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## Limitations on the Lobbying of Section 501(c)(3) Organizations—A Choice for the Public Charities

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# LIMITATIONS ON THE LOBBYING OF SECTION 501(c)(3) ORGANIZATIONS—A CHOICE FOR THE PUBLIC CHARITIES

JAMES H. NIX\*

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## INTRODUCTION

An organization engaging in more than an insubstantial amount of lobbying cannot qualify for exemption from income taxation under Internal Revenue Code section 501(c)(3), and thus is not eligible to receive contributions which are deductible for income, estate, and gift tax purposes.<sup>1</sup> While this limitation on the legislative activities of section 501(c)(3) organizations has been a part of the Code since 1934, prior to the Tax Reform Act of 1976<sup>2</sup> no real definition or content had been given to the "substantial activities" standard. The fact that neither Congress, the Internal Revenue Service, nor, until recently, the courts found it necessary or desirable to provide to either the exempt organizations or to the administrative agents useful guidelines with regard to what was substantial lobbying activity resulted in a reluctance by many charitable organizations to lobby to any extent and in a feeling of insecurity in those organizations which chose to lobby. Due to this lack of guidelines and the resulting inconsistencies in the statute's enforcement, organizations with legislative programs which were found to be substantial frequently perceived themselves to be the victims of selective enforcement. Compounding the problem presented to the 501(c)(3) organizations by the law's uncertainty was the severe consequence of a determination that the organization had engaged in substantial lobbying; the result was that the organ-

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<sup>1</sup> I.R.C. §§ 170(c)(2), 2055(a)(2), 2522(a)(2).

<sup>2</sup> Pub. L. No. 94-455, 90 Stat. 1520 (amending various provisions of the Internal Revenue Code of 1954, codified in scattered sections of 26 U.S.C.).

ization would lose its exempt status unless it was able to qualify under some other subsection of 501(c). In any event, following such a determination the organization would lose its right to receive deductible contributions; thus the primary sources of the organization's support would dry up, and in most cases the effective existence of the organization would end.

In response to a rising volume of criticism and in an effort to eliminate the vagueness of the statute, in 1976 Congress enacted an elective set of objective standards for determining whether a public charity has engaged in "substantial" lobbying. This article will examine the provisions of this legislation and the alternative to making the election under the new provisions, and then will discuss the factors which the charitable organizations should consider in deciding whether to make the election to come under the objective standards.

#### THE 1976 LEGISLATION

An organization otherwise qualifying for exemption under section 501(c)(3) will be denied such exemption unless "no substantial part" of its activities "is carrying on propaganda, or otherwise attempting, to influence legislation."<sup>3</sup> As amended by the Tax Reform Act of 1976, Internal Revenue Code sections 501(h) and 4911 now provide that a public charity may elect to have the substantiality of its legislative activity determined on the basis of a sliding scale which defines the permissible limits of lobbying in terms of the organization's expenditures for influencing legislation. The basic level of permissible expenditures for an electing organization (*i.e.*, the "lobbying nontaxable amount") is 20 percent of the first \$500,000 of the organization's "exempt purpose expenditures" for the year, plus 15 percent of the second \$500,000, plus 10 percent of the third \$500,000, plus 5 percent of any additional expenditures. In no event, however, may an organization's lobbying nontaxable amount exceed \$1,000,000. Within this overall limitation on lobbying expenditures is a second limitation on amounts expended to influence the general public on legislative matters. The permissible level of expenditures for such grass roots lobbying (*i.e.*, the "grass roots nontaxable amount") is one-fourth of the lobbying nontaxable amount.

An organization which exceeds either of these expenditure limitations in a given taxable year will be subject to a nondeductible excise tax of 25 percent of its excess expenditures. If both limitations are exceeded, then the tax will be determined on the

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<sup>3</sup> I.R.C. § 501(c)(3).

basis of the greater of the two excess amounts. If the organization's lobbying expenditures "normally" (*i.e.*, on the average over a four year period) exceed the lobbying nontaxable amount or the grass roots nontaxable amount by more than 50 percent (*i.e.*, normally exceed the "lobbying ceiling amount" or the "grass roots ceiling amount"), then the organization will be deemed to have engaged in substantial lobbying activity and thus will lose its section 501(c)(3) tax exempt status. Section 504, also added to the Code in 1976, prevents an organization which loses its exempt status by reason of excess lobbying from becoming an exempt section 501(c)(4) social welfare organization.

The 1976 legislation provides definitions of the critical terminology and rules to assure obedience to the spirit as well as the letter of the statute. Section 4911(d) defines "influencing legislation" to include both grass roots lobbying and direct lobbying of those in positions to participate in the formulation of legislation. The statute then significantly narrows the scope of activities subject to the new expenditure limitations by excepting certain categories of activity from the general definition.<sup>4</sup> Section 4911(e) defines "exempt purpose expenditures" and provides rules for computing the amount of expenditures paid or incurred for the purpose of influencing legislation.<sup>5</sup> Rules to forestall the creation of numerous commonly controlled organizations for the purpose of avoiding the expenditure limitations are provided at section 4911(f). Finally, the 1976 Reform Act added section 170(f)(6) which prevents the circumvention of the expenditure limitations by disallowing an individual's deduction of out-of-pocket expenditures on behalf of a charitable organization if such expenditures are made for the purpose of influencing legislation.

The section 501(h) election is not available to (1) churches, integrated auxiliaries of churches, or organizations affiliated with churches; (2) organizations which are public charities because they are support organizations for certain types of social welfare organizations, labor unions, or trade associations; or (3) private foundations. Generally speaking, it is those organizations commonly considered to be public charities which may elect to have the substantiality of their lobbying activities determined under these expenditure limitations.<sup>6</sup> Organizations which are ineligible to make the section 501(h) election and nonelecting organizations will continue

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<sup>4</sup> See discussion in text accompanying note 61, *infra*.

<sup>5</sup> See discussion in text accompanying notes 35-39, *infra*.

<sup>6</sup> See discussion in text accompanying notes 22-31, *infra*.

to be subject to the law as it existed prior to the introduction of these new provisions.<sup>7</sup>

In addition to these objective limitations on lobbying, the Tax Reform Act of 1976 added section 7428,<sup>8</sup> another provision which is of particular significance to charitable organizations threatened with loss of exempt status. This provision, in relevant part, authorizes the Tax Court, the Court of Claims, and the U.S. District Court for the District of Columbia to make declarations with respect to the continuing qualification of charitable organizations in cases where there is an actual controversy involving an I.R.S. determination with respect to such qualification. This prerovocation declaratory judgment procedure is in contrast to prior law under which the only recourse for a charitable organization whose exempt status was revoked was to sue for a refund of taxes paid. The problem under the old law was that the organization's ability to attract charitable contributions was lost during the period between revocation and review and the organization would frequently die from lack of support. This new procedure places charitable organizations in a position where it is practical to contest unjustifiable or arbitrary administrative demands.

#### PRIOR LAW: THE ALTERNATIVE STANDARD

The determination of whether attempts to influence legislation are a substantial part of a section 501(c)(3) organization's activities is a factual one. Prior to the introduction of sections 501(h) and 4911 to the Code by the Tax Reform Act of 1976, there was no simple rule offering guidance as to what amount of activity would be considered substantial; the Service had not dealt with this issue in either the regulations or in its rulings. For organizations ineligible to make the 501(h) election and for eligible organizations choosing not to make the election, this situation continues.

While the concept of substantiality has in this context defied definition by the Service, cases which have had to deal with the issue give indications of the factors which the courts find important in determining whether lobbying is a substantial part of an organization's activities. In the most recent decisions addressing this issue, *Christian Echoes National Ministry, Inc. v. United States*<sup>9</sup> and *Haswell v. United States*,<sup>10</sup> the courts have agreed that to determine the substantiality of an organization's attempts to influence legislation it is necessary to balance the lobbying activi-

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<sup>7</sup> I.R.C. § 501(h)(7).

<sup>8</sup> I.R.C. § 7428.

<sup>9</sup> 470 F.2d 849 (10th Cir. 1972).

<sup>10</sup> 500 F.2d 1133 (Ct. Cl. 1974).

ties of the organization in the context of the objectives and circumstances of the organization. In *Christian Echoes*, the government had revoked the tax exemption of the plaintiff on the basis of a finding that a substantial part of the organization's activities consisted of carrying on propaganda, or otherwise attempting to influence legislation.<sup>11</sup> The government contended that the organization's program of radio and television broadcasts, evangelical campaigns, and publications of magazines, newspaper columns, and leaflets included substantial attempts to influence legislation. Consistent with the organization's mission, which was described by its founder as a battle against communism, socialism, and political liberalism, the organization's publications appealed to readers to write to their congressmen, to work for or oppose specific pending legislation, and to try to exert other influence in the political sector. Their objectives included such specifics as limitation of foreign aid, withdrawal from the United Nations, termination of diplomatic relations with communist countries, and abolishment of the federal income tax. The organization's broadcasts and evangelical campaigns contained similar appeals. Balancing these activities in the context of the organization's objectives and other efforts, the court agreed with the government's conclusion and found that the promotion of governmental policies consistent with its objectives was an essential part of the program of *Christian Echoes* and that the activities of *Christian Echoes* in influencing or attempting to influence legislation were not incidental, but were substantial and continuous. Accordingly the revocation of the exempt status of *Christian Echoes* was upheld.

The issue in *Haswell v. United States*<sup>12</sup> was the deductibility of the taxpayer's contributions to the National Association of Railroad Passengers in 1967 and 1968. The government contended that the contributions were not deductible because the organization was not operated exclusively for a section 170(c)(2)(B) purpose since a substantial part of its activities involved attempts to influence legislation. The goals of the N.A.R.P. were to attain (1) adequate legal control over train discontinuances, (2) fair and equal treatment of railroad passengers by the government, and (3) a national transportation policy in which railroad passenger service was an essential element. The N.A.R.P. program included educational activities to inform the public of the problems of railroad

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<sup>11</sup> Participation or intervention in political campaigns on behalf of candidates for public office was an alternate and independent ground for revocation. 470 F.2d at 853.

<sup>12</sup> 500 F.2d 1133 (Ct. Cl. 1974).

passengers, litigation before the Interstate Commerce Commission and other regulatory agencies to oppose specific proposals for discontinuance of passenger train service, and attempts to influence legislation. To better focus its lobbying efforts, the N.A.R.P. had contracted with a lobbying consulting firm, which, during the years in question, arranged for the N.A.R.P. to present testimony at various committee hearings, organized cocktail parties for legislators at which the N.A.R.P. could make known its views, and made various other contacts with members of Congress. In examining the substantiality of these activities, the court found that in 1967 approximately \$10,000 of a total budget of \$50,000 was spent on lobbying, and that in 1968 approximately \$20,000 of a total budget of \$100,000 was spent on lobbying. While the amounts expended to influence legislation were not great, the fact that in each year the organization's lobbying expenditures were approximately twenty percent of total expenditures indicated to the court the relative importance of these activities to the organization's program as a whole. Furthermore, the court found that these legislative efforts were of fundamental importance to the organization in the achievement of its goals. Based on these findings, the court concluded that the N.A.R.P. was engaged in substantial lobbying. Therefore, the taxpayer was not entitled to the claimed deductions.

At least some of the factors which may influence a court's decision are indicated by these decisions. These factors include the amount of money spent on lobbying and the relative importance of that amount to the organization's total budget, the importance of lobbying to the achievement of the objectives of the organization, and the continuity of the attempts by the organization to influence legislation. The time and effort expended by members or employees of an organization is another very relevant factor.<sup>13</sup> But these are only factors. In a given case there may be other equally relevant considerations, and the presence or absence of any one of these enumerated factors may not be determinative. For example, in *League of Women Voters of United States v. United States*,<sup>14</sup> it

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<sup>13</sup> It was suggested in the hearings on the new legislation that the impact or importance of an organization's legislative efforts was a significant factor in the view of the Service. *Hearings on H.R. 10612 Before the Senate Committee on Finance*, 94th Cong., 2nd Sess. 3263 (1976) (statement of Elvis Stahr, Chairman, Coalition of Concerned Charities). While in terms of visibility (and therefore of detection) of excessive lobbying impact may be significant, such impact is irrelevant to the issue of substantiality.

<sup>14</sup> 180 F. Supp. 379 (Cl. Ct. 1960).

was held that a bequest to the League of Women Voters was not deductible for estate tax purposes because the League had engaged in substantial lobbying. The Court of Claims determined that although a relatively insignificant amount of money was spent on direct attempts to influence legislation, a very substantial portion of the energies and efforts of the League members was spent in formulating the League's position on various legislative issues and on attempts to induce legislative action in accordance with the League's position. Furthermore, the court found that influencing legislation was really the ultimate purpose of the League's educational program. In these circumstances, the absence of significant expenditures was not of controlling importance.

As illustrated by *League of Women Voters*, the substantiality of the lobbying activities of an organization may be dependent on which of the organization's activities are characterized as "propaganda, or other attempts, to influence legislation,"<sup>15</sup> and indeed this characterization is often the central problem in cases where substantial lobbying is an issue. Once this determination of the nature of the organization's activities is made, the substantiality of the lobbying activities in the context of the organization's total program is frequently self-evident.<sup>16</sup> This definitional problem and its effect on an organization's decision to exercise the section 501(h) election will be discussed in detail in a following section of this article.

Prior to the introduction of section 501(h) to the Code, courts generally rejected any suggestion that a determination of substantiality should be made on a strict percentage basis. The courts evidently reasoned that the factors which are important in the determination of the substantiality of an organization's lobbying activities are so complex as to resist quantification, and therefore that a percentage test was generally not workable. In *Seasongood v. Commissioner*,<sup>17</sup> however, the Sixth Circuit did conclude that where less than five percent of an organization's efforts and activities was devoted to attempts to influence legislation, the organization had not engaged in substantial lobbying. *Seasongood* is some-

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<sup>15</sup> *Id.* at 380 (quoting Int. Rev. Code of 1939, ch. 1, § 812(d), 53 Stat. 124 (now I.R.C. § 501(c)(3)).

<sup>16</sup> The Exempt Organizations Handbook, Internal Revenue Manual 7751 § 394 (1977). With regard to a definition of "substantial," the only guidance that the Handbook gives to agents is that the determination is a factual one and that there is no simple rule.

<sup>17</sup> 227 F.2d 907 (6th Cir. 1955).

what anomalous in that, in reversing the decision of the Tax Court,<sup>18</sup> which had included detailed findings of fact regarding the attempts of the taxpayer's organization to influence legislation, the Sixth Circuit seems to have based its finding that less than five percent of the time and effort of the organization was involved in lobbying on the bare statement of the taxpayer, which the court said was "not successfully challenged either by adversary witnesses or destructive analysis."<sup>19</sup> This case would seem to be of extremely limited value as precedent.

While it is possible to isolate a number of the factors which courts have found important in determining the substantiality of an organization's lobbying, the section 501(c)(3) organizations have found it very difficult to anticipate when their attempts to influence legislation approach a substantial level. It should be noted that only for the last six years have organizations had the limited guidance of *Christian Echoes*. *Haswell* was decided even more recently. Prior to these decisions there was practically no guidance as to how substantiality would be determined. In the hearings which led to the enactment of sections 501(h) and 4911, charitable organizations pointed out that this absence of guidelines left broad discretion to the I.R.S., and complained that there was no consistent pattern of administration from one district to the next.<sup>20</sup> The charities argued further that the uncertainty of this situation, when combined with the fact that the only sanction for an I.R.S. determination of substantial lobbying was loss of exemption, chilled the often beneficial lobbying of the charities and deprived legislative bodies of information, which they both needed and wanted.<sup>21</sup> Congress did, of course, deal with these criticisms by providing elective, objective standards for determining the substantiality of an organization's lobbying, and by cushioning the effect of a finding that an organization had excess expenditures by, first, imposing an excise tax on those excess expenditures and, second, revoking the exempt status of the organization only when its lobbying expenditures are "normally" over 150 percent of the threshold lobbying nontaxable amount. The remainder of this article is devoted to the considerations which should go into a public

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<sup>18</sup> 22 T.C. 671 (1954).

<sup>19</sup> 227 F.2d at 912.

<sup>20</sup> *Hearings on H.R. 10612 Before the Senate Committee on Finance*, 94th Cong., 2nd Sess. 3263 (1976) (statement of Elvis Stahr, Chairman, Coalition of Concerned Charities).

<sup>21</sup> *Id.* at 3264.

charity's decision of whether to make the election to come under these objective standards.

#### CONSIDERATIONS IN MAKING THE SECTION 501(h) ELECTION

With the introduction of section 501(h) to the Internal Revenue Code by the Tax Reform Act of 1976, eligible section 501(c)(3) organizations must face the issue of whether to exercise the election to have the substantiality of their lobbying determined under the new expenditure tests or simply to take no positive action in this regard and thus remain under the standards of prior law. There is no simple answer which is "right" for all organizations. There are, however, several factors which should be considered in deciding whether to make the section 501(h) election, any one of which may be determinative for a given organization. These include (1) the eligibility of the organization to make the election, (2) the administrative burdens placed on an electing organization, (3) the political sensitivity of the organization's objectives, (4) the nature of the organization's activities, and (5) the sanctions for violating the standards.

#### *Eligibility*

Eligibility to make the section 501(h) election is, of course, the threshold consideration for any section 501(c)(3) organization wishing to come under the new provisions. The statute restricts the organizations to which section 501(h) applies to the public charities, excepting only those organizations which are support organizations for section 501(c)(4) social welfare organizations, section 501(c)(5) labor unions, and section 501(c)(6) trade associations and "disqualified organizations," a term which is defined to encompass churches, integrated auxiliaries of churches, and organizations affiliated with churches or their integrated auxiliaries.<sup>22</sup> Although the exempt status of a private foundation is dependent on the insubstantiality of its lobbying activities, the private foundations have since 1969 been subject to an excise tax on lobbying expenditures under section 4945,<sup>23</sup> and are not eligible to make the section 501(h) election.

Of particular note is the disqualification of churches and related organizations. This provision was included in the statute at the request of a number of church groups which took the position

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<sup>22</sup> I.R.C. § 501(h)(3)-(4).

<sup>23</sup> I.R.C. § 4945.

that any restriction on the lobbying of religious organizations is an unconstitutional restraint on the first amendment right of free exercise of religion, and that if Congress designated churches as organizations permitted to elect under the new rules, the I.R.S. might infer a congressional intent to enforce the lobbying restrictions against churches even if the churches did not in fact make the election.<sup>24</sup> The churches sought this exclusion even though in the one decision which addressed this constitutional issue, *Christian Echoes National Ministry, Inc. v. United States*,<sup>25</sup> the Tenth Circuit held that the limitations on lobbying in section 501(c)(3) are constitutionally valid, reasoning that first amendment rights are not absolute and that in the face of a compelling governmental interest (*i.e.*, guaranteeing the separation of church and state), a limited restraint (*i.e.*, the denial of tax exempt status) is permissible. By disqualifying churches from electing under the new provisions, Congress sought to remain neutral on this constitutional issue, and indeed the Committee reports provide that the legislation is not to be regarded as either approval or disapproval of the decision of the Tenth Circuit in *Christian Echoes*.<sup>26</sup>

It is not only churches which are disqualified from making the election. Any organization is disqualified if it is an integrated auxiliary of a church or a convention or association of churches, or if it is a member of an affiliated group of organizations if one or more members of such group is a church or an integrated auxiliary of a church.<sup>27</sup> Section 4911(f)(2) defines what is meant by affiliation in this context: Two organizations are members of an affiliated group if (1) the governing instrument of one of the organizations requires it to be bound by the decisions of the other with regard to legislative issues (*i.e.*, issues on which the organization might lobby), or (2) the governing board of one of the organizations includes persons who (i) are specifically designated representatives of the other organization or are members of the governing board, officers, or paid executive staff members of that other organization and (ii) by aggregating their votes those persons have sufficient voting power to cause or prevent action on legislative issues by the first organization.<sup>28</sup> But what is meant by an "integrated auxiliary of a church" in this context is not certain. When this legislation was first re-

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<sup>24</sup> H.R. REP. NO. 94-1210, 94th Cong., 2d Sess. 16 (1976).

<sup>25</sup> 470 F.2d 849 (10th Cir. 1972).

<sup>26</sup> H.R. REP. NO. 94-1210, 94th Cong., 2d Sess. 16 (1976).

<sup>27</sup> I.R.C. § 501(h)(5).

<sup>28</sup> I.R.C. § 4911(f)(2).

ported, the House Ways and Means Committee adopted the definition provided in sections 6033, 508(c), and 6043(b) in the then outstanding proposed regulations. The proposed regulations defined an "integrated auxiliary of a church" as

an organization described in section 501(c)(3), (a) whose primary purpose is to carry out the tenets, functions, and principles of faith of the church with which it is affiliated, and (b) whose operations in implementing such primary purpose directly promote religious activity among the members of the church.<sup>29</sup>

Under this definition, organizations considered to be integrated auxiliaries include the men's and women's clubs of religious organizations, mission societies, and theological seminaries; however, schools of a general academic or vocational nature, hospitals, orphanages, and old age homes, which are associated with churches but which are the types of organizations frequently established without regard to church relationships, would not be considered to be integrated auxiliaries, and thus would not be disqualified from making the section 501(h) election. The Conference Committee chose to take no position with regard to the application of the definition of an integrated auxiliary provided in these proposed regulations,<sup>30</sup> and, indeed, when the regulations were finalized certain changes were made so that now an organization affiliated with a church will be considered an integrated auxiliary for purposes of section 6033 if the principal activity of the organization is exclusively religious, *i.e.*, if it applied for exemption on its own it would qualify for exemption as a religious organization.<sup>31</sup> While the Service is free to redefine an integrated auxiliary in the context of section 501(h), until regulations are issued under these new provisions, the definition in the regulations under section 6033 is the only indication of an administrative position, and an organization whose primary objective is identical to that of the corresponding exempt secular organization is probably free to make the section 501(h) election.

### *The Administrative Burden*

An eligible organization wishing to come under the specific limitations of sections 501(h) and 4911 must make an affirmative election and meet certain reporting requirements which make pos-

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<sup>29</sup> Prop. Treas. Reg. § 2.6033-2(g) (1976).

<sup>30</sup> H.R. REP. No. 94-1515, 94th Cong., 2d Sess. 533 (1976).

<sup>31</sup> Treas. Reg. § 1.6033-2(g)(5), T.D. 7454, 1977-1 C.B. 366.

sible the enforcement of the limitations. Initially the organization must file an election (Form 5768) at the appropriate Internal Revenue Service Center prior to the end of the first taxable year for which the election is to be effective.<sup>32</sup> Then for each taxable year for which the election is effective, section 6033(b)(8) requires the organization to include with its annual return the following information: the amount of its lobbying expenditures, its lobbying nontaxable amount, the amount of its grass roots expenditures, and its grass roots nontaxable amount.<sup>33</sup> If the organization is a member of an affiliated group as defined in section 4911(f), then the return must also include these amounts with respect to the affiliated group.<sup>34</sup>

In order to be able to supply the required information, an electing organization will have to keep a detailed account of its "exempt purpose expenditures," since the computation of the organization's lobbying nontaxable amount (and therefore its grass roots nontaxable amount) is based on the amount of such expenditures. "Exempt purpose expenditures" is defined by section 4911(e) to include not only the direct expenditures for the organization's exempt purpose but also the expenses of administering the charitable programs of the organization,<sup>35</sup> all amounts paid or incurred for lobbying,<sup>36</sup> and a reasonable allowance for depreciation of the organization's capital assets used for these purposes.<sup>37</sup> Amounts paid or incurred for the fundraising unit of the organization are not "exempt purpose expenditures";<sup>38</sup> and it is not unreasonable to suppose that the Service will require that an appropriate portion of the organization's overhead expenses be allocated to the fundraising unit. Finally, it should be noted that the expenses of carrying on a trade or business which are unrelated to the organization's exempt purpose, and thus produce "unrelated business taxable income," are not exempt purpose expenditures.<sup>39</sup>

"Lobbying expenditures" and "grass roots expenditures" are defined terms and will have to be accounted for in accordance with

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<sup>32</sup> I.R.C. § 501(h)(6).

<sup>33</sup> I.R.C. § 6033(b)(8). This and all other information required to be furnished on the organization's information return will be made available to the public pursuant to I.R.C. § 6104(b).

<sup>34</sup> *Id.*

<sup>35</sup> I.R.C. § 4911(e)(1)(A).

<sup>36</sup> I.R.C. § 4911(e)(1)(B)(iii).

<sup>37</sup> I.R.C. § 4911(e)(4).

<sup>38</sup> I.R.C. § 4911(e)(1)(c)(i).

<sup>39</sup> See Treas. Reg. § 1.513-1(d)(3).

the statute. Accounting for such expenditures will involve decisions with regard to which actions of the organization are attempts to influence legislation,<sup>40</sup> as well as determinations of the costs of such actions. An excerpt from the explanation of the statute's requirements contained in the report of the House Ways and Means Committee is illustrative:

[I]f an organization communicates with a member or employee of a legislative body and one of the purposes is influencing legislation, then the appropriate portion of the costs of that effort are to be treated as lobbying expenditures. If the communication is with a government official or employee who is not in a legislative body, then the costs of the communication are to be taken into account only if the principal purpose of the communication is to influence legislation.<sup>41</sup>

With some justification, the administrator of the public charity may balk when faced with the prospect of having to make (and justify) such determinations on a recurring basis.

Having avoided private foundation status and thus the administrative, accounting, and reporting requirements of Chapter 42 of the Code, public charities are generally able to hold non-program-related expenses to a minimum. In the typical situation, the reporting requirements of public charities are minimal; such organizations are required to account for expenditures only in terms of broadly defined categories.<sup>42</sup> The detailed provisions of section 4911 and the reporting requirements of section 6033(b)(8) will impose an additional administrative burden on any organization making the section 501(h) election. The extent of this burden will depend to some extent on the existing administrative structure and capability of the organization. But electing organizations must face the fact that resources will be diverted from charitable purposes when time and attention of the organization's administrative staff are devoted to meeting the statute's reporting requirements and when it becomes necessary to utilize outside professional help to deal with problems which arise in interpreting the statute or in accounting for expenditures.

### *The Avoidance of Subjective Enforcement*

One theme running through the hearings which led to the

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<sup>40</sup> See discussion in text accompanying notes 48-62, *infra*.

<sup>41</sup> H.R. REP. NO. 94-1210, 94th Cong., 2d Sess. 11 (1976).

<sup>42</sup> I.R.C. § 6033(h)(1)-(7).

introduction of sections 501(h) and 4911 to the Code was that the lack of precise administrative guidelines defining substantiality resulted in inconsistent enforcement of the restrictions on the lobbying of section 501(c)(3) organizations. Witnesses testifying on behalf of the charitable organizations charged that the law gave District Directors, revenue agents, and other I.R.S. officials broad discretion, which at times was abused in order to challenge the actions and to suppress the views of organizations with which they disagreed.<sup>43</sup> Furthermore, witnesses claimed that the absence of a determinable standard nurtured an uneven and selective enforcement of the statute.<sup>44</sup> *Christian Echoes National Ministry, Inc. v. United States*<sup>45</sup> is an example of this selective enforcement and of another factor which plays a significant role in this area: the desire of the I.R.S. to successfully prosecute and publicize selected cases in areas where the law's parameters have not been clearly defined in order to encourage voluntary and restrained compliance. In *Christian Echoes*, the district court found that other churches and associations of churches engaged in lobbying activities similar to those of Christian Echoes, and that Christian Echoes was chosen as the subject of the exempt status revocation because of its relatively small size which simplified the investigatory process, and to serve as a warning to other organizations engaging in such conduct. The district court held that this rather arbitrary selection of Christian Echoes was a violation of the organization's rights under the fifth amendment. The Tenth Circuit reversed, holding that unless based on an unacceptable classification such as race, religion, or politics, selective enforcement does not result in a denial of the fifth amendment right to due process.<sup>46</sup>

Prior to the changes instituted by the Tax Reform Act of 1976, because of the absence of standards and the lack of prerevocation judicial review, an administrative threat of loss of exemption due to substantial lobbying, however unjustified, was generally sufficient to bring the organization's activity into conformity with the demands of the I.R.S. The section 501(h) election provides organizations dealing in controversial or administratively sensitive areas with a safe harbor, within which they can maneuver without worry of arbitrary administrative action. The section 7428 declaratory

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<sup>43</sup> See, e.g., *Hearings on H.R. 13720 Before the House Ways and Means Comm.*, 92d Cong., 2d Sess. 222 (1972) (statement of Stuart Johnson).

<sup>44</sup> *Id.* at 177.

<sup>45</sup> 470 F.2d 849 (10th Cir. 1972).

<sup>46</sup> *Id.* at 857.

judgment procedure is an additional safeguard available to both electing and nonelecting organizations.<sup>47</sup> But the objective standards under which electing organizations operate provide a degree of certainty not available to nonelecting organizations.

### *The Nature of the Organization's Activities*

An important consideration in any eligible organization's determination of whether to exercise the section 501(h) election is whether, and to what extent, its activities could be classified as "carrying on propaganda, or otherwise attempting, to influence legislation."<sup>48</sup> In this regard, it should be noted that there is a variance as to what activities come within this statutory phrase for electing and for nonelecting organizations. The section 4911 definition of "influencing legislation,"<sup>49</sup> which is only to apply to organizations making the section 501(h) election, is somewhat narrower than the definition given by the Service and the courts prior to the enactment of these provisions. Because of this variance, it is possible for a nonelecting organization which remains subject to prior law to lose its exemption on the basis of those activities' expenses which would not have been considered lobbying expenditures under section 4911. The important issue in determining whether to make the section 501(h) election is whether under prior law a substantial part of the organization's activities might be regarded as "carrying on propaganda, or otherwise attempting, to influence legislation."

The regulations state that an organization will be regarded as attempting to influence legislation if it

- (a) Contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or
- (b) Advocates the adoption or rejection of legislation.<sup>50</sup>

In accordance with this regulation, the I.R.S. takes the position that "influencing legislation" includes both direct and grass roots lobbying, and that the motive of the lobbyist or the fact that the advocated legislation will further the charitable purpose of the organization is irrelevant.<sup>51</sup> The weight of judicial authority is in

<sup>47</sup> I.R.C. § 7428.

<sup>48</sup> I.R.C. § 501(c)(3).

<sup>49</sup> I.R.C. § 4911(d).

<sup>50</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii), T.D. 7428, 1976-2 C.B. 160.

<sup>51</sup> Rev. Rul. 67-293, 1967-2 C.B. 185.

accord with this view.<sup>52</sup> "Legislation" is defined by the Regulations to include "action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure."<sup>53</sup> "Legislation" includes foreign as well as domestic laws.<sup>54</sup> It should be noted that this definition excludes action by an executive branch or its administrative agencies (for example, a school board or the Food and Drug Administration), although, of course, urging members of an executive branch to support an action by the legislature is "influencing legislation."

Four primary categories of activity have been excepted from the regulations' definition of "influencing legislation." Discussions and analyses of (and the distribution of reports on) broad social and economic problems which are not directed toward specific legislation are not considered to be attempts to influence legislation.<sup>55</sup> Making available the results of nonpartisan analysis, study, or research is also an activity excepted from the definition. Such nonpartisan analysis need not be neutral; but in contrast to propaganda, the presentation of the facts and issues must be balanced, fair, and complete, and must explain the opposing points of view.<sup>56</sup> The third category of excepted activity is making available technical advice or assistance to a governmental body or committee in response to a written request.<sup>57</sup> Finally, there seems to be no question that a charitable organization may initiate contacts with the legislative body with respect to a possible decision which might affect the organization's existence, powers and duties, tax exempt status, or its right to receive deductible contributions, without running afoul of the restrictions on influencing legislation.<sup>58</sup>

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<sup>52</sup> See, e.g., *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974); *Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849 (10th Cir. 1972); *League of Women Voters of United States v. United States*, 180 F. Supp. 379 (Ct. Cl. 1960); *Roberts Dairy Co. v. Comm'r*, 195 F.2d 948 (8th Cir. 1952). *But see* *Seasongood v. Comm'r*, 277 F.2d 907 (6th Cir. 1955).

<sup>53</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii), T.D. 7428, 1976-2 C.B. 160.

<sup>54</sup> Rev. Rul. 73-440, 1973-2 C.B. 177.

<sup>55</sup> Rev. Rul. 70-79, 1970-1 C.B. 127.

<sup>56</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(iv), T.D. 7428, 1976-2 C.B. 160; Rev. Rul. 68-263, 1968-1 C.B. 256; Rev. Rul. 64-195, 1964-2 C.B. 138.

<sup>57</sup> Rev. Rul. 70-449, 1970-2 C.B. 111.

<sup>58</sup> In 1969 Congress imposed an excise tax on amounts expended by private foundations to influence legislation. The definition of influencing legislation which applies in the private foundation context appears at I.R.C. § 4945(e), and contains the final three noted exceptions. While the definition does not expressly apply to

While it is clear that direct lobbying of members of a legislative body and indirect lobbying by means of appeals to public opinion with regard to legislative matters are attempts to influence legislation, it is not entirely clear to what extent the organization's support activities will be considered to be a part of those attempts. This problem is illustrated by the decision of the Court of Claims in *League of Women Voters of United States v. United States*.<sup>59</sup> The League admitted to only insubstantial direct lobbying, but the Court accepted the government's argument that the League's extensive program of research and discussion which led to the formulation of a legislative program was all a part of a substantial effort by the League to influence legislation. This decision stands as a warning that attempts to influence legislation do not necessarily begin at the moment of contact with the legislator or the first appeal to the public.

Against this background of the activities which are considered to be "attempts to influence legislation" under the law prior to the enactment of sections 501(h) and 4911, and which will continue to be so considered for organizations not making the section 501(h) election, stands the section 4911(d) definition of "influencing legislation." While this definition is in most respects identical to that of prior law,<sup>60</sup> section 4911(d) excepts two additional categories from the activities which will be considered to be influencing legislation.<sup>61</sup> The more important of these exceptions allows communication between the organization and its bona fide members unless the communication directly encourages the members to lobby. Under this exception the efforts of the members of the League of Women Voters in the formulation of their legislative program would not have been considered a part of the organization's attempts to influence legislation. The second new category of excepted activity allows communication with government officials or employees who are not members or employees of a legislative body, provided that the principal purpose of the communication is not to influence legislation. This exception eliminates the necessity

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public charities, the I.R.S. has apparently tacitly accepted the definition's application to all 501(c)(3) organizations.

<sup>59</sup> 180 F. Supp. 379 (Ct. Cl. 1960).

<sup>60</sup> While the broad social policy exception does not appear in the statute, it applies equally to electing organizations. This is so because it deals with the issue of what is "influencing legislation" while the other exceptions are of activities which are influencing legislation, but are not considered so because of legislative or administrative grace.

<sup>61</sup> I.R.C. § 4911(d)(2)-(3).

of allocating at least a portion of the costs of such communication to lobbying expenditures.

These additional exceptions to "influencing legislation," which, in effect, narrow the scope of activities considered to be lobbying for organizations making the section 501(h) election, can be a significant factor in the decision of many organizations considering whether to make that election. Generally, however, the more important difference in the limitations on lobbying of electing organizations and nonelecting organizations is the fact that the substantiality of the lobbying of electing organizations is determined solely on the basis of the amount of lobbying expenditures vis-a-vis the organization's exempt purpose expenditures. Thus an organization whose legislative program is implemented largely by the use of volunteers, or an organization which by efficient management is able to sustain significant legislative activity at a minimal cost, is able to make the section 501(h) election to come within the expenditure limitations and to continue its legislative program without being threatened with the revocation of its exemption on that basis. This is especially beneficial to membership organizations which, by virtue of the size and commitment of their memberships, are able to mobilize large groups of people at a minimal expense.

An organization which takes a public position on pending legislation or which contacts a participant in the legislative process with regard to legislation (unless it falls within one of the noted exceptions) is engaging in lobbying. If an organization engages in such activity to any extent, it should make a judgment with regard to the substantiality of its efforts based on the criteria established in *Christian Echoes*, *Haswell*, and *League of Women Voters*.<sup>62</sup> If, under the construction of the facts most favorable to the government, a finding of substantiality might be made, then the organization should either reduce its legislative activity or consider whether, based on the amounts of its lobbying expenditures and exempt purpose expenditures, it might fit within the safe harbor limitations of section 501(h). If it can fit within the expenditure limitations, the organization may make the section 501(h) election and continue its lobbying activity unchecked. But if its lobbying expenditures exceed the 501(h) limits and under the alternative standard a finding of substantiality is possible, the organization must reduce its legislative activity. The sanctions imposed on a charitable organization which is found to be in violation of the

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<sup>62</sup> See discussion in text accompanying notes 9-16, *supra*.

limitations on lobbying are so extreme as not to be an acceptable risk.

### *Sanctions*

If a charitable organization is found to have engaged in substantial lobbying, the tax exempt status of that organization will be revoked. Since no objective index of substantiality exists for nonelecting organizations, it is possible for such organizations which have not exercised an adequate degree of caution to be caught without warning. In contrast, substantiality for an electing organization depends on an objective standard based on the amount of the organization's lobbying expenditures vis-a-vis its exempt purpose expenditures. An electing organization is first subjected to an excise tax of 25 percent on excess lobbying expenditures and only loses its exemption if its lobbying expenditures normally exceed a ceiling amount. This two-tiered system of sanctions, when combined with the statutory record keeping requirements, make the electing organization acutely aware of its status with regard to the ultimate sanction of loss of exemption.

While the loss of status as a section 501(c)(3) organization due to excess lobbying (and the accompanying loss of the right to receive deductible contributions) is a devastating blow, prior to the Tax Reform Act of 1976 an organization finding itself in this situation was able to remain exempt on its own income as a social welfare organization under section 501(c)(4),<sup>63</sup> and was thus often able to survive. This switch in status from section 501(c)(3) to section 501(c)(4) enabled organizations to build up an endowment out of deductible contributions as a charitable organization and then to use that endowment to support substantial lobbying efforts as a social welfare organization. Congress therefore enacted section 504, which provides that a section 501(c)(3) organization which loses that status by reason of excessive lobbying cannot at any time thereafter be treated as a section 501(c)(4) social welfare organization. Without the availability of the section 501(c)(4) status, the loss of exemption will almost necessarily be a killing blow to a charitable organization.

A final consideration for those organizations which have existed as public charities with significant legislative programs prior to the 1976 Reform Act, is that the availability of this election may lead to a shift in the administrative approach of the I.R.S. The

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<sup>63</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(v), T.D. 7428, 1976-2 C.B. 160.

previous harshness of a determination of excessive lobbying is now tempered by the availability at the organization's election of the new standard with its gradient sanctions. The fact that an organization now, in effect, chooses to come under the facts and circumstances test of prior law may lead the Service to take a somewhat harder line and to give closer scrutiny to the legislative activities of nonelecting organizations.

#### CONCLUSION

The Tax Reform Act of 1976 has presented a choice for public charities which should neither be ignored nor exercised blindly. For a public charity engaging in significant legislative activity, the section 501(h) election provides a safe harbor within which the organization may continue to lobby without risking its exempt status. But this election entails a significant administrative burden which need not be undertaken by organizations whose legislative activity is insubstantial even under the government's most expansive view of attempts to influence legislation. The situation of each public charity should be evaluated in light of the considerations discussed herein to determine the right choice for that organization.