Internal Revenue Bulletin. The Revenue Procedure implements the Congressional amendments to Section 527 in Public Law 107-276, which was signed into law by President Bush on November 2, 2002. Within twenty-four hours after its formation, a state PAC must file IRS Form 8871, Political Organization Notice of Section 527 Status, electronically at the Political Organization Filing Center at www.irs.gov/polorgs.91 Prior to filing Form 8871, the PAC must obtain an employer identification by filing IRS Form SS-4, which it can do on-line at www.irs.gov, or by telephone at 1-800-829-4933. The filed Form 8871 is available for public inspection at the Political Organization Disclosure Page at www.irs.gov/polorgs.92 For Forms 8871 due on or after June 30, 2003, the IRS must post the filed forms on its website within forty-eight hours of filing.93

In addition, the PAC must make its filed Form 8871 available for public inspection during regular business hours at its principal office in the same manner as Section 501(c)(3) organizations make their applications for exemption available for public inspection.94 The PAC is subject to a penalty of $20 for each day during which it fails to satisfy its public inspection obligation.95

A PAC must file an amended Form 8871 within thirty days after any material change.96 The Code does not define material change, but a sponsor of the Section 527 amendments, Representative Kevin Brady, Republican from Texas, stated that a change of address is an example of a material change.97 No amended Form 8871 is required for changes prior to November 2, 2002.

An exemption from the Form 8871 filing obligation applies to any PAC that reasonably anticipates that its annual gross receipts will always be less than $25,000.98 A newly formed PAC does not have to file Form 8871 if it reasonably anticipates that its annual gross receipts will be less than $25,000 for its first six taxable years. Once the PAC has annual receipts of $25,000 or more for any taxable year, it must file Form 8871 within thirty days of receiving $25,000 in a single taxable year.99

If a state PAC does not timely file Form 8871, the PAC’s political organization taxable income for the period the form is delinquent includes its exempt function income of contributions and fundraising receipts, less any deductions directly connected with the production of this income.100 If a state PAC does not timely file an amended Form 8871, the income inclusion applies during the period beginning on the date on which the material change occurs and ending on the date on which the amended Form 8871 is filed.101 In these situations, the PAC cannot deduct its exempt function expenditures because I.R.C. §162(e) disallows a
deduction for political campaign expenditures. The PAC determines its tax by multiplying its taxable income, which is generally the sum of its exempt function income and net investment income, by the highest corporate tax rate. The PAC files IRS Form 1120-POL to report the income and pay the tax. If the PAC can show that the failure to file Form 8871 was due to reasonable cause and not due to willful neglect, the IRS may waive all or any portion of the tax assessed. Finally, contributions to a PAC that does not timely file Form 8871 remain exempt from federal gift tax.

The PAC must provide on Form 8871 its name and address; its purpose; the names and addresses of its officers, any highly compensated employees, contact person, custodian of records, and members of its board of directors, if any; the name and address of, and relationship to, any related entities under I.R.C. §168(h)(4); and whether the PAC claims an exemption from filing IRS Form 8872 as a qualified state or local political organization. A related entity means two entities that have (a) significant common purposes and substantial common membership; or (b) directly or indirectly substantial common direction or control. Highly compensated employees are the five employees (other than officers and directors) who are reasonably expected to have the highest annual compensation over $50,000. Compensation includes both cash and noncash amounts, whether paid currently or deferred.

Status as a qualified state or local political organization is important because it gives the PAC an exemption from filing IRS Form 8872, Political Organization Report of Contributions and Expenditures. This exemption is important because the failure to make the required Form 8872 filing subjects any unreported contributions or expenditures to tax at the highest corporate rate. A qualified state or local political organization is a political organization that satisfies the following requirements:

(a) the PAC limits its exempt function to the selection process relating solely to any state or local public office, or office in a state or local political organization. Selection process means influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any state or local public office, or office in a political organization. A corporation can satisfy this requirement by limiting the PAC’s purposes in the PAC’s bylaws to this selection process, and should avoid the catch-all purpose of “all lawful activities;”

(b) the PAC is required under state law to report to a state agency, and the PAC does so, the information that otherwise would be required to be reported on IRS Form 8872. The PAC will satisfy this requirement even if the state law does not require reporting of the identical information required on Form 8872, as long as at least the following two items are required to be reported under state law, and the PAC reports these items. First, the name and address of every person who contributes $500 or more in the aggregate to the PAC during the calendar year, and the amount of each contribution. Second, the name and address of every person to whom the PAC makes expenditures aggregating $800 or more during the calendar year, and the amount of each expenditure. If state law requires the reporting of additional information, the PAC must report the additional information to the state agency. Section 14-102 of the New York State Election Law, which requires detailed statements of campaign receipts, contributions, and expenditures of political committees, satisfies this requirement;
(c) the state agency makes the reports filed by the PAC publicly available. Section 14-108.4 of the New York State Election Law, which provides that each statement shall constitute part of the public record of the Board and shall be open to public inspection, satisfies this requirement. The Board makes the reports available on-line at [www.elections.state.ny.us/finance/cf_database_access.htm](http://www.elections.state.ny.us/finance/cf_database_access.htm);

(d) the PAC makes the reports filed with the state agency publicly available; and

(e) no federal candidate or officeholder controls or participates in the direction of the PAC, solicits contributions for the PAC, or directs any of the PAC’s disbursements.  

A New York PAC has two other IRS filing obligations. First, if the PAC has more than $100 in political organization taxable income, which is generally its net investment income and excludes its exempt function income of contributions and fundraising receipts, it must file an annual income tax return on IRS Form 1120-POL. The form is due on or before the fifteenth day of the third month after the close of the PAC’s taxable year. For a calendar year PAC, the form is due on or before March 15. A PAC can obtain an automatic six month extension by filing IRS Form 7004 by the initial due date of the form. A PAC that does not timely file Form 1120-POL is subject to a penalty of five percent of the tax due for each month or partial month that the failure continues, with a maximum penalty of twenty-five percent of the tax due. In addition, the PAC is subject to a penalty for failure to pay when due any amount shown on the return as tax owed equal to .5% of the amount of the unpaid tax for each month or partial month during which the failure continues, with a maximum penalty of twenty-five percent of the unpaid tax. Both the failure to file and failure to pay penalties are subject to abatement if the PAC shows that the failure was due to reasonable cause and not willful neglect. Finally, effective retroactively for taxable years beginning after June 30, 2000, Form 1120-POL is not available for public inspection at the IRS or the PAC.

Second, a qualified state or local political organization must file an information return on IRS Form 990 if it has annual gross receipts of $100,000 or more. Tax-exempt organizations with gross receipts of less than $100,000 and assets of less than $250,000 file IRS Form 990-EZ. Tax-exempt organizations with gross receipts of less than $25,000 do not file Form 990 or Form 990-EZ. The form is due on or before the fifteenth day of the fifth month after the close of the PAC’s taxable year. For a calendar year PAC, the form is due on or before May 15. A PAC can obtain an automatic three month extension by filing IRS Form 8868 by the initial due date of the form. A PAC that does not timely file Form 990 or Form 990-EZ is subject to a penalty of $20 per day for each day that the failure continues, with a maximum penalty of the lesser of $10,000, and five percent of the PAC’s gross receipts for the year. For PACs with gross receipts exceeding $1 million for any year, the penalty increases to $100 per day, with a maximum penalty of $50,000.

If the IRS makes a written demand specifying a reasonable future date by which the PAC must file Form 990 or Form 990-EZ and any organization manager does not comply with the demand, the manager is subject to a penalty of $10 for each day during which the failure continues after the date specified in the demand. The maximum penalty imposed on all
managers for failures with respect to any one return is $15,000. The penalties for failure to file Form 990 or Form 990-EZ by the PAC and the organization manager are subject to abatement if the failure was due to reasonable cause.

Form 990 or Form 990-EZ for taxable years beginning after June 30, 2000, including the Schedule B contributor information, is available for public inspection beginning on July 1, 2003 at the Political Organization Disclosure Page at www.irs.gov/polorgs. In addition, the PAC must make the filed forms available for public inspection at its principal place of business during regular business hours for the three year period beginning on the last day prescribed for filing the form including extensions. The PAC must provide copies of the form for a reasonable reproduction charge unless the form is widely available, such as on the Internet, and the PAC provides the Internet address to the person requesting the form. The PAC is subject to a penalty of $20 per day, with a maximum of $10,000, for each failure to satisfy the public inspection requirement.
ENDNOTES


2 N.Y. Elec. Law §14-100.1.

3 11 C.F.R. §102.5(a)(1)(ii) and (2); Rev. Rul. 2003-49, Q&A-7, 2003-20 I.R.B. 903-04; see also N.Y. State Board of Elections 1989 Opinion No. 2 (corporation formed a federal PAC and a state PAC; state PAC would act as the collecting agent for both PACs, and would remit predetermined percentage of contributions to federal PAC; state PAC “would have to report all contributions received by it even if it only retains a portion of those receipts. The New York Election Law [Sections 14-118(1) and 14-102(1)] makes it mandatory that any political action committee which contributes to New York candidates or political committees must report all contributions and all expenditures”).

4 N.Y. Election Law §§14-114.8 (individuals) and 14-116.2 (corporations); Handbook, at 15.

5 Id.

6 N.Y. State Board of Elections 1977 Opinion No. 11.


8 Id.


10 Id.


12 N.Y. Elec. Law §14-114.1.c.

13 N.Y. City Campaign Finance Act §3-707.

14 Handbook, at 17 and 58.

15 N.Y. Elec. Law §14-100.9 (definition of contribution); N.Y. State Board of Elections Reg. §6200.6 (definition of contribution other than money); N.Y. State Board of Elections 1978 Opinion No. 1 (PAC was composed of senior and middle management officers of bank; participation in PAC was a function of officer position; bank must allocate the percentage of officers’ salaries attributable to PAC administration as a corporate contribution to the PAC); N.Y. State Board of Elections 1975 Opinion No. 1; N.Y. State Board of Elections 1975 Opinion No. 5.

16 2 U.S.C. §441b(b)(2)(C; 11 C.F.R. §§114.1(a)(2)(iii) and (b) and 114.5(b); FEC Advisory Opinion 1991-35 (corporation’s indemnification is an administrative expense not subject to contribution prohibition); FEC Advisory Opinion 1980-135 (same); FEC Advisory Opinion 1979-42 (corporation’s payment of insurance premiums for PAC’s officers is an administrative expense not subject to contribution prohibition).


18 TAM 8202019 (September 30, 1981).

19 N.Y. Tax Law §208.9; 20 N.Y.C.R.R. §3-2.2(b).


22 Compare Advanced Mining Systems, Inc. v. Fricke, 623 A.2d 82, 84 (Del. Ch. 1992) (provision in bylaws for corporation to indemnify directors to the extent permitted by Delaware law does not entitle directors to advances) with Barry v. Barry, 28 F.3d 848, 858 (8th Cir. 1994) (under Minnesota law, director is entitled to advances under contractual indemnification unless corporation provides otherwise) with Happy Kids, Inc. v. Glasgow, 2002 WL 72937, No. 01CIV.6434(GEL) (S.D.N.Y. January 17, 2002) (Lynch, J.) (when agreement provided for indemnification to the fullest extent permitted by law, court awarded advance of reasonable litigation expenses pursuant to N.Y. Bus. Corp. Law §724(c)) with Booth Oil Site Administrative Group v. Safety-Kleen Corp., 137 F. Supp. 2d 228 (W.D.N.Y. 2000) (in absence of indemnification agreement, under N.Y. Bus. Corp. Law §724(c) a director or officer is entitled to an advance award of litigation expenses and fees when director or officer raises a genuine issue of fact or law as to whether indemnification is required; advance award must be repaid under N.Y. Bus. Corp. Law. §725(a) if the director or officer is ultimately found not to be entitled to indemnification, or the expenses advanced exceed the indemnification to which the director or officer is entitled). See also Sean T. Carnathan, “Will the Company Cover an Ex-Officer’s Legal Costs?,” 13 Business Law Today 33 (September/October 2003) (discusses whether publicly-traded corporation’s advancement of legal expenses violates Sarbanes-Oxley Act of 2002 prohibition against corporation’s extension of personal credit to directors and officers).

23 See generally Norwood P. Beveridge, “Does the Corporate Director Have a Duty Always to Obey the Law?,” 45 DePaul Law Review 729, 747-48 (1998) (“[I]t is undesirable to have any basic conflict between desired conduct by the director and the statutory right of indemnification, although it is recognized that in some circumstances a director may be indemnified for conduct constituting a breach of duty. However, a director should not be indemnified, for example, against the consequences of intentional and unreasonable violation of law which causes damage to the corporation”) (footnote omitted); Pamela H. Bucy, “Indemnification of Corporate Executives Who Have Been Convicted of Crimes: An Assessment and Proposal,” 24 Indiana Law Review 279 (1991).

24 I.R.C. §162(f) (payment of penalty paid to a government for violation of law not deductible); Huff v. Commissioner, 80 T.C. 804 (1983) (corporation’s payment of civil penalty for violation of California Business and Professions Code imposed on corporate officers who were severally liable was includable in officers’ gross income); N.Y. Tax Law §612(a) (New York adjusted gross income of a resident individual means his or her federal adjusted gross income as defined in the laws of the United States with certain modifications); N.Y. City Admin. Code §11-1712(a) (New York City adjusted gross income of a city resident individual means his or her federal adjusted gross income with certain modifications).


26 Del. Gen. Corp. Law §145(g).


28 N.Y. Bus. Corp. Law §726(b).

29 N.Y. Bus. Corp. Law §726(e).

30 N.Y. Elec. Law §14-120.1.

31 N.Y. State Board of Elections 1975 Opinion No. 11.

32 N.Y. Labor Law §193.1.b.

34 N.Y. Labor Law §197.


36 Id.

37 Id.

38 11 C.F.R. §114.5(a).


40 11 C.F.R. §114.5(a)(3)-(4).

41 11 C.F.R. §114.5(a)(2).

42 I.R.C. §6113(a).


44 I.R.C. §6710(a).

45 I.R.C. §6710(c).

46 I.R.C. §6710(b).

47 I.R.C. §6710(d).


49 2 U.S.C. §441e(a); 11 C.F.R. §110.20(g).

50 11 C.F.R. §110.20(i).

51 2 U.S.C. §441e(b)(1)-(2); 11 C.F.R. §110.20(a)(3).


56 FEC Advisory Opinion 1992-16.


58 FEC Advisory Opinion 1980-111.

11 C.F.R. §110.20(a)(5).
11 C.F.R. §110.20(a)(7).
2 U.S.C. §437g(a)(5).
N.Y. Elec. Law §14-118.1.
Handbook, at 18.
Handbook, at 18.
N.Y. Elec. Law §14-118.1.
N.Y. Elec. Law §14-102.1.
N.Y. State Board of Elections Reg. §6200.2(c).
Handbook, at 58.
N.Y. State Board of Elections Reg. §6200.2(a).
Handbook, at 8.
N.Y. Elec. Law §14-110; N.Y. State Board of Elections Reg. §6200.1(b)-(c); Handbook, at 9-10.
N.Y. Elec. Law §14-126.2.
N.Y. Elec. Law §14-126.3.
Id.
N.Y. Elec. Law §14-126.4.
N.Y. Penal Law §55.10.2(b).
N.Y. Penal Law §70.15.1.
N.Y. Penal Law §80.05.1.
86 N.Y. Penal Law §80.05.5.

87 N.Y. Penal Law §80.00.2.

88 N.Y. Penal Law §70.00.2(e).

89 N.Y. Penal Law §70.00.4.

90 N.Y. Penal Law §80.00.1.a-b.

91 I.R.C. §527(i)(1)(A).

92 I.R.C. §6104(a).

93 I.R.C. §527(k)(1).

94 I.R.C. §§527(k)(1) and 6104(d)(7); Treas. Reg. §301.6104(d)-1(b)-(d).


96 I.R.C. §527(i)(1)-(2).


98 I.R.C. §527(i)(5)(B).


100 I.R.C. §527(i)(4).

101 Id.


103 I.R.C. §§11(b) and 527(b)(1).

104 I.R.C. §527(l)(1)-(2).


110 I.R.C. §§11(b) and 527(b)(1) and (j)(1); Rev. Rul. 2003-49, Q&A-43, 2003-20 I.R.B. 903, 907.


113 I.R.C. §6072(b).
114 I.R.C. §6651(a)(1).
115 I.R.C. §6651(a)(2).
116 I.R.C. §6104(b) and (d)(1)(A).
117 I.R.C. §6033(g)(1).
119 I.R.C. §6652(c)(1)(A).
120 I.R.C. §6652(c)(1)(B).
121 I.R.C. §6652(c)(3).
122 I.R.C. §6104(b) and (d)(1)-(4); Treas. Reg. §301.6104(d)-2.
123 I.R.C. §6652(c)(1)(C).