the subsidiary itself assumes the indebtedness and whether or not the property is subject to the indebtedness.

(j) *Certain trusts described in section 501(c)(17).* (1) In the case of a supplemental unemployment benefit trust described in section 501(c)(17), or in the case of a corporation described in section 501(c)(2) all of the stock of which was acquired before January 1, 1960, by such a trust, any indebtedness incurred by such trust or such corporation before such date, in connection with real property which is leased before such date, and any indebtedness incurred by such trust or such corporation on or after such date necessary to carry out the terms of such lease, shall not be considered as an indebtedness described in section 514(g) and in this section.

(2) If a supplemental unemployment benefit trust described in section 501(c)(17) lends any money to another such supplemental unemployment benefit trust forming part of the same plan, for the purpose of acquiring or improving real property, such loan will not be treated as an indebtedness of the borrowing trust except to the extent that the loaning trust:

(i) Incurs any indebtedness in order to make such loan;

(ii) Incurred indebtedness before the making of such loan which would not have been incurred but for the making of such loan; or

(iii) Incurred indebtedness after the making of such loan which would not have been incurred but for the making of such loan and which was reasonably foreseeable at the time of making such loan.

[T.D. 7229, 37 FR 28155, Dec. 21, 1972]

FARMERS' COOPERATIVES

§ 1.521–1 Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

(a)(1) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of either the quantity or the value of the products furnished by them, are exempt from income tax except as otherwise provided in section 522, or part I, subchapter T chapter 1 of the Code, and the regulations thereunder. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of either the quantity or the value of milk or of butterfat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in anyother way than on such a proportionate basis, the association does not meet the requirements of the Code and is not exempt. In other words, nonmember patrons must be treated the same as members insofar as the distribution of patronage dividends is concerned. Thus, if products are marketed for nonmember producers, the proceeds of the sale, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such proceeds result, whether or not such patrons are members of the association. In order to show its cooperative nature and to establish compliance with the requirement of the Code that the proceeds of sales, less necessary expenses, be turned back to all producers on the basis of either the quantity or the value of the products furnished by them, it is necessary for such an association to keep permanent records of the business done both with members and nonmembers. The Code does not require, however, that the association keep ledger accounts with each producer selling through the association. Any permanent records which show that the association was operating during the taxable year on a cooperative basis in the distribution of patronage dividends to all producers will suffice. While under the Code patronage dividends must be paid to all producers on the same basis, this requirement is complied with if an association instead of paying patronage dividends to nonmember producers incash, keeps permanent records from which the proportionate shares of the patronage dividends due to nonmember producers can be determined, and such shares are

made applicable toward the purchase price of a share of stock or of a membership in the association. See, however, paragraph (c)(1) of §1.1388–1 for the meaning of *payment in money* for purposes of qualifying a written notice of allocation.

(2) An association which has capital stock will not for such reason be denied exemption (i) if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and (ii) if substantially all of such stock (with the exception noted below) is owned by producers who market their products or purchase their supplies and equipment through the association. Any ownership of stock by others than such actual producers must be satisfactorily explained in the association's application for exemption. The association will be required to show that the ownership of its capital stock has been restrictedas far as possible to such actual producers. If by statutory requirement all officers of an association must be shareholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a shareholder for any reason ceases to be a producer and the association is unable, because of a constitutional restriction or prohibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that under such circumstances a small amount of the outstanding capital stock is owned by shareholders who are no longer producers will not destroy the exemption. The restriction placed on the ownership of capital stock of an exempt cooperative association shall not apply to nonvoting preferred stock, provided the owners of such stock are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends.

(3) The accumulation and maintenance of a reserve required by State statute, or the accumulation and maintenance of a reasonable reserve or surplus for any necessary purpose, such as to provide for the erection of buildings and facilities required in business or for the purchase and installation of machinery and equipment or to retire indebtedness incurred for such purposes, will not destroy the exemption. An association will not be denied exemption because it markets the products of nonmembers, provided the value of the products marketed for nonmembers does not exceed the value of the products marketed for members. Anyone who shares in the profits of a farmers' cooperative marketing association, and is entitled to participate in the management of the association, must be regarded as a member of such association within the meaning of section 521.

(b) Cooperative associations engaged in the purchasing of supplies and equipment for farmers, fruit growers, livestock growers, dairymen, etc., and turning over such supplies and equipment to them at actual cost, plus the necessary operating expenses, are exempt. The term *supplies and equipment* as used in section 521 includes groceries and all other goods and merchandise used by farmers in the operation and maintenance of a farm or farmer's household. The provisions of paragraph (a) of this section relating to a reserve or surplus and to capital stock shall apply to associations coming under this paragraph. An association which purchases supplies and equipment for nonmembers will not for such reason be denied exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the value of the purchases made for nonmembers who are not producers does not exceed 15 percent of the value of all its purchases.

(c) In order to be exempt under either paragraph (a) or (b) of this section an association must establish that it has no taxable income for its own account other than that reflected in a reserve or surplus authorized in paragraph (a) of this section. An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements of the Code. Business done for the United States or

any of its agencies shall be disregarded in determining the right to exemption under section 521 and this section. An association to be entitled to exemption must not only be organized but actually operated in the manner and for the purposes specified in section 521.

(d) Cooperative organizations engaged in occupations dissimilar from those of farmers, fruit growers, and the like, are not exempt.

(e) An organization is not exempt from taxation under this section merely because it claims that it complies with the requirements prescribed therein. In order to establish its exemption every organization claiming exemption under section 521 is required to file a Form 1028. The Form 1028, executed in accordance with the instructions on the form or issued therewith, should be filed with the district director for the internal revenue district in which is located the principal place of business or principal office of the organization. However, an organization which has been granted exemption under the provisions of the Internal Revenue Code of 1939 or prior law may rely on that ruling, unless affected by substantive changes in the Internal Revenue Code of 1954 or any changes in the character, purposes, or methods of operation of the organization, and it is not necessary in such case for the organization to request a new determination as to its exempt status.

(f) A cooperative association will not be denied exemption merely because it makes payments solely in nonqualified written notices of allocation to those patrons who do not consent as provided in section 1388 and §1.1388–1, but makes payments of 20 percent in cash and the remainder in qualified written notices of allocation to those patrons who do so consent. Nor will such an association be denied exemption merely because, in the case of patrons who have so consented, payments of less than $5 are made solely in nonqualified written notices of allocation while payments of $5 or more are made in the form of 20 percent in cash and the remainder in qualified written notices of allocation. In addition, a cooperative association will not be denied exemption if it pays a smaller amount of interest or dividends on nonqualified written notices of allocation held by persons who have not consented as provided in section 1388 and §1.1388–1 (or on per-unit retain certificates issued to patrons who are not qualifying patrons with respect thereto within the meaning of §1.61–5(d)(2)) than it pays on qualified written notices of allocation held by persons who have so consented (or on per-unit retain certificates issued to patrons who are qualifying patrons with respect thereto) provided that the amount of the interest or dividend reduction isreasonable in relation to the fact that the association receives no tax benefit with respect to such nonqualified written notices of allocation (or such certificates issued to nonqualifying patrons) until redeemed. However, such an association will be denied exemption if it otherwise treats patrons who have not consented (or are not qualifying patrons) differently from patrons who have consented (or are qualifying patrons), either with regard to the original payment or allocation or with regard to the redemption of written notices of allocation or per-unit retain certificates. For example, if such an association pays patronage dividends in the form of written notices of allocation accompanied by qualified checks, and provides that any patron who does not cash his check within a specified time will forfeit the portion of the patronage dividend represented by such check, then the cooperative association will be denied exemption under this section as it does not treat all patrons alike.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6643, 28 FR 3162, Apr. 2, 1963; T.D. 6855, 30 FR 13135, Oct. 15, 1965]

§1.522–1 Tax treatment of farmers' cooperative marketing and purchasing associations exempt under section 521.

(a) *In general.* (1) Section 522 is applicable to farmers', fruit growers', or like associations organized and operated on a cooperative basis in the manner prescribed in section 521. Although such an association is subject to both normal tax and surtax, as in the case of corporations generally, certain special rules for the computation of taxable income are provided in section 522(b) and §1.522–2. For the purpose of any law

which refers to organizations exempt from income taxes such an association shall, however, be considered as an organization exempt under section 501. Thus, the provisions of section 243, providing a credit for dividends received from a domestic corporation subject to taxation, are not applicable to dividends received from a cooperative association subject to section 522. The provisions of section 1501, relating to consolidated returns, are likewise not applicable.

(2) Rules governing the manner in which amounts allocated as patronage dividends, refunds, or rebates are to be taken into account in computing the taxable income of such an association are set forth in §1.522–3. For the tax treatment, as to patrons, of amounts received during the taxable year as patronage dividends, rebates, or refunds, see section 61 and §1.61–5.

(b) *Meaning of terms.* For purposes of §§1.522–1 to 1.522–3, inclusive, §§1.6044–1 and 1.61–5, the following terms shall have the meaning ascribed below:

(1) *Cooperative association.* The term *cooperative association* includes any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons, except that the term does not include any cooperative or nonprofit corporation (including any cooperative or nonprofit corporation engaged in rural electrification) exempt from taxation under section 501(a) and described in section 501(c) (12) or (15) or any corporation subject to a tax imposed by subchapter L, chapter 1 of the Code (relating to insurance companies).

(2) *Patron.* The term *patron* includes any person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or a nonmember of the cooperative association, and whether an individual, a trust, estate, partnership, company, corporation, or cooperative association.

(3) *Allocation.* The term *allocation* includes distributions made by a cooperative association to a patron in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, similar documents, or in any other manner whereby there is disclosed to a patron the dollar amount apportioned on the books of the association for the account of such patron. Thus, a mere credit to the account of a patron on the books of the cooperative association, without disclosure to the patron, is not an allocation.

(4) *Patronage dividends, rebates, and refunds.* The term *patronage dividend, rebate, or refund* includes any amount allocated by a cooperative association, to the account of a patron on the basis of the business done with or for such patron. The following are not patronage dividends, rebates, or refunds:

(i) Amounts distributed in redemption of capital stock, or in redemption or satisfaction of certificates of indebtedness, revolving fund certificates, retain certificates, letters of advice, or other similar documents;

(ii) Amounts allocated (whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, refund, or rebate) by the association for products of members or other patrons to the extent such amounts are fixed without reference to the earnings of the cooperative association. For this purpose, the term *earnings* includes the excess of amounts retained (or assessed) by the association to cover expenses or other items over the amount of such expenses or other items.

(c) *Examples.* The application of paragraph (b) of this section may be illustrated by the following examples:

Example 1. Cooperative A, a marketing association operating on a pooling basis, receives the products of patron W on January 5, 1954. On the same day Cooperative A advances to W 45 cents per unit for the products so delivered and allocates to him a *retain certificate* having a face value calculated at the rate of 5 cents per unit. During the operatiion of the pool, and before substantially all the products in the pool are disposed of, Cooperative A advances to W an additional 40 cents per unit, the amount being determined by reference to the market price of the products sold and the anticipated price of the unsold products. At the close of the pool on November 10, 1954, Cooperative A determines the excess of its receipts over the sum of its expenses and its previous advances to patrons, and allocates to W an additional

3 cents per unit and shares of the capital stock of A having an aggregate of face value calculated at the rate of 2 cents per unit.

The amount of patronage dividends, rebates, or refunds allocated to W during 1954 amount to 5 cents per unit, consisting of the aggregate of the following per-unit allocations: The amount of cash distribution (3 cents), and the face value of the capital stock of A (2 cents), which are fixed with reference to the earnings of A. The amount of the two distributions in cash (85 cents) and the face amount of the *retain certificate* (5 cents), which are fixed without reference to the earnings of A, do not constitute patronage dividends, rebates, or refunds.

Example 2. Cooperative B, a marketing association operating on a pooling basis, receives the products of patron X on March 5, 1954. On the same day Cooperative B pays to X $1.00 per unit for such products, this amount being determined by reference to the market price of the product when received, and issues to him a participation certificate having no face value but which entitles X on the close of the pool to the proceeds derived from the sale of his products less the previous payment of $1.00 and the expenses and other charges attributable to such products. On March 5, 1957, Cooperative B, having sold the products in the pool, having deducted the previous payments for such products, and having determined the expenses and other charges of the pool, redeems the participation certificate of X in cash for 10 cents per unit. The allocation made to X during 1957, amounting to 10 cents per unit, is a patronage dividend, rebate, or refund. Neither the payment to X in 1954 of $1.00 nor the issuance to him of the participation certificate in that year constitutes a patronage dividend, rebate, or refund within the meaning of this section.

Example 3. Cooperative C, a purchasing association, obtains supplies for patron Y on May 1, 1954, and receives in return therefor $100. On February 1, 1955, Cooperative C, having determined the excess of its receipts over its costs and expenses, allocates to Y a cash distribution of $1.00 and a revolving fund certificate of a face amount of $1.00. The amount of patronage dividends, rebates, or refunds allocated to Y for 1955 is $2.00, the aggregate of the cash distribution of $1.00, and the face amount, $1.00, of the revolving fund certificate.

Example 4. Cooperative D, a service association, sells the products of members on a fee basis. It receives the products of patron Z under an agreement not to pool his products with those of other members, to sell his products, and to deliver to him the proceeds of the sale. Patron Z makes payments to Cooperative D during 1954 aggregating $75 for service rendered him by Cooperative D during that year. On May 15, 1955, Cooperative D, having determined the excess of its receipts over its costs and expenses, allocates to Z a cash distribution of $2.00. Such amount is a patronage dividend, rebate, or refund allocated by Cooperative D during 1955.

(d) *Returns of exempt cooperative associations.* For requirements of annual returns by exempt cooperative associations, see sections 6012 and 6072(d) and paragraph (f) of § 1.6012–2.

§ 1.522–2 Manner of taxation of cooperative associations subject to section 522.

(a) *In general.* Farmers', fruit growers', or like associations, organized and operated in compliance with the requirements of section 521 and § 1.521–1 shall be subject to the taxes imposed by section 11 or section 1201, except that there shall be allowed as deductions from gross income, in addition to the other deductions allowable under chapter 1 of the Code, certain special deductions provided in section 522(b)(1)(A) and paragraph (c) of this section, and section 522(b)(1)(B) and paragraph (d) of this section. Amounts allocated as patronage dividends, refunds, or rebates, whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated, with respect to patronage for the taxable year or for preceding taxable years, shall be taken into account in the manner provided in section 522 and in § 1.522–3.

(b) *Cooperative association exempt from tax before January 1, 1952.* (1) For the purpose of determining the method of accounting under section 446 in the case of a cooperative association which was exempt from tax for taxable years beginning prior to January 1, 1952, the method of accounting, recognized under sections 41, 42, and 43 of the Internal Revenue Code of 1939 and the regulations prescribed thereunder and utilized in the return of such association for its last taxable year to which the Internal Revenue Code of 1939 was applicable, shall be deemed to constitute the method of accounting regularly employed by the cooperative association. Any change from this method may be made only if permission is

obtained from the Commissioner to change to another recognized method in accordance with section 446 and the regulations thereunder.

(2) In any case where inventories are an income-producing factor, see sections 471 and 472 and the regulations thereunder. The elective method of inventorying goods provided in section 472 may be adopted by the cooperative association for any taxable year beginning after December 31, 1953, inaccordance with the requirements of section 472 and the regulations thereunder. However, in order to use such method for such a taxable year the cooperative association (unless it has used such method for a taxable year beginning after 1951 and before 1954 pursuant to an election exercised as provided in 26 CFR (1939) 39.22(d)–3 (Regulations 118) must exercise the election provided in section 472 and the regulations thereunder, even if it may have utilized such method for accounting purposes for taxable years beginning before January 1, 1952.

(3) The following rules shall be applicable in computing the net operating loss deduction provided in section 172: No net operating loss carryover shall be allowed from a taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt from tax under section 101(12) of the Internal Revenue Code of 1939. In the case of a taxable year beginning prior to January 1, 1952, for which the association was not exempt under section 101(12) of the Internal Revenue Code of 1939 and of any taxable year beginning after December 31, 1951, the amount of the net operating loss carryback or carryover from such year shall not be reduced by reference to the income of any taxable year beginning prior to January 1, 1952, for which the association was exempt from tax under section 101(12) of the Internal Revenue Code of 1939. However, any taxable year beginning prior to January 1, 1952, for which the cooperative association was exempt under section 101(12) of the Internal Revenue Code of 1939 shall be taken into account in determining the period for which a net operating loss may be carried back or carried over, as the case may be.

(4) The adjustments to the cost or other basis provided in sections 1011 and 1016 and the regulations thereunder, are applicable for the entire period since the acquisition of the property. Thus, proper adjustment to basis must be made under section 1016 for depreciation, obsolescence, amortization, and depletion for all taxable years beginning prior to January 1, 1952, although the cooperative association was exempt from tax under section 521 or corresponding provisions of prior law for such years. However, no adjustment for percentage or discovery depletion is to be made for any year during which the association was exempt from tax. If a cooperative association has made a proper election in accordance with section 1020 and the regulations prescribed thereunder with respect to a taxable year beginning before 1952 in which the association was not exempt from tax, the adjustment to basis for depreciation for such years shall be limited in accordance with the provisions of section 1016(a)(2).

(5) In the case of tax exempt and partially taxable bonds purchased at a premium and subject to amortization under section 171, proper adjustment to basis must be made to reflect amortization with respect to such premium from the date of acquisition of the bond. (For principles governing the method of computation, see the example in paragraph (b) of §1.1016–9, relating to mutual savings banks, building and loan associations, and cooperative banks.) The basis of a fully taxable bond purchased at a premium shall be adjusted from the date of the election to amortize such premium in accordance with the provisions of section 171 except that no adjustment shall be allowable for such portion of the premium attributable to the period prior to the election.

(6) In the case of a mortgage acquired at a premium where the principal of such mortgage is payable in installments, adjustments to the basis for the premium must be made for all taxable years (whether or not the association was exempt from tax under section 521

during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period of payments of the mortgage loans of such association. For the purpose of this adjustment, the term *premium* includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage is the cost including buying commissions, attorneys' fees or brokerage fees, but such value does not include amounts paid for accrued interest.

(c) *Deduction for dividends paid.* There is allowable as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 521 and §1.521–1, amounts paid as dividends during the taxable year upon the capital stock of the cooperative association. For the purpose of the preceding sentence, the term *capital stock* includes common stock (whether voting or nonvoting), preferred stock, or any other form of capital represented by capital retain certificates, revolving fund certificates, letters of advice, or other evidence of a proprietary interest in a cooperative association. Such deduction is applicable only to the taxable year in which the dividends are actually or constructively paid to the holder of capital stock or other proprietary interest of the cooperative association. If a dividend is paid by check and the check bearing a date within the taxable year is deposited in the mail, in a cover properly stamped and addressed tothe shareholder at his last known address, at such time that in the ordinary handling of the mails the check would be received by such holder within the taxable year, a presumption arises that the dividend was paid to such holder in such year. The determination of whether a dividend has been paid to such holder by the corporation during its taxable year is in no way dependent upon the method of accounting regularly employed by the corporation in keeping its books. For further rules as to the determination of the right to a deduction for dividends paid, under certain specific circumstances, see section 561 and the regulations thereunder.

(d) *Deduction for amounts allocated from income not derived from patronage.* There is allowable as a deduction from the gross income of a cooperative association operated in compliance with the requirements of section 521 and §1.521–1 amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether such amounts are paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. For this purpose, allocations made after the close of the taxable year and on or before the 15th day of the ninth month following the close of the taxable year shall be considered as made on the last day of such taxable year to the extent that such allocations are attributable toincome derived during the taxable year or during years prior to the taxable year. As used in this paragraph, the term *income not derived from patronage* means incidental income derived from sources not directly related to the marketing, purchasing, or service activities of the cooperative association. For example, income derived from the lease of premises, from investment in securities, from the sale or exchange of capital assets, constitutes income not derived from patronage. Business done with the United States shall constitute income not derived from patronage. In order that the deduction for income not derived from patronage may be applicable, it is necessary that the amount sought to be deducted be allocated on a patronage basis in proportion, insofar as is practicable, to the amount of business done by or for patrons during the period to which such income is attributable. Thus, if capital gains are realized from the sale or exchange of capital assets acquired and disposed of during the taxable year, income realized from such gains must be allocated to patrons of such year in proportion to theamount of business done by such patrons during the taxable year. Similarly, if capital gains are realized by

the association from the sale or exchange of capital assets held for a period of more than one taxable year income realized from such gains must be allocated, in proportion insofar as is practicable, to the patrons of the taxable years during which the asset was owned by the association, and to the amount of business done by such patrons during such taxable years.

§ 1.522–3 Patronage dividends, rebates, or refunds; treatment as to cooperative associations entitled to tax treatment under section 522.

(a) *General rule.* Patronage dividends, refunds, or rebates, allocated by a cooperative association entitled to tax treatment under section 522 to a patron shall be taken into account in computing the gross income of such association for the taxable year, as an increase in its other cost of goods sold in the case of an association marketing products for patrons, or as a reduction in its gross receipts, in the case of an association purchasing supplies and equipment or performing services for patrons, as the case may be, if:

(1) The allocation is made in fulfillment and satisfaction of a valid obligation of such association to the patron, which obligation was in existence prior to the receipt by the cooperative association of the amount allocated, and

(2) The allocation is made on or before the 15th day of the ninth month following the close of the taxable year in which the amounts allocated were received by the cooperative association

For the purpose of subparagraph (1) of this paragraph, amounts allocated by a cooperative association entitled to tax treatment under section 522 will be deemed allocated in fulfillment and satisfaction of a valid enforceable obligation, if made pursuant to provisions of the bylaws, articles of incorporation, or other contract, whereby the association is obligated to make such allocation after the retention of *reasonable reserves* and after payment of dividends on capital stock or other proprietary capital interests. Notwithstanding the provisions of subparagraphs (1) and (2) of this paragraph, amounts allocated as patronage dividends, refunds, or rebates during the taxable year, on or before the 15th day of the ninth month following the close of such year, with respect to patronage for years preceding the taxable year, shall be taken into account as an increase in its other cost of goods sold, or as a reduction in gross receipts, for the taxable year, as the case may be, where retention as *reasonable reserves* of the amounts so allocated beyond the year in which earned was proper in accordance with the provisions of section 521 and where the allocation is made to the patron on a patronage basis is proportion insofar as is practicable, to the amount of business done by such patrons during the taxable year or years in which the retained amounts were received by the cooperative association.

(b) *Examples.* This section may be illustrated by the following examples:

Example 1. E, a cooperative association entitled to tax treatment under section 522, organized without capital stock, is engaged in the business of marketing products for its patrons on a non-pool basis. The by-laws of Cooperative E provide that there shall be allocated to patrons as patronage dividends within a reasonable time following the close of the year all of the gross returns from sales, less expenses of operation for the year and amounts retained as *reasonable reserves* necessary to the operation of Cooperative E. At the close of the taxable year, 1954, it is determined that from the gross returns from sales less operating expenses and all taxes for such year, $5,000 is to be retained as *reasonable reserves* for various necessary purposes of Cooperative E. It is assumed that the retention of such amount is proper in accordance with the provisions of section 521. Such $5,000 is apportioned on the books of Cooperative E to patrons of 1954 on a patronage basis, or permanent records are kept from which an apportionment to such patrons can be made. On March 1, 1955, pursuant tothe terms of the by-laws, $200,000, the balance of the gross returns for the taxable year, is allocated to patrons of 1954 on the basis of patronage. $100,000 of such $200,000 is allocated in cash. The remaining $100,000 is allocated in *retain certificates,* bearing no interest and redeemable in the discretion of the Board of Directors of Cooperative E. There may be added to the cost of goods sold by Cooperative E for 1954, $200,000 ($100,000 in cash, $100,000 in retain certificates), the total amount allocated as patronage dividends, rebates, or refunds in fulfillment and satisfaction of the obligation of the by-laws, on March 1, 1955, before the 15th day of the ninth month following the close of 1954. There may not be added to the cost of goods sold by Cooperative E for 1954, $5,000, the amount retained as reserves apportioned on

the books, but not allocated as patronage dividends, rebates, or refunds.

Example 2. The facts are the same as example 1, it additionally appearing that at the close of 1955 it is determined by Cooperative E to allocate as cash patronage dividends, rebates, or refunds to patrons of 1954, $5,000, the amount retained as *reasonable reserves* for 1954 in accordance with the provisions of section 521. On March 1, 1956, such amount is allocated. There may be added to the cost of goods sold by Cooperative E for 1955, $5,000, the amount allocated with respect to patronage of a preceding year, 1954, properly maintained as a reserve under section 521.

§ 1.522–4 Taxable years affected.

Section 522 and §§ 1.522–1, 1.522–2, and 1.522–3, are applicable to taxable years beginning before January 1, 1963, and also to amounts paid during taxable years beginning after December 31, 1962, the tax treatment of which is not prescribed in section 1382 and the regulations thereunder.

[T.D. 6643, 28 FR 3163, Apr. 2, 1963]

§ 1.527–1 Political organizations; generally.

Section 527 provides that a political organization is considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes. A political organization is subject to tax only to the extent provided in section 527. In general, a political organization is an organization that is organized and operated primarily for an exempt function as defined in § 1.527–2(c). Section 527 provides that a political organization is taxed on its political organization taxable income (see § 1.527–4) which, in general, does not include the exempt function income (see § 1.527–3) of the political organization. Furthermore, section 527 provides that an exempt organization, other than a political organization, may be subject to tax under section 527 when it expends an amount for an exempt function, see § 1.527–6. The taxation of newsletter funds is provided under section 527(g) and § 1.527–7. A special rule for principal campaign committees is provided under section 527(h) and § 1.527–9.

[T.D. 8041, 50 FR 30817, July 30, 1985]

§ 1.527–2 Definitions.

For purposes of section 527 and these regulations:

(a) *Political organization*—(1) *In general.* A *political organization* is 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 for an exempt function activity (as defined in paragraph (c) of this section). Accordingly, a political organization may include a committee or other group which accepts contributions or makes expenditures for the purpose of promoting the nomination of an individual for an elective public office in a primary election, or in a meeting or caucus of a political party. A segregated fund (as defined in paragraph (b) of this section) established and maintained by an individual may qualify as a political organization.

(2) *Organizational test.* 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.

(3) *Operational test.* A political organization does not have to engage exclusively in activities that are an exempt function. For example, a political organization may:

(i) Sponsor nonpartisan educational workshops which are not intended to influence or attempt to influence the selection, nomination, election, or appointment of any individual for public office,

(ii) Pay an incumbent's office expenses, or

(iii) Carry on social activities which are unrelated to its exempt function,

provided these are not the organization's primary activities. However, expenditures for purposes described in

the preceding sentence are not for an exempt function. See §1.527–2 (c) and (d). Furthermore, it is not necessary that a political organization operate in accordance with normal corporate formalities as ordinarily established in bylaws or under state law.

(b) *Segregated fund*—(1) *General rule.* A *segregated fund* is a fund which is established and maintained by a political organization or an individual separate from the assets of the organization or the personal assets of the individual. The purpose of such a fund must be to receive and segregate exempt function income (and earnings on such income) for use only for an exempt function or for an activity necessary to fulfill an exempt function. Accordingly, the amounts in the fund must be dedicated for use only for an exempt function. Thus, expenditures for the establishment or administration of a political organization or the solicitation of political contributions may be made from the segregated fund, if necessary to fulfill an exempt function. The fund must be clearly identified and established for the pruposes intended. A savings or checking account into which only contributions to the political organization are placed and from which only expenditures for exempt functions are made may be a segregated fund. If an organization that had designated a fund to be a segregated fund for purposes of segregating amounts referred to in section 527(c)(3) (A) through (D), expends more than an insubstantial amount from the segregated fund for activities that are not for an exempt function during a taxable year, the fund will not be treated as a segregated fund for such year. In such a case amounts referred to in section 527(c)(3)(A)–(D),segregated in such fund will not be exempt function income. Further, if more than insubstantial amounts segregated for an exempt function in prior years are expended for other than an exempt function the facts and circumstances may indicate that the fund was never a segregated fund as defined in this paragraph.

(2) *Record keeping.* The organization or individual maintaining a segregated fund must keep records that are adequate to verify receipts and disbursements of the fund and identify the exempt function activity for which each expenditure is made.

(c) *Exempt function*—(1) *Directly related expenses.* An *exempt function*, as defined in section 527(e)(2), includes 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 (the selection process). Whether an expenditure is for an exempt function depends upon all the facts and circumstances. Generally, where an organization supports an individual's campaign for public office, the organization's activities and expenditures in futherance of the individual's election or appointment to that office are for an exempt function of the organization. The individual does not have to be an announced candidate for the office. Furthermore, the fact that an individual never becomes a candidate is not crucial in determining whether an organization is engaging in an exempt function. An activity engaged in between elections which is directly related to, and supports, the process of selection, nomination, or election of an individual in the next applicable political campaign is an exempt function activity.

(2) *Indirect expenses.* Expenditures that are not directly related to influencing or attempting to influence the selection process may also be an expenditure for an exempt function by a political organization. These are expenses which are necessary to support the directly related activities of the political organization. Activities which support the directly related activities are those which must be engaged in to allow the political organization to carry out the activity of influencing or attempting to influence the selection process. For example, expenses for overhead and record keeping are necessary to allow the political organization to be established and to engage in political activities. Similarly, expenses incurred in soliciting contributions to the political organization are necessary to support the activities of the political organization.

(3) *Terminating activities.* An exempt function includes an activity which is

in furtherance of the process of terminating a political organization's existence. For example, where a political organization is established for a single campaign, payment of campaign debts after the conclusion of the campaign is an exempt function activity.

(4) *Illegal expenditures.* Expenditures which are illegal or are for a judicially determined illegal activity are not considered expenditures in furtherance of an exempt function, even though such expenditures are made in connection with the selection process.

(5) *Examples.* The following examples illustrate the principles of paragraph (c) of this section. The term *exempt function* when used in the following examples means exempt function within the meaning of section 527(e)(2).

(i) *Example 1.* A wants to run for election to public office in State X. A is not a candidate. A travels throughout X in order to rally support for A's intended candidacy. While in X, A attends a convention of an organization for the purpose of attempting to solicit its support. The amount expended for travel, lodging, food, and similar expenses are for an exempt function.

(ii) *Example 2.* B, a member of the United States House of Representatives, is a candidate for reelection. B travels with B's spouse to the district B represents. B feels it is important for B's reelection that B's spouse accompany B. While in the district, B makes speeches and appearances for the purpose of persuading voters to reelect B. The travel expenses of B and B's spouse are for an exempt function.

(iii) *Example 3.* C is a candidate for public office. In connection with C's campaign, C takes voice and speech lessons to improve C's skills. The expenses for these lessons are for an exempt function.

(iv) *Example 4.* D, an officeholder and candidate for reelection, purchases tickets to a testimonial dinner. D's attendance at the dinner is intended to aid D's reelection. Such expenditures are for an exempt function.

(v) *Example 5.* E, an officeholder, expends amounts for periodicals of general circulation in order to keep informed on national and local issues. Such expenditures are not for an exempt function.

(vi) *Example 6.* N is an organization described in section 501(c) and is exempt from taxation under section 501(a). F is employed as president of N. F, as a representative of N, testifies in response to a written request from a Congressional committee in support of the confirmation of an individual to a cabinet position. The expenditures by N that are directly related to F's testimony are not for an exempt function.

(vii) *Example 7.* P is a political organization described in section 527(e)(2). Between elections P does not support any particular individual for public office. However, P does train staff members for the next election, drafts party rules, implements party reform proposals, and sponsors a party convention. The expenditures for these activities are for an exempt function.

(viii) *Example 8.* Q is a political organization described in section 527(e)(2). Q finances seminars and conferences which are intended to influence persons who attend to support individuals to public office whose political philosophy is in harmony with the political philosophy of Q. The expenditures for these activities are for an exempt function.

(d) *Public office.* The facts and circumstances of each case will determine whether a particular Federal, State, or local office is a *public office.* Principles consistent with those found under §53.4946–1(g)(2) (relating to the definition of public office) will be applied.

(e) *Principal campaign committee.* A *principal campaign committee* is the political committee designated by a candidate for Congress as his or her principal campaign committee for purposes of section 302(e) of the Federal Election Campaign Act of 1971 (2 U.S.C. section 432(e)), as amended, and section 527(h) and §1.527–9.

[T.D. 7744, 45 FR 85731, Dec. 30, 1980; as amended by T.D. 8041, 50 FR 30817, July 30, 1985]

§1.527–3 Exempt function income.

(a) *General rule*—(1) For purposes of section 527, exempt function income consists solely of amounts received as:

(i) Contributions of money or other property,

(ii) Membership dues, fees, or assessments from a member of a political organization, or

(iii) Proceeds from a political fund raising or entertainment event, or proceeds from the sale of political campaign materials, which are not received in the ordinary course of any trade or business,

but only to the extent such income is segregated for use only for exempt functions of the political organization.

(2) Income will be considered segregated for use only for an exempt function only if it is received into and disbursed from a segregated fund as defined in §1.527–2(b).

(b) *Contributions.* The rules of section 271(b)(2) apply in determining whether the transfer of money or other property constitutes a contribution. Generally, money or other property, whether solicited personally, by mail, or through advertising, qualifies as a contribution. In addition, to the extent a political organization receives Federal, State, or local funds under the $1 *checkoff* provision (sections 9001–9013), or any other provision for financing of campaigns, such amounts are to be treated as contributions.

(c) *Dues, fees, and assessments.* Amounts received as membership fees and assessments from members of a political organization may constitute exempt function income to the political organization. Membership fees and assessments received in consideration for services, goods, or other items of value do not constitute exempt function income. However, filing fees paid by an individual directly or indirectly to a political party in order that the individual may run as a candidate in a primary election of the party (or run in a general election as a candidate of that party) are to be treated as exempt function income. For example, some States provide that a certain percentage of the first year's salary of the office sought must be paid to the State as a filing (or *qualifying*) fee and party assessment. The State then transfers part of this fee to the candidate's party. In such a case, the entire amount transferred to the party is to be treated as exempt function income. Furthermore, amounts paid by an individual directly to the party as a qualification fee are treated similarly.

(d) *Fund raising events*—(1) *In general.* Amounts received from fund raising and entertainment events are eligible for treatment as exempt function income if the events are political in nature and are not carried on in the ordinary course of a trade or business. Whether an event is *political* in nature depends on all facts and circumstances. One factor that indicates an event is a political event is the extent to which the event is related to a political activity aside from the need of the organization for income or funds. For example, an event that is intended to rally and encourage support for an individual for public office would be a political fund raising event. Examples of political events can include dinners, breakfasts, receptions, picnics, dances, and athletic exhibitions.

(2) *Ordinary course of any trade or business.* Whether an activity is in the ordinary course of a trade or business depends on the facts and circumstances of each case. Generally, proceeds from casual, sporadic fund raising or entertainment events are not in the ordinary course of a trade or business. Factors to be taken into account in determining whether an activity is a trade or business include the frequency of the activity, the manner in which the activity is conducted, and the span of time over which the activity is carried on.

(e) *Sale of campaign materials.* Amounts received from the sale of campaign materials are eligible for treatment as exempt function income if the sale is not carried on in the ordinary course of a trade or business (as defined in paragraph (d)(2) of this section), and is related to a political activity of the organization aside from the need of such organization for income or funds. Proceeds from the sale of political memorabilia, bumper stickers, campaign buttons, hats, shirts, political posters, stationery, jewelry, or cookbooks are related to such a political acitivity where such items can be identified as relating to distributing political literature or organizing voters to vote for a candidate for public office.

[T.D. 7744, 45 FR 85732, Dec. 30, 1980]

§ 1.527–4 Special rules for computation of political organization taxable income.

(a) *In general.* Political organization taxable income is determined according to the provisions of section 527(b) and the rules set forth in this section.

(b) *Limitation on capital losses.* If for any taxable year a political organization has a net capital loss, the rules of sections 1211(a) and 1212(a) apply.

(c) *Allowable deductions*—(1) *In general.* To be deductible in computing political organization taxable income, expenses, depreciation, and similar items must not only qualify as deductions allowed by chapter 1 of the Code, but must also be directly connected with the production of political organization taxable income.

(2) *Directly connected with defined.* To be *directly connected with* the production of political organization taxable income, an item of deduction must have a proximate and primary relationship to the production of such income and have been incurred in the production of such income. Items of deduction attributable solely to items of political organization taxable income are proximately and primarily related to such income. Whether an item of deduction is incurred in the production of political organization taxable income is determined on the basis of all the facts and circumstances of each case.

(3) *Dual use of facilities or personnel.* Expenses, depreciation, and similar items that are attributable to the production of exempt function income and political organization taxable income shall be allocated between the two on a reasonable and consistent basis. For example, where facilities are used both for an exempt function of the organization and for the production of political organization taxable income, expenses, depreciation, and similar items attributable to such facilities (for example, items of overhead) shall be allocated between the two uses of a reasonable and consistent basis. Similarly, where personnel are employed both for an exempt function and for the production of political organization taxable income, expenses and similar items attributable to such personnel (for example, items of salary) shall be allocated between the activities on a reasonable and consistent basis. The portion of any such item so allocated to the production of political organization taxable income is directly connected with such income and is allowable as a deduction in computing political organization taxable income to the extent that it qualifies as an item of deduction allowed by chapter 1 of the Code. Thus, for example, assume that X, a political organization, pays its manager a salary of $10,000 a year and that it derives political organization taxable income. If 10 percent of the manager's time during the year is devoted to deriving X's gross income (other than exempt function income), a deduction of $1,000 (10 percent of $10,000) would generally be allowable for purposes of computing X's political organization taxable income.

[T.D. 7744, 45 FR 85733, Dec. 30, 1980]

§ 1.527–5 Activities resulting in gross income to an individual or political organization.

(a) *In general*—(1) *General rule.* Amounts expended by a political organization for an exempt function are not income to the individual or individuals on whose behalf such expenditures are made. However, where a political organization expends any other amount for the personal use of any individual, the individual on whose behalf the amount is expended will be in receipt of income. Amounts are expended for the personal use of an individual where a direct or indirect financial benefit accrues to such individual. For example, if a political organization pays a personal legal obligation of a candidate for public office, such as the candidate's federal income tax liability, the amount paid is includible in such candidate's gross income. Similarly, if a political organization expends anyamount of its exempt function income for other than an exempt function, and the expenditure results in a direct or indirect financial benefit to the political organization, it must include the amount of such expenditure in its gross income. For example, if a political organization expends exempt function income for making an improvement or addition to its facilities, or for equipment, which is not necessary for or used in carrying out an

exempt function, the amount of the expenditure will be included in the political organization's gross income. However, if a political organization expends exempt function income to make ordinary and necessary repairs on the facilities the political organization uses in conducting its exempt function, such amounts will not be included in the political organization's gross income.

(2) *Expenditure for an illegal activity.* Expenditures by a political organization that are illegal or for an activity that is judicially determined to be illegal are treated as amounts not segregated for use only for the exempt function and shall be included in the political organization's taxable income. However, expenses incurred in defense of civil or criminal suits against the organization are not treated as taxable to the organization. Similarly, voluntary reimbursement to the participants in the illegal activity for similar expenses incurred by them are not taxable to the organization if the organization can demonstrate that such payments do not constitute a part of the inducement to engage in the illegal activity or part of the agreed upon compensation therefor. However, if the organization entered into an agreement with the participants to defray such expenses as part of the inducement, such payments would be treated as an expenditure for an illegal activity. Except where necessary to prevent the period of limitation for assessment and collection of a tax from expiring, a notice of deficiency will not generally be issued until after there has been a final determination of illegality by an appropriate court in a criminal proceeding.

(b) *Certain uses not treated as income to a candidate.* Except as otherwise provided in paragraph (a) of this section, if a political organization:

(1) Contributes any amount to or for the use of any political organization described in section 527(e)(1) or newsletter fund described in section 527(g),

(2) Contributes any amount to or for the use of any organization described in paragraph (1) and (2) of section 509(a) which is exempt from taxation under section 501(a), or

(3) Deposits any amount in the general fund of the U.S. Treasury or in the general fund of any State or local government,

such amount shall not be treated as an amount expended for the personal use of a candidate or other person. No deduction shall be allowed under the Internal Revenue Code of 1954 for the contribution or deposit described in the preceding sentence.

(c) *Excess funds*—(1) *General rule.* Generally, funds controlled by a political organization or other person after a campaign or election are excess funds and are treated as expended for the personal use of the person having control over the ultimate use of such funds. However, such funds will not be treated as excess funds to the extent they are:

(i) Transferred within a reasonable period of time by the person controlling the funds in accordance with paragraph (b) of this section, or

(ii) Held in reasonable anticipation of being used by the political organization for future exempt functions.

(2) *Excess funds transferred at death.* Where excess funds are held by an individual who dies, and these funds go to the individual's estate or any other person (other than an organization or fund described in paragraph (b) of this section), the funds are income of the decedent and will be included in the decedent's gross estate unless the estate or other person receiving such funds transfers the funds within a reasonable period of time in accordance with paragraph (b) of this section.

This paragraph (c)(2) will not apply where the individual who dies provides that the funds be transferred to an organization or fund described in paragraph (b) of this section.

[T.D. 7744, 45 FR 85733, Dec. 30, 1980]

§ 1.527–6 Inclusion of certain amounts in the gross income of an exempt organization which is not a political organization.

(a) *Exempt organizations—General rule.* If an organization described in section 501(c) which is exempt from tax under section 501(a) expends any amount for an exempt function, it may be subject to tax. There is included in the gross income of such organization for the

taxable year an amount equal to the lesser of:

(1) The net investment income of such organization for the taxable year, or

(2) The aggregate amount expended during the taxable year for an exempt function.

The amount included will be treated as political organization taxable income.

(b) *Exempt function expenditures*—(1) *Directly related expenses.* (i) Except as provided in this section, the term *exempt function* will generally have the same meaning it has in §1.527–2(c). Thus, expenditures which are directly related to the selection process as defined in §1.527–2(c)(1) are expenditures for an exempt function. Expenditures for indirect expenses as defined in §1.527–2(c)(2), when made by a section 501(c) organization are for an exempt function only to the extent provided in paragraph (b)(2) of this section. Expenditures of a section 501 (c) organization which are otherwise allowable under the Federal Election Campaign Act or similar State statute are for an exempt function only to the extent provided in paragraph (b)(3) of this section.

(ii) An expenditure may be made for an exempt function directly or through another organization. A section 501(c) organization will not be absolutely liable under section 527(f)(1) for amounts transferred to an individual or organization. A section 501(c) organization is, however, required to take reasonable steps to ensure that the transferee does not use such amounts for an exempt function.

(2) *Indirect expenses.* [Reserved]

(3) *Expenditures allowed by Federal Election Campaign Act.* [Reserved]

(4) *Appointments or confirmations.* Where an organization described in paragraph (a) of this section appears before any legislative body in response to a written request by such body for the purpose of influencing the appointment or confirmation of an individual to a public office, any expenditure directly related to such appearance is not treated as an expenditure for an exempt function.

(5) *Nonpartisan activity.* Expenditures for nonpartisan activities by an organization to which paragraph (a) of 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.

(c) *Character of items included in gross income*—(1) *General rule.* The items of income included in the gross income of an organization under paragraph (a) of this section retain their character as ordinary income or capital gain.

(2) *Special rule in determining character of item.* If the amount included in gross income is determined under paragraph (a)(2)(ii) of this section, the character of the items of income is determined by multiplying the total amount included in gross income under such paragraph by a fraction, the numerator of which is the portion of the organization's net investment income that is gain from the sale or exchange of a capital asset, and the denominator of which is the organization's net investment income. For example, if $5,000 is included in the gross income of an organization under paragraph (a)(2) of this section, and the organization had $100,000 of net investment income of which $10,000 is long term capital gain, then $500 would be treated as long term capital gain:

$$\frac{\text{Capital gain}}{\text{net investment income}} \times \text{Amount expended on an exempt function} = \text{Portion of income subject to tax under SS section 1201}$$

$$\frac{\$10{,}000}{\$100{,}000} \times \$5{,}000 = \$500$$

(d) *Modifications.* The modifications described in section 527(c)(2) apply in computing the tax under paragraph (a)(2) of this section. Thus, no net operating loss is allowed under section 172 nor is any deduction allowed under part VIII of subchapter B. However, there is allowed a specific deduction of $100.

(e) *Transfer not treated as exempt function expenditures.* Provided the provisions of this paragraph (e) are met, a transfer of political contributions or dues collected by a section 501(c) organization to a separate segregated fund as defined in paragraph (f) of this section is not treated as an expenditure for an exempt function (within the meaning of §1.527–2(c)). 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. A transfer is considered promptly and directly made if:

(1) The procedures followed by the section 501(c) organization satisfy the requirements of applicable Federal or State campaign law and regulations;

(2) The section 501(c) organization maintains adequate records to demonstrate that amounts transferred in fact consist of political contributions or dues, rather than investment income; and

(3) The political contributions or dues transferred were not used to earn investment income for the section 501(c) organization.

(f) *Separate segregated fund.* An organization or fund described in section 527(f)(3) is a separate segregated fund. To avoid the application of paragraph (a) of this section, an organization described in section 501(c) that is exempt from taxation under section 501(a) may, if it is consistent with its exempt status, establish and maintain such a separate segregated fund to receive contributions and make expenditures in a political campaign. If such a fund meets the requirements of §1.527–2(a) (relating to the definition of a political organization), it shall be treated as a political organization subject to the provisions of section 527. A segregated fund established under the Federal Election Campaign Act will continue to be treated as a segregated fund when it engages in exempt function activities as defined in §1.527–2(c), relating to State campaigns.

(g) *Effect of expenditures on exempt status.* Section 527(f) and this section do not sanction the intervention in any political campaign by an organization described in section 501(c) if such activity is inconsistent with its exempt status under section 501(c). For example, an organization described in section 501(c)(3) is precluded from engaging in any political campaign activities. The fact that section 527 imposes a tax on the exempt function (as defined in §1.527–2(c)) expenditures of section 501(c) organizations and permits such organizations to establish separate segregated funds to engage in campaign activities does not sanction the participation in these activities by section 501(c)(3) organizations.

[T.D. 7744, 45 FR 85734, Dec. 30, 1980]

§1.527–7 Newsletter funds.

(a) *In general.* For purposes of this section, a fund established and maintained by an individual who holds, has been elected to, or is a candidate (within the meaning of section 41(c)(2)) for nomination or election to, any Federal, State, or local elective public office for the use by such individual exclusively for an exempt function, as defined in paragraph (c) of this section, shall be a newsletter fund. If assets of a newsletter fund are used for any purpose other than the exempt function of the newsletter fund as defined in paragraph (c) of this section, such amount shall be treated as expended for the personal use of the individual who established and maintained such fund. In addition, future contributions to such fund are treated as income to the individual who established and maintained the fund. In such a case, the facts and circumstances may indicate that the fund was never established and maintained exclusively for an exempt function as defined in paragraph (c) of this section.

(b) *Determination of taxable income.* A newsletter fund shall be treated as if it were a political organization for purposes of determining its taxable income. However, the specific $100 deduction provided by section 527(c)(2)(A) shall not be allowed.

(c) *Exempt function.* For purposes of this section, the exempt function of a newsletter fund consists solely of the preparation and circulation of the newsletter. Among the expenditures treated as preparation and circulation expenditures of the newsletter are:

(1) Secretarial services,

(2) Printing,

(3) Addressing, and

(4) Mailing.

(d) *Nonexempt function purposes.* Newsletter fund assets may not be used for campaign activities. Therefore, an exempt function of a newsletter fund does not include:

(1) Expenditures for an exempt function as defined in §1.527–2(c) or

(2) Transfers of unexpended amounts to a political organization described in section 527(e)(1).

(e) *Excess funds.* Excess funds held by a newsletter fund which has ceased to engage in the preparation and circulation of the newsletter are treated as expended for the personal use of the individual who established and maintained such fund. However, to the extent such excess funds are within a reasonable period of time:

(1) Contributed to or for the use of any organization described in paragraph (1) or (2) of section 509(a) which is exempt from taxation under section 501(a),

(2) Deposited in the general fund of the U.S. Treasury or in the general fund of any State or local government (including the District of Columbia), or

(3) Contributed to any other newsletter fund as described in paragraph (a) of this section,

the excess funds are not treated as expended for the personal use of such individual. In such a case the individual is not allowed a deduction under the Internal Revenue Code of 1954 for such contribution or deposit.

[T.D. 7744, 45 FR 85735, Dec. 30, 1980]

§1.527–8 Effective date; filing requirements; and miscellaneous provisions.

(a) *Assessment and collections.* Since the taxes imposed by section 527 are taxes imposed by subtitle A of the Code, all provisions of law and of the regulations applicable to the taxes imposed by subtitle A are applicable to the assessment and collection of the taxes imposed by section 527. Organizations subject to the tax imposed by section 527 are subject to the same provisions, including penalties, as are provided for corporations, in general, except that the requirements of section 6154 concerning the payment of estimated tax do not apply. See, generally, sections 6151, et. seq., and the regulations prescribed thereunder, for provisions relating to payment of tax.

(b) *Returns.* For requirements of filing annual returns with respect to political organization taxable income, see section 6012 (a) (6) and the applicable regulations.

(c) *Taxable years, method of accounting, etc.* The taxable year (fiscal year or calendar year, as the case may be) of a political organization is determined without regard to the fact that such organization may have been exempt from tax during any prior period. See sections 441 and 446, and the regulations thereunder in this part, and section 7701 and the regulations in Part 301 of this chapter (Regulations on Procedure and Administration). Similarly, in computing political organization taxable income, the determination of the taxable year for which an item of income or expense is taken into account is made under the provisions of sections 441, 446, 451, 461, and the regulations thereunder, whether or not the item arose during a taxable year beginning before, on, or after the effective date of the provisions imposing a tax upon political organization taxable income. If a method for treating bad debts was selected in a return of income (other than an information return) for a previous taxable year, the taxpayer must follow such method in its returns under section 527, unless such method is changed inaccordance with the provisions of §1.166–1. A taxpayer who has not previously selected a method for treating bad debts may, in its first return under section 6012 (a) (6), exercise the option granted in §1.166–1.

(d) *Effective date.* Except as provided in paragraph (b)(2) of §1.527–6 and in paragraph (a) of §1.527–9, the regulations under section 527 apply to taxable

years beginning after December 31, 1974.

[T.D. 7744, 45 FR 85735, Dec. 30, 1980; as amended by T.D. 8041, 50 FR 30817, July 30, 1985]

§ 1.527–9 Special rule for principal campaign committees.

(a) *In general.* Effective with respect to taxable years beginning after December 31, 1981, the tax imposed by section 527(b) on the political organization taxable income of a principal campaign committee shall be computed by multiplying the political organization taxable income by the appropriate rates of tax specified in section 11(b). The political organization taxable income of a campaign committee not a principal campaign committee is taxed at the highest rate of tax specified in section 11(b). A candidate for Congress may designate one political committee to serve as his or her principal campaign committee for purposes of section 527(h)(1). If a designation is made, it shall be made in accordance with the requirements of paragraph (b) of this section. A candidate for Congress may have only one designation in effect at any time. Under 11 CFR 102.12, no political committee may be designated as the principal campaign committee of more than one candidate for Congress. Further, no political committee that supports or has supported more than one candidate for Congress may be designated as a principal campaign committee. No designation need be made where there is only one political campaign committee with respect to a candidate.

(b) *Manner of designation.* If a candidate for Congress elects to make a designation under section 527(h) and this section, he or she shall designate his or her principal campaign committee by appending a copy of his or her Statement of Candidacy (that is, the Federal Election Commission Form 2, or equivalent statement that the candidate filed with the Federal Election Commission under 11 CFR 101.1(a)), to the Form 1120–POL filed by the principal campaign committee for each taxable year for which the designation is effective. This designation may also be made by appending to the Form 1120–POL statement containing the following information: The name and address of the candidate for Congress; his or her taxpayer identification number; his or her party affiliation and the office sought; the district and State in which the office is sought; and the name and address of the principal campaign comittee. This designation shall be made on or before the due date (as extended) for filing Form 1120–POL. Only a candidate for Congress may make a designation in accordance with this paragraph.

(c) *Manner of revoking designation.* A designation of a principal campaign committee that has been filed in accordance with this section may be revoked only with the consent of the Commissioner. In general, the Commissioner will grant such consent in every case where the candidate for Congress has revoked his or her designation in compliance with the requirements of the Federal Election Commission by filing an amended Statement of Organization or its equivalent pursuant to 11 CFR 102.2(a)(2). In the case of the revocation of the designation of a principal campaign committee by a candidate followed by the designation of another principal campaign committee by such candidate, for purposes of determining the appropriate rate of tax under section 11(b) for a taxable year, the political organization taxable income of the first principal campaign committee shall be treated as that of the subsequent principal campaign committee. In a case where consent to revoke a designation of a principal campaign committee is granted and a new designation is filed, the Commissioner may condition his consent upon the agreement of the candidate for Congress to insure compliance with the preceding sentence.

[T.D. 8041, 50 FR 30817, July 30, 1985]

HOMEOWNERS ASSOCIATIONS

§ 1.528–1 Homeowners associations.

(a) *In general.* Section 528 only applies to taxable years of homeowners associations beginning after December 31, 1973. To qualify as a homeowners association an organization must either be a condominium management association or a residential real estate