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Taxation of Exempts (WG&L)
2012
Volume 24, Number 02, September/October 2012
Articles
ADVOCACY BY SECTION 501(c)(3) ORGANIZATIONS—FEDERAL TAX LAW RESTRICTIONS ON LOBBYING ACTIVITIES, Taxation of Exempts (WG&L), Sep/Oct 2012

ADVOCACY BY SECTION 501(c)(3) ORGANIZATIONS—FEDERAL TAX LAW RESTRICTIONS ON LOBBYING ACTIVITIES

Section 501(c)(3) charities face a choice between a lack of precise guidance and a system of numerical limits that may be too small for the biggest groups, while private foundations must scrutinize their activities to ensure that they do not engage in lobbying under the tax laws.

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Section 501(c)(3) provides, as a requirement for exemption under Section 501(c)(3), that "no substantial part of the activities" of an organization may constitute "carrying on propaganda, or otherwise attempting, to influence legislation." Although the "no substantial part" requirement has been a part of the law for decades, there is remarkably little guidance on the subject. This leaves public charities in a quandary—they are permitted to engage in some lobbying but too much may jeopardize their tax exemption, and there is no bright-line test for determining how much lobbying is too much.

In 1976, Congress responded to public charities' complaints about the vagueness of the "no substantial part" requirement by enacting Sections 501(h) and 4911, which permit public charities to elect to be governed by specific expenditure limitations on their lobbying activities. The so-called "lobbying election" provides bright-line rules in the form of dollar limitations that enable electing charities to achieve certainty as to the amount of lobbying that is permissible under Section 501(c)(3). The regulations implementing the lobbying election contain definitions and exceptions that are quite liberal, and it is advantageous for many public charities to make the lobbying election. Unfortunately, the dollar limitations for the lobbying election were not indexed for inflation, so what seemed like reasonable dollar limits when the election was enacted in 1976 have lost significant economic value in the intervening 36 years. Accordingly, some larger organizations find it more advantageous to rely on the vague "no substantial part" test than it would be to make the lobbying election. Private foundations, on the other hand, are prohibited from using their funds for lobbying under Section 4945, but there are exceptions to the definition of lobbying that closely resemble the exceptions set forth in Sections 501(h) and 4911 and provide some guidance about how private foundations can comply with these rules.

The discussion below deals solely with the tax law restrictions on lobbying activities by Section 501(c)(3) organizations. The tax laws are not the only source of federal regulation of lobbying activities by tax-exempt organizations, however. The Lobbying Disclosure Act[1] (LDA) establishes registration and quarterly reporting requirements for persons, including

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Section 501(c)(3) organizations, that engage in certain lobbying activities, and Section 501(c)(3) organizations must also consider these rules when conducting lobbying activities. The Secretary of the Senate and the Clerk of the House of Representatives provide useful guidance on the lobbying registration and reporting requirements under the LDA, available online at http://lobbyingdisclosure.house.gov/amended_lda_guide.html.

'No substantial part' test

There are two issues under the "no substantial part" test—what activities are considered "lobbying," and when are those activities considered "substantial."

What is lobbying?

The regulations under Section 501(c)(3) define lobbying as an attempt to influence legislation. "Legislation" is defined as action by Congress, a state legislature, a local council, or similar governing body, as well as action by the public in a referendum or similar type of ballot measure initiative.[2] "Legislation" includes some matters that do not, strictly speaking, involve the passage of a bill. For example, the term includes the action required by the Senate to ratify a treaty or to confirm a Supreme Court nominee. Similarly, "legislation" is not limited to matters that are the subject of a bill that has been introduced; it also includes specific legislative proposals that an organization supports or opposes. An organization is deemed to engage in lobbying activities if it contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation, or if it advocates the adoption or rejection of legislation.[3]

Example. A coalition of environmental organizations, all exempt under Section 501(c)(3), has determined that the law governing federal regulation of wetlands is insufficient to protect endangered wildlife. It has drafted a proposal for legislation that would expand current legal restrictions. This proposal is considered "legislation," even though no bill has been introduced in Congress.

It is important to note that "legislation" does not include attempts to influence the executive branch or administrative agencies with respect to regulatory (as opposed to legislative) matters. This distinction is of critical importance to public charities, as it allows them to engage in unlimited advocacy with respect to actions taken by administrative agencies on purely regulatory matters.

Example. The coalition described above is also concerned about regulations issued by the Environmental Protection Agency on the subject of federally regulated wetlands. Coalition members contact the EPA to seek its support for their legislative proposal, and to urge the EPA to modify its regulations concerning wetlands preservation. The coalition members' effort to seek EPA support for the legislative proposal is lobbying because the effort, while directed to an administrative agency, is seeking support for a legislative matter. The coalition's effort to seek modification of agency regulations is not lobbying because it concerns a matter that is purely administrative.

What is not lobbying?

Under the private foundation regulations, there are several exceptions for activities that are not considered to be lobbying. These exceptions are considered generally applicable to public charities as well. They include the following:

Nonpartisan study, analysis, and research. Lobbying does not include the conduct of nonpartisan analysis, study, or research as long as the dissemination of such analysis does not advocate the adoption of legislation to implement its findings.[4] The analysis may conclude that legislation is appropriate to achieve a given objective if it contains a "sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion."[5] This exception generally covers the type of work product developed through a thoughtful academic examination of an issue that addresses both sides before coming to a conclusion. Note, however, that a product may lose its qualification as nonpartisan analysis if it is disseminated to those interested in only one side of a particular issue.

Example. The Free Trade Institute researches and publishes white papers on issues concerning free trade. One such paper researches the economic effect of embargoes and concludes that the United States should reverse its policy toward Cuba and open up free trade. The paper notes that this course of action would require legislation by the U.S. Congress. A copy of the paper is circulated to the Senate and read by Senator Jones, who introduces legislation to open trade relations with Cuba and cites the paper as the basis for her

action. The white paper falls within the nonpartisan study, analysis, and research exception, even though it leads to the introduction of legislation.

Examinations of broad social, economic, and similar problems. Lobbying does not include examinations of broad social, economic, and similar problems.[6] Where such examinations are directed to topics that are also the subject of specific legislation, however, this exception does not permit references to such legislation or statements encouraging the readers to take action with respect to such legislation.

It is sometimes difficult to distinguish between this exception and the exception described above for "nonpartisan study, analysis, and research," since both exceptions cover the type of work product that is developed by countless public charities. In general, this exception is intended to cover very broad examinations of particular societal problems that, by their nature, are and will be the subject of legislation. Take access to health care, for example. A broad examination of the subject of access to health care would fall under this exception; a more narrow examination of a particular type of effort related to improving access to health care would be more likely to fall within the exception for "nonpartisan study, analysis, and research." The basic difference between the two exceptions is that there is more latitude under the "nonpartisan study, analysis, and research" exception to reach a conclusion as to a particular legislative solution, as long as that conclusion is the product of traditional scholarly analysis. As a practical matter, however, Section 501(c)(3) organizations are not required to report activities falling within one of the exceptions to lobbying, so the difference between the "nonpartisan analysis" and the "broad examination" exception is largely of academic interest.

Example. Legal Think Tank is studying the potential impact of proposed legislation that would increase immigrants' rights to education in the state and wishes to publish its findings. The think tank may publish findings generally related to the impact of programs designed to increase access to education for immigrants but, under the "broad examination" exception, it may not refer specifically to the proposed legislation nor may the publication support or oppose the legislation. Under the "nonpartisan study, analysis, and research" exception, however, the think tank may refer to and reach a view about the proposed legislation as long as it does so in a balanced way, considering both sides of the issue.

Requests for technical advice or assistance. Although Congress has restricted the lobbying activities of Section 501(c)(3) organizations, it has done so in a manner that preserves its access to the vast expertise represented by such organizations and their employees. So that such expertise remains available to lawmakers, the term "lobbying" does not include the provision of technical advice to a governmental body, or committee or subcommittee thereof, in response to a written request by the ranking majority or minority member.[7] Under

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this exception, an organization's employee may provide oral and/or written testimony at Congressional hearings on proposed legislation, and may express a view about such legislation's merits (or lack thereof). Congressional staff are familiar with the "technical advice" exception, and generally are quite willing to request testimony in accordance with the applicable requirements. Note, however, that this exception covers only technical advice that is made available on a bipartisan basis, such as at a committee or subcommittee hearing. It does not apply to advice provided at the request of an individual legislator. A sample request for technical advice is set forth in Exhibit 1 on page 15.[8]

Exhibit 1. Sample Request for Technical Advice.

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Oversight Subcommittee of the Ways and Means Committee
United States House of Representatives

Dear President X:

The Oversight Subcommittee of the Ways and Means Committee of the
United
States House of Representatives is holding a hearing at 10:00 a.m. on
April 15, 2013 on the subject of lobbying activities by Section
501(c)(3)
organizations. The Subcommittee invites you to testify to provide
technical
advice and assistance with respect to the adequacy of current federal
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legislation to regulate such activities without imposing an undue impediment
on the ability of Section 501(c)(3) organizations to engage fully in the
public debate. We would appreciate your willingness to address issues such
as whether the expenditure limits contained in the lobbying election under
Sections 501(h) and 4911 are adequate for public charities, whether public
charities choose to make the lobbying election rather than to rely on the
"no substantial part" test under Section 501(c)(3) due to the inadequate
expenditure limits under Sections 501(h) and 4911, and whether the Form 990
reporting rules provide an appropriate mechanism for the disclosure of
lobbying activities.

Sincerely,

Y, Chairman of the Oversight Subcommittee

Example. Dr. Urban, a noted scholar of urban planning who has conducted extensive research on the impact of car-free zones on city transportation, is also the executive director of an advocacy organization that promotes the use of bicycles in urban environments. Dr. Urban receives a letter from the chairman of a committee of the state legislature, inviting her to testify at an upcoming hearing on a plan to place a pedestrian zone downtown in the state capital. Her organization is in favor of the plan. Dr. Urban may testify at the hearing; her testimony will not be considered lobbying because it will fall within the technical advice exception.

Self-defense communications. Congress and the IRS have also recognized that public charities must be free to engage in lobbying with respect to issues that go to the heart of their existence,

powers, duties, tax-exempt status, and deductibility of contributions. This exception for "self-defense" lobbying allows public charities to communicate with legislators and/or their staff with respect to proposed legislation in the areas outlined above, and even to initiate legislation in those areas.[9] The exception is fairly limited, however, and does not cover proposed legislation involving public policy issues that may be of importance to the charities in carrying out their educational programs. For example, lobbying against legislation that would reduce federal funding for a particular program of interest to a charity would not qualify under the self-defense exception; lobbying against legislation to eliminate the charitable contribution deduction would qualify. The exception also does not cover grassroots lobbying activities.

Example. The House Ways and Means Committee is considering proposed legislation that would prohibit all lobbying by organizations receiving federal funding. Such legislation would affect the powers of public charities, and their direct lobbying in opposition to the proposal would be within the self-defense exception and therefore would not be considered lobbying for purposes of Section 501(c)(3).

The subject matter of the sample technical advice request in Exhibit 1 would also fall within the self-defense exception.

How much lobbying is substantial?

Neither Section 501(c)(3) nor the regulations thereunder provide guidance as to when lobbying activities constitute a substantial part of a charity's activities. It is simply not clear whether this determination is based on the charity's activities, its expenditures, or both. A few cases provide some limited guidance. In *Seasongood,* 48 AFTR 711, 227 F2d 907, 56-1 USTC ¶9135 (CA-6, 1955), the court looked at lobbying expenditures as a percentage of total expenditures and held that 5% of the organization's budget was not substantial. Subsequent cases have rejected a percentage test or have combined it with an overall evaluation of the significance of the charity's lobbying activities.[10] Some factors that may be used in determining substantiality include the controversial nature of the stance taken or particular policy being lobbied and whether or not the lobbying activity is part of a continuous campaign or intermittent in nature. The IRS takes the position that nonelecting charities must consider lobbying activities undertaken by volunteers on their behalf in determining the substantiality of their lobbying activities. Without any bright-line test

in this area, charities subject to the "no substantial part" test must exercise caution as to the size and scope of their lobbying activities.

The lobbying election under Sections 501(h) and 4911

The vagueness of the "no substantial part" test led Congress to enact Sections 501(h) and 4911, which permit public charities to elect to be subject to specific expenditure limitations on their direct and grassroots lobbying activities. The most important thing to keep in mind about the expenditure test is that it looks only at actual expenditures. If there is no expenditure involved in a specific

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lobbying activity (e.g., the activity is conducted at no expense by volunteers), that activity is not counted under this test. The IRS has issued extensive regulations that provide electing charities with a clear set of standards that govern their lobbying activities.

Definitions of lobbying.

The lobbying election establishes separate expenditure limitations for direct and grassroots lobbying, and it is important for electing charities to understand these definitions and categorize their lobbying activities accordingly.

Direct lobbying. Direct lobbying is defined as an attempt to influence legislation through communication with a member or staff of a legislative body or with any other government official who may participate in the formulation of the legislation, including an official of an administrative agency who has some responsibility for legislative matters, if the principal purpose of the communication is to influence legislation.[11] The communication must refer to "specific legislation" and reflect a view on such legislation. Communications with members or staff of legislative bodies for the purpose of obtaining information on the status of legislative proposals and not to influence the outcome are not considered direct lobbying.

Grassroots lobbying. Grassroots lobbying is defined as an attempt to influence legislation through a communication with members of the public that seeks to encourage them to engage in lobbying in support of or in opposition to legislation.[12] The communication must (1) refer to

specific legislation, (2) reflect a view on the legislation, and (3) include a "call to action" that encourages the recipient to take action with respect to the legislation. A communication includes a "call to action" if it incorporates any one of the following elements:

- It urges the recipient to contact a legislator, staffer, or other government employee who participates in the formulation of legislation for the principal purpose of influencing legislation.
- It states the address, telephone number, or similar information for a legislator or employee of a legislative body.
- It provides a petition or tear-off postcard for the principal purpose of influencing legislation.
- It states one or more legislators' positions on the legislation, or identifies them as members of a committee or subcommittee that will consider the legislation; however, this does not include naming the main sponsor(s) for purposes of identifying the legislation.

The regulations provide that the first three types of "calls to action" are deemed to be "direct" encouragement, while the fourth type is deemed "indirect."[13] The distinction between direct and indirect calls to action is relevant in determining whether certain activities fall within the "nonpartisan analysis" exception discussed below.

The regulations for electing public charities recognize the fine line between "lobbying" and "education," particularly in the case of advocacy organizations whose purpose is to educate the

public on cause-related issues, including the impact of proposed legislation on the cause served by the organization. The "call to action" requirement allows electing charities to make fairly direct advocacy communications that they will be able to treat as public education rather than grassroots lobbying by eliminating any "tag line" urging the reader to take action. Some electing charities have become extremely adept at crafting advocacy campaigns directed at legislative issues without crossing the line into grassroots lobbying. The sample advertisement set forth in Exhibit 2 on page 17 illustrates how an advocacy organization, working within the bounds of the lobbying election definitions, can communicate an inescapable lobbying message to the public

that nevertheless falls short of the grassroots lobbying definition. Note, however, that there is a special rule (see below) for certain paid media advertisements within two weeks of a vote on highly publicized legislation, and under that rule it would be possible for the communication in Exhibit 2 to be considered grassroots lobbying, depending on the timing of the communication.

Exhibit 2. Full-Page Ad in *The New York Times.*

Wetlands are valuable ecosystems that are home to many endangered species in our country and contribute to the wider health and well-being of our environment. Adequate preservation of our wetlands is critical to the conservation of many threatened species of animals and to the conservation of much of our nation's water resources.

The U.S. Congress is fast becoming one of the major threats to our healthy environment and to the preservation of wetlands. The Wildlife and Wetlands Conservation Act would actually decrease current regulations governing the use of wetlands and provide tax incentives for development of certain wetlands currently under protection.

More than ever, we need to strengthen the protections afforded to our nation's wetlands. Studies show that wetlands preservation is the key to stimulating the restoration of many damaged ecosystems and to ensuring an adequate water supply for future generations. Now is the time to stand up for a healthy environment and ensure that critical protections afforded under the law are not eroded.

Working together, concerned citizens can continue to improve the health
of our wetlands by ensuring that they are adequately protected. Congress
should say "NO" to the Wildlife and Wetlands Conservation Act.

WETLANDS: THE KEY TO OUR ENVIRONMENT'S FUTURE

Sponsored by Local Conservation Organization, Rural Community Development
Corporation

Advocates for Healthy Rivers and Save the Wetlands!

Special rule for mass media advertisements. The advertisement in Exhibit 2 illustrates the liberality of the definition of grassroots lobbying, and shows how far an advocacy communication intending to arouse public action can go without crossing the boundary that separates education from grassroots lobbying. There is, however, a special rule that applies in the case of mass media advertisements involving highly publicized legislation.[14] Under this rule, a paid advertisement will be presumed to be grassroots lobbying if it does all of the following:

- Appears in the mass media two weeks before a vote of a legislative body or a committee thereof (but not a subcommittee) on a piece of highly publicized legislation.
- Reflects a view on the legislation.
- Either refers to the legislation or encourages the public to communicate with legislators on the general subject of such legislation.

Mass media is defined to include "television, radio, billboards, and general circulation newspapers and magazines." If the electing charity is itself a mass media publisher or broadcaster, the regulations provide that all portions of that organization's mass media publications or broadcasts are treated as paid advertisements in the mass media, except those specific portions that are advertisements paid for by another person.

Legislation is considered to be "highly publicized" if (1) it is covered frequently in general circulation newspapers and on radio and television and (2) the pendency of the legislation or its terms, purpose, or effect are known to a significant segment of the public (not just the affected interest groups) in the area where the paid mass media advertisement appears. A charity may rebut the presumption that a mass media advertisement is grassroots lobbying by demonstrating that the timing is unrelated to the upcoming legislative action or that it is a type of communication regularly made by the organization without regard to the legislation.

The hypothetical advertisement in Exhibit 2 is an example of a communication that could fit—depending on the timing of the vote and whether the legislation is "highly publicized"—within the special rule for mass media advertisements, and therefore be considered grassroots lobbying even though there is no call to action or "tag line."

What is not lobbying?

Sections 501(h) and 4911, and the regulations thereunder, explicitly incorporate the exceptions set out in the previous section on "What is not lobbying?" In the case of the exception for nonpartisan analysis, the regulations offer more guidance as to the requirements of the exception, as well as whether activities falling outside that exception will be considered direct or grassroots lobbying. The regulations also contain rules governing the treatment of certain membership communications for purposes of the lobbying restrictions.

Nonpartisan analysis. The regulations grapple with the question of whether an activity that meets the definition of grassroots lobbying may nonetheless fall within the nonpartisan analysis exception.[15] They resolve the question by holding that the nonpartisan analysis exception does not apply to a communication that refers to specific legislation, reflects a view on the legislation, and directly encourages the recipient to take action by making a direct call to action in one or more of the forms described above. For these purposes, a direct call to action includes urging the recipient to contact a legislator or staffer to support or oppose the legislation, identifying the name and address or telephone number of a relevant legislator, or providing a petition or tear-off postcard to send to the legislator. If, however, the call to action is

indirect, the exception remains available. An indirect call to action includes an identification of the legislators' positions on the issue or their membership on an applicable committee, but does not contain the legislators' addresses or telephone numbers.

Example. City Community Development Corporation (CCDC) is located in a deteriorated part of a large city. Working with advisors from a local college, CCDC prepares a nonpartisan analysis concerning the use of economic revitalization as a means to combat further deterioration of the community in which the college is located. The report examines various revitalization proposals and concludes that the establishment of a high-technology research park adjacent to the campus would be the most effective approach because it would attract technology-related businesses to the area, creating new jobs for low-income community residents. The report supports proposed legislation that would offer economic incentives for development of the technology research park, and lists the names of the members of the City Council who will consider the legislative proposal. The report does not, however, urge readers to contact the City Council members to ask for their support of the proposed legislation. Although the report meets the definition of a grassroots lobbying communication, it does not directly urge the reader to engage in lobbying. Accordingly, the report falls within the nonpartisan analysis exception and is not considered grassroots lobbying.

The regulations also include a special rule for nonpartisan analysis that is presented in a series. Normally, each broadcast or publication must qualify for the nonpartisan analysis exception on its own. The regulations provide, however, that a broadcast or publication that is part of a series will be evaluated as a part of the whole. If the series, taken together, qualifies for the nonpartisan analysis exception, each separate presentation will qualify even though it would not if considered on its own.

Membership communications. Many public charities are formed as membership organizations, and they consider it part of their mission to keep members informed on current public policy issues, including the status of legislation that would affect them and/or their members. The regulations establish reasonable standards for determining whether such organizations' communications with their members should constitute lobbying at all and, if so, whether such communications should be characterized as direct or grassroots lobbying.[16] The regulations also

provide a fairly liberal definition of "member" that—for these purposes—is considered to be someone who provides more than a nominal amount of time or money to the charity.

For written communications made primarily to members (i.e., more than half of the recipients are members), expenditures for a communication that refers to and reflects a view on specific legislation are not lobbying expenditures if the communication satisfies the following requirements:

(1.) The communication is directed only or primarily to members of the organization.

(2.) The specific legislation mentioned in the communication is of interest to the organization and its members.

(3.) The communication does not directly encourage the reader to engage in direct lobbying (individually or through the organization).

(4.) The communication does not directly encourage the member to engage in grassroots lobbying (individually or through the organization).

Expenditures for a communication that satisfies (1), (2), and (4), but not (3) are treated as direct lobbying. Expenditures for a communication that satisfies (1), (2), and (3), but not (4) are treated as grassroots lobbying.

Subsequent use of nonlobbying communications. In many cases, a charity's nonlobbying communication may form the basis for a future lobbying communication. This often happens with the products of nonpartisan research and analysis undertaken by public charities. For example, the results of the analysis may indicate so clearly that legislation is—or is not—appropriate that the charity itself, or others, may seek to adapt the product to a lobbying use. The issue is whether—and under what circumstances—the subsequent lobbying use of a nonpartisan analysis or other nonlobbying communication may, in retrospect, taint the nonlobbying nature of the original product.

The regulations contain a very sensible rule that addresses this issue. In essence, the subsequent grassroots lobbying use of materials that originally were not lobbying communications will cause the expenses of preparing the original materials to be treated as for grassroots lobbying in limited circumstances.

This rule covers only materials or communications that refer to and reflect a view on specific legislation but that do not, in their initial format, directly encourage recipients to engage in lobbying (e.g., materials or communications that meet the "nonpartisan analysis" exception).

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If such materials are later used to encourage grassroots lobbying, they will not be treated as grassroots lobbying communications if the charity's primary purpose in preparing the materials was not for use in lobbying.[17] The IRS will assume that there was a nonlobbying primary purpose if the charity makes a "substantial distribution" of the materials in their nonlobbying form either prior to or contemporaneous with the lobbying distribution. If there has been no such substantial nonlobbying distrbution, expenses made within six months of the lobbying use may be treated as lobbying expenditures under the regulations.[18]

Example. CCDC, which prepared the nonpartisan analysis described in the preceding example, includes the executive summary of that analysis in its annual report, as part of a special summer report on economic development activity under consideration in the college's community. It also makes the entire report available on the Internet. In the fall, CCDC modifies the executive summary to include an explicit request that readers contact City Council members to voice support for the proposed legislation, and sends it out to a number of local businesses. The expenses associated with this distribution of the report will be treated as grassroots lobbying. However, the expenses associated with the preparation of the original report will not be considered grassroots lobbying because CCDC made a substantial nonlobbying dissemination of the report prior to its subsequent use for lobbying purposes.

Expenditure limits.

Section 4911 contains the annual expenditure limits on total lobbying and grassroots lobbying by electing public charities, which are shown in Exhibit 3 on page 20. These limits, which are expressed as a percentage of the charities' exempt purpose expenditures, operate on a sliding scale and become proportionately smaller as the exempt purpose expenditures become larger. There is an overall maximum annual limitation of $1 million in total lobbying expenditures and $250,000 in grassroots lobbying.

Exhibit 3. Expenditure Limits for Electing Public Charities.

Exempt Purpose Expenditures	Total Lobbying Nontaxable Amount	Grassroots Nontaxable Amount
Up to $500,000	20% of exempt purpose expenditure	25% of total lobbying nontaxable amount
Over $500,000 to $1 million	$100,000 + 15% of excess over $500,000	$25,000 + 3.75% of excess over $500,000
Over $1 million to $1.5 million	$175,000 + 10% of excess over $1 million	$43,750 + 2.5% of excess over $1 million
Over $1.5 million to $17 million	$225,000 + 5% of excess over $1.5 million	$56,250 + 1.25% of excess over $1.5 million
Over $17 million	$1 million	$250,000

What costs are included as lobbying expenditures?

All costs of preparing a direct or grassroots lobbying communication are included as expenses for purposes of the expenditure limits.[19] These include the costs of researching, drafting, reviewing, copying, publishing, mailing, paper, ink, videotape, and transmission facilities, as well as an allocable share of employee compensation and overhead expenses. Note, however, that activities of volunteers are not counted as lobbying for organizations making the lobbying election. Since the election is strictly an expenditure test, lobbying conducted by volunteers and other no-cost activities are simply disregarded.

What are exempt purpose expenditures? The lobbying expenditure limit is based on a percentage of a charity's exempt purpose expenditures. These are administrative expenses incurred for exempt purposes, including expenses for lobbying, depreciation and amortization of assets, grants that are restricted for nonlobbying purposes, and costs of in-house fundraising that is not conducted by a separate fundraising unit.[20] Exempt purpose expenditures do not include payments of unrelated business income tax, unrelated business income expenses, capital expenses for buildings or

improvements, or expenses for separate fundraising units or outside fundraising consultants.

Allocating mixed lobbying expenditures. Because the lobbying election contains separate expenditure limits for grassroots and total lobbying activities, the regulations contain special rules governing the allocation of expenditures that serve both direct and grassroots lobbying purposes. [21] These so-called "mixed lobbying expenditures" primarily involve lobbying communications that are sent to both members and nonmembers. They should not be confused with another category of expenditures also requiring allocation, so-called "mixed-purpose expenditures," which involve communications that have both lobbying and nonlobbying purposes. The special allocation rules for "mixed-purpose expenditures" are described below.

In the case of "mixed lobbying expenditures," the regulations provide as follows: [22]

- The costs of a mixed lobbying communication sent primarily to members that encourages grassroots lobbying are allocated to grassroots lobbying.
- The costs of a mixed lobbying communication sent primarily to members that encourages direct lobbying are allocated between direct and grassroots lobbying expenditures based on the proportion of members and nonmembers receiving the communication.
- The costs of a mixed lobbying communication sent primarily to nonmembers are treated as grassroots lobbying unless the charity can demonstrate that the communication was made primarily to encourage direct lobbying. In that case, the charity may make a reasonable allocation between direct and grassroots lobbying.

Example. The Coalition of Educational Museums is exempt under Section 501(c)(3). It relies on contributions from the public and has a mailing list with 10,000 names. About 80% of the names on the list are members of the coalition who make regular annual contributions. The remaining names include former and prospective members and other community organizations. The coalition sends out a newsletter to everyone on the mailing list, urging them to contact their senators or representatives to oppose pending legislation that would apply guidelines to the content of exhibits for museums that receive federal funding. The coalition must treat 80% of the cost of preparing and sending out the alert as direct lobbying and 20% as grassroots lobbying.

Allocating mixed-purpose expenditures. Many communications that include a lobbying component are also intended to serve other, equally important nonlobbying purposes. Newsletters are a common example. They typically cover a wide variety of issues of interest to members, including—but by no means limited to—current legislative developments. It would be inappropriate and unfair to require electing charities to treat the entire cost of such communications as lobbying, and the regulations instead provide reasonable allocation rules.[23] If a mixed-purpose communication is sent "primarily" to members of a charity (i.e., more than half the recipients are members), the expenses of that communication must be allocated between the lobbying and the nonlobbying components on a reasonable basis. An allocation will not be considered "reasonable" if it treats as lobbying only the expenditures relating to the specific sentences containing the lobbying message, without including an allocation for the overall cost of the communication.

If communications are sent primarily to nonmembers, the lobbying expenditures include all costs attributable to the lobbying communication and other communications on "the same specific subject of the lobbying message."[24] A communication is considered to be on the same specific subject of the lobbying message if it discusses an issue that would be directly affected by the legislation mentioned in the lobbying message, or if it discusses the background or consequences of the specific legislation. General fundraising appeals and background information about the charity are not considered to be the same specific subject, while information about the potential adverse effects of the legislation to the charity is.

Example. The Coalition of Educational Museums, in the preceding example, prepares a fundraising letter to send to everyone on its mailing list. The fundraising letter describes the coalition's activities over the past year and mentions the pending legislation that would have an adverse impact on the content of museum exhibits across the country. The letter asks recipients to contribute to the organization, as well as to contact their senators and representatives to oppose the proposed legislation. The letter spends equal time addressing the fundraising and the lobbying issues. The coalition should treat 50% of the cost of the fundraising letter as lobbying, and should allocate the lobbying component between direct lobbying and grassroots lobbying based on the proportion of members and nonmembers who receive the communication. Assuming the mailing costs $10,000, the coalition should treat $5,000 as lobbying, of which

$4,000 would be direct lobbying and $1,000 would be grassroots lobbying.

What happens if lobbying limits are exceeded?

The expenditure limits described above are annual limitations. If an electing charity exceeds either the total or grassroots lobbying expenditure limits for a given year, it will be subject to a 25% excise tax on the excess amounts. If both the total and grassroots limits are exceeded, the excise tax will be levied only on the higher excess amount.[25]

In addition to providing annual expenditure limitations, Sections 501(h) and 4911 provide a separate mechanism for determining what amount of lobbying will jeopardize an electing charity's exemption. Under these rules, an organization will not jeopardize its exemption unless it exceeds either the total limit or the grassroots limit by more than 50%, calculated using an average of the most recent four years. The four-year averaging mechanism reflects an understanding that charities' lobbying needs vary from year to year. It allows electing charities to engage in fluctuating amounts of lobbying activities over a four-year period without risking loss of exemption. The trade-off, however, is that electing charities must pay an excise tax penalty for each year in which the annual limitations are exceeded.

Affiliated organizations. Section 4911 and the regulations thereunder provide that the lobbying expenditures of "affiliated" organizations must be aggregated in order to prevent related organizations from avoiding the expenditure limitations.[26] Organizations are considered to be "affiliated" if one organization can control the other's action on legislative issues through interlocking directors or provisions in their governing instruments requiring one charity to be bound by the decisions of the other.[27]

Where two or more charities are members of an affiliated group and at least one member has made the lobbying election, the expenditure limits must be calculated on an aggregate basis. If the aggregate expenditures exceed the permitted limits, each of the electing affiliated organizations must pay a proportionate share of the penalty excise tax.[28] For purposes of assessing the excise tax, only the electing organizations' lobbying expenditures are aggregated.

If a nonelecting organization is part of the affiliated group, its lobbying expenditures are not counted for purposes of assessing the excise tax.

Nonelecting organizations within the affiliated group are not liable for any excise tax on excess lobbying expenditures; they remain subject to the "no substantial part" test discussed above.[29] Nonelecting organizations must report the aggregated exempt purpose expenditures, direct lobbying expenditures, and grassroots lobbying expenditures for all of their affiliated organizations on the Form 990. However, they are not required to calculate any excise tax on excess expenditures.[30]

A public charity may therefore choose not to elect to be governed by the Section 501(h) expenditure test, but organizations affiliated with the charity, such as a supporting organization, may individually choose to elect Section 501(h) treatment. The nonelecting organization will be required to report all of the aggregated lobbying expenditures for all affiliated organizations, but it will not be liable for any excise tax under Section 4911 for excess expenditures made by its affiliated electing organizations.

Procedures for making and revoking the lobbying election.

The lobbying election is made on Form 5768. The election is effective for the designated tax year (which may be the year in which the form is filed) and all subsequent years until it is revoked. Form 5768 is also used to revoke the lobbying election, but revocation will not be effective until the following tax year. After an election is revoked, a charity may make a new election, but it will not be effective until at least one tax year after the year of revocation.[31]

Example. Charity X wishes to make the lobbying election to be effective for calendar year 2012. Charity X may make the election at any time between 1/1/12 and 12/31/12, and the election will have retroactive effect for all of 2012. Charity X may also make the election before January 1, 2012, but must specify that the election is not to become effective until 2012.

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Recordkeeping and reporting of lobbying expenditures

All charities—both electing and nonelecting—are required to disclose their lobbying expenditures on Schedule C of Form 990, and to maintain records that will enable them to calculate and report these expenditures.[32] In order to meet these IRS reporting obligations, charities must maintain records of their lobbying expenditures, including not only the time and direct expenses attributable to lobbying activities, but also an allocable portion of administrative and overhead expenses. Electing charities need to report lobbying expenditures only as either direct or grassroots. Nonelecting charities must report expenditures in separate categories for media advertisements; mailings to members, legislators, or the public; publications or published or broadcast statements; grants to other organizations for lobbying purposes; direct contact with legislators or their staff; and rallies, demonstrations, seminars, speeches, etc. Charities are permitted to use any reasonable allocation method. While daily timesheets are not required, it is important for employees whose job descriptions include a lobbying component to maintain some time records that may be used to calculate and substantiate the portions of their salaries allocable to lobbying activities. It is equally important for employees involved in substantial lobbying activities to keep track of their time in order to calculate and substantiate what portions of their salaries are allocable to nonlobbying activities.

Electing charities must report their lobbying expenditures on Form 990, Schedule C, Part II-A; nonelecting charities must report their expenditures on Part II-B. Note that nonelecting charities are required to attach a narrative description of their lobbying activities in addition to reporting the expenditure amounts. There is a common misperception that nonelecting charities are not required to maintain detailed records of their lobbying activities. This is not the case, and failure to do so may prevent a charity from completing its Form 990 accurately, making it more difficult for the charity to establish, in the event of an IRS audit, that lobbying constitutes "no substantial part" of its activities.

To elect or not elect?

There are clear advantages to making the lobbying election. The principal advantage is the certainty that comes from having bright-line rules rather than the vague and highly subjective "no substantial part" test. There is anecdotal evidence that the IRS has, on occasion, taken an initial audit position that a nonelecting charity's lobbying expenditures were large enough to jeopardize

its exempt status, even though the amounts were well within the expenditure limits for electing charities. In such a case, making the lobbying election would have prevented a thorny audit issue.

For some larger public charities, the problem is the size of the expenditure limitations under the lobbying election—$1 million for total lobbying expenditures, and the separate $250,000 limit for grassroots lobbying expenditures. These figures clearly limit the utility of the lobbying election for larger institutions that periodically need to become involved in legislative issues that, while important to the institutional interests, are not within the self-defense exception.

It seems unlikely that $6 million in total lobbying expenses over a four-year period would be considered "substantial" in the context of a major charity with an annual budget of over $500 million. Yet if a charity of that size made the lobbying election and incurred that amount of lobbying expenditures, it would be subject to an excise tax of $500,000 and—even worse—would be within $1 of losing its tax exemption. Here is why. The maximum allowable lobbying amount over the four-year period is $1 million per year, or $4 million. Amounts in excess of that are taxed at a 25% rate. That percentage of the $2 million in excess expenditures comes to $500,000. Incurring even $1 of lobbying expenses in excess of the 150% ceiling—in this case, $6 million—places the organization's tax exemption at risk.

Although some large public charities may consider the expenditure limits to be an obstacle to making the election, the result may be different for other institutions, particularly those whose lobbying expenditures regularly fall comfortably within the applicable annual limits. These organizations may determine that the expenditure limits pose no realistic concern, and that the election could be terminated

in the unlikely event it needs to undertake a major legislative effort.

Attributing the lobbying activities of officers, directors, and staff to the organization

One of the challenges for public charities is to determine when the activities of officers, directors, and staff will—or might—be attributed to the organization for purposes of the restrictions on lobbying. In many cases, the views of those affiliated with public charities are sought because of

their work on behalf of their institutions, but their testimony or other participation in the legislative process is solely in their individual capacities and not at the behest, or on behalf, of the organization with which they are affiliated.

Employees of Section 501(c)(3) organizations do not, of course, forfeit the ability to speak out in their individual capacities on matters of legislative importance because of the tax status of their employers. However, it is common for the press to identify persons by their employment affiliation, and Section 501(c)(3) organizations are occasionally dismayed to find themselves featured prominently in articles about lobbying by their employees. It is advisable for public charities to adopt institutional guidelines cautioning employees who wish to participate, as individuals, in the legislative process to do so without using institutional resources, and to communicate clearly that they are speaking only as individuals and not for their institutions.

Restrictions applicable to private foundations

Private foundations are prohibited from making expenditures "to carry on propaganda, or otherwise to attempt, to influence legislation."[33] Such expenditures, if made, are subject to an excise tax under Section 4945.

The lobbying prohibition under Section 4945 applies to both direct and grassroots lobbying, as described by the regulations under Sections 501(h) and 4911. In general, "legislation" includes "action by Congress, any state legislature, any local council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure" with respect to specific legislative proposals.[34] "Legislation" does not include action by "executive, judicial or administrative bodies," but the prohibition does extend to contacting employees of executive branch agencies who have legislative responsibility over certain matters.

The regulations under Section 4945 contain four exceptions to the prohibition against lobbying. They allow private foundations to make expenditures for nonpartisan analysis, study, or research; technical advice or assistance to a governmental body in response to a written request for such advice or assistance; self-defense communications; and examinations and discussions of broad social, economic, and similar problems.[35] These exceptions are discussed in detail above.

Although the Section 4945 exceptions to lobbying apply equally to private foundations and public charities, the exceptions pertaining to membership communications, described above, do not.[36] A private foundation's membership communications (if any) are governed by the general regulations for determining whether or not they constitute lobbying communications. A private foundation may, however, earmark a grant to an electing public charity for the purpose of membership communications, and such a grant will not be a taxable expenditure. In such a case, the private foundation should rely on the special rules for membership communications to determine whether the electing charity meets all the requirements for a permissible membership communication before making the grant.

In general, the prohibition against lobbying expenditures does not extend to grants made to other public charities that lobby. General support grants to organizations that lobby are permitted if the grant is not specifically earmarked to be used for lobbying purposes. A grant is considered "earmarked" if it is made pursuant to an agreement, either written or oral, that a grant will be used for specific purposes.[37]

Specific project grants may be made to public charities that lobby if the total amount given to the grantee in a tax year for that project, plus any other grants given by the foundation for that project, does not exceed the amount budgeted by the grantee for nonlobbying program activities. Where the grant is a multiyear grant,

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this regulation applies to each year of the grant, measured by the actual annual disbursement or by an amount derived from dividing the amount of the grant equally over the years of the grant. The foundation may choose which method of grant measurement to use.[38] In determining whether a grant meets these requirements, a private foundation may rely on budget documents or other sufficient evidence provided by the grantee public charity. Both the general and specific project grant regulations apply equally to grants to electing and nonelecting public charities.

Example. Private Foundation makes an annual $100,000 general support grant to Charity X. This grant is not specifically earmarked for any particular project and is mixed in with X's other funds for various administrative and programmatic uses, including some lobbying. In addition to this general support grant, Private Foundation has been asked to give an additional $100,000 grant to

X for a specific project. According to X's proposed budget, the project will have a budget of $200,000, of which $50,000 will be used for lobbying purposes. Neither of these grants is a taxable expenditure. The general support grant is not earmarked and is therefore acceptable. The specific project grant amount of $100,000 is less than $150,000, which is the nonlobbying amount budgeted for the specific project.

In addition to these permissible grants to public charities, private foundations may make grants to a charity conditioned on the charity's receiving a matching grant from a governmental body. These grants will not be considered taxable expenditures.[39]

Finally, a private foundation may make expenditures for the purpose of carrying on discussions with government officials as long as (1) the subject of the discussions is a program jointly funded by the foundation and the government or a new program being considered for joint funding; (2) the discussions are for the purpose of exchanging data or information pertaining to such program; and (3) the discussions are not undertaken by foundation managers in an attempt to persuade government officials or employees to take particular positions on specific legislative issues.

Conclusion

Public charities can monitor and report on their lobbying activities by relying on either the "no substantial part" test or the lobbying election under Section 501(h). Although the "no substantial part" test leaves little guidance as to the level of lobbying that jeopardizes an organization's exemption, the lobbying election uses dollar limitations that have lost significant economic value over time, particularly for larger organizations. The good news is that public charities have a choice and, with good monitoring and expense tracking mechanisms in place, can engage in activities that comply with these rules. Private foundations, in contrast, do not have such a choice, but Section 4911 provides useful guidance about the types of activities that are not considered lobbying under the tax laws.

[1]

2 U.S.C. section 1601 et. seq.

[2] Reg. 1.501(c)(3)-1(c)(3)(ii).

[3] *Id.*

[4] Rev. Rul. 70-79, 1970-1 CB 127.

[5] Reg. 53.4945-2(d)(1)(ii).

[6] Reg. 53.4945-2(d)(4).

[7] Rev. Rul. 70-449, 1970-2 CB 111; Reg. 53.4945-2(d)(2).

[8] Note that because the subject matter of this technical advice request relates to a matter affecting the powers and duties of the institution, the university president's testimony would also fall within the so-called "self-defense exception."

[9]

Reg. 53.4945-2(d)(3).

[10]

See Christian Echoes National Ministry, Inc., 31 AFTR 2d 73-460, 470 F2d 849, 73-1 USTC ¶9129 (CA-10, 1972).

[11]

Reg. 56.4911-2(b)(1).

[12]

Reg. 56.4911-2(b)(2).

[13]

Regs. 56.4911-2(b)(2)(iii)-(iv).

[14]

Reg. 56.4911-2(b)(5)(ii).

[15]

Reg. 56.4911-2(c)(1).

16

Reg. 56.4911-5.

17

Reg. 56.4911-2(b)(2)(v)(C).

18

Reg. 56.4911-2(b)(2)(v)(D).

19

Reg. 56.4911-3(a).

20

Reg. 56.4911-4.

21

Reg. 56.4911-3(a)(3).

22

Reg. 56.4911-5.

23

Reg. 56.4911-3(a)(2)(ii).

[24]

Reg. 56.4911-3(a)(2)(i).

[25]

Reg. 56.4911-1(b).

[26]

Section 4911(f).

[27]

Reg. 56.4911-7(a)(1).

[28]

Reg. 56.4911-8(d)(2).

[29]

Reg. 56.4911-8(d)(1).

[30]

See Reg. 56.4911-9(d)(4)(ii).

31

Reg. 1.501(h)-2.

32

See Reg. 56.4911-6.

33

Section 4945(d)(1).

34

Reg. 53.4945-2(a)(1); Reg. 56.4911-2(d)(1).

35

Regs. 53.4945-2(d)(1)-(4).

36

Reg. 53.4945-2(a)(2).

37

Reg. 53.4945-2(a)(5)(i).

38

Regs. 53.4945-2(a)(6)(i)-(ii).

[39]

Reg. 53.4945-2(a)(3).