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Insight in Protecting the Charitable Non-Profit Exempt Status

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Insight in Protecting the Charitable Non-Profit Exempt Status

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I. Exempt Status

Non-profit and charitable organizations all have one major hazard in common. To be effective they must become part of the process of formulating public policy. To do this they must be in contact with and take an active role respecting the public policy formulation process, including constant attempts to influence public officials and bodies. Maximization of the potential impact on the formulation process is a function of the amount of monies available for expenditure in policy promulgation. Thus, the generation of funds is essential to both livelihood and effectiveness. One of their major fund raising advantages is their tax exempt status. It not only provides them with tax exemption, but contributors are provided deductions for contributions.

A hazard surfaces in the expenditure of funds during the policy making process. The hazard is the potential loss of a tax exempt status if the entity crosses the line with respect to its attempts to influence and become part of the policy-making process. Indeed that line is technical and gray to say the least. This memorandum is dedicated to the non-profit or charitable exempt institution that is presently struggling with this challenge.

Tax exempt status is obtained by satisfying the mandated qualifications of I.R.C. § 501(c)(3) (1987):

> Corporations, and any community chest, fund, or foundation, organized and operated exclusively for... charitable, scientific testing for public safety, literary or educational purposes... no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in . . . any political campaign on behalf of any candidate for public office.

Desirability of qualifying under § 501(c)(3) rests on the fact that contributions to such organizations are deductible by the donor.[1] As a broad generalization, it might be said that if an organization loses its tax exempt status, donations to it will no longer be deductible and, hypothetically prospective donors will turn elsewhere.[2]

II. Jeopardizing the Status

A. Action Organizations

One hazard by which a § 501(c)(3) organization may lose its tax exempt status is if it is an "action organization" as defined in Reg. § 501(c)(3)-1. Essentially, an organization is an "action organization" if it engages in substantial legislative activity, Reg. § 501(c)(3)-1(c)(3)(ii); if it supports individual candidates for public office, Reg. § 501(c)(3)-(1)(c)(3)(iii); or if its primary objective may be attained only be legislation or the defeat of legislation and it advocates or campaigns for such a primary objective, Reg. § 501(c)(3)-1(c)(3)(iv). Each of these will be discussed below.

B. Substantial Legislative Activity v. Non-partisan Study

1. Advocating or Lobbying

The motivation behind the restriction of lobbying activities is the philosophy that the federal government should not subsidize, via tax exemptions, the activities of organizations that are directed toward the accomplishment of legislative goals.[3] As the court of claims held in *Haswell v. United States*,[4] "[A]n organization that engages in substantial activities aimed at influencing legislation is disqualified from a tax exemption, whatever the motivation."[5]

The question at this point is: what is "attempting to influence legislation?" Reg. § 501(c)(3)(c)(iii) provides two tests, either one of which is sufficient for disqualification purposes: (1) advocate the adoption or defeat of legislation; (2) engage in grass roots lobbying, i.e. urging the public to contact legislators.

"Legislation" is defined in the same regulation to mean "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." The validity of these regulations were upheld in *Christian Echoes National Ministry, Inc. v. United States*.[6]

An apparent loophole exists in the above regulation in that it does not prohibit contact with legislative staff aids or the executive branch. However, another related regulation, Reg. § 153.4945-2(a)(1) seems to narrow this loophole by proscribing communications with an employee of a legislative body or with an "official" of the executive branch. Also note that attempts to influence changes in the law of a foreign country may be prohibited,[7] as may attempts to influence the United Nations and other multinational organizations.[8]

2. Nonpartisan Study

There are relatively few exceptions to the proscriptions outlined above. Reg. § 501(c)(3)-1(c)(3)(iv) does except from the definition of an "action organization" an organization "engaging in nonpartisan analysis, study or research and making the results thereof available to the public." In *Haswell*, the court of claims held that in order to qualify for this exception, the organization must make available to the public "full and fair objective expositions that would enable the public to reach an independent conclusion on the subject."[9] For example, an organization which merely educated the public on the issue of cost reform without expending funds or otherwise participating, advocating or disapproving of legislation or constitutional amendment would not thereby lose its tax exempt status.[10]

A second exception exists if a representative testified before a congressional committee at the express invitation of the committee to give expert testimony.[11] If, however, the invitation is "arranged" by the organization, the exception will not apply.[12]

3. Private Foundations

The regulations with respect to private foundations are slightly less restrictive. In addition to the exceptions noted above, private foundations do not attempt to influence legislation if they: (1) make available the results of nonpartisan studies to governmental bodies.[13] (2) communicate with a legislative body about a matter which may affect the existence of the organization[14] and (3) examine broad social, economic or similar problems even if of a type with which the government would be expected to deal.[15] To date, it is unclear whether these provisions would be applicable to other § 501(c)(3) organizations, but logic and common sense suggest that they should apply if for no other reason than to ensure uniformity and predictability.

4. Substantiality of Activity

At the outset, it was noted that only "substantial" attempts to influence legislation will result in loss of tax exempt status. Unfortunately, neither the Code nor the regulations purport to define the word "substantial." Some early decisions adopted a strict quantitative measure based upon the amount of time and effort the organization devoted to political activities.[16]

Other courts have looked beyond direct contact by the organization and have focused on activities in preparation for the influencing of legislation.[17] Still other courts have looked to the ethics of, and the motive behind the activity in order to determine the substantiality questions.[18]

The latest and perhaps dominant authority on the substantiality question is *Haswell*. The test therein developed is as follows:

> The political efforts of an organization must be balanced in the context of the objectives and circumstances of the organization to determine whether a substantial part of its activities is to influence, or is an attempt to influence, legislation. A percentage test to determine whether the activities are substantial is not appropriate. Such a test obscures the complexity of balancing the organization's activities in relating to the organization's activities in relation to its objectives and circumstances in the context of the totality of the organization.[19]

The court went on to indicate that the amount of money "devoted to each category of operations" could be used as a yardstick but failed to indicate how much weight should be accorded to this measure of substantiality.[20]

"If there is an exception . . . it [is] . . . voter education"

The only conclusion that can be drawn from these authorities is that the question of substantiality can only be answered on a case by case basis. The *Haswell* test and other cases are confusing and vague. Thus, caution must be exercised with regard to lobbying activities.

C. Intervention in Political Campaigns

The second area of regulatory proscription for § 501(c)(3) organizations, and the easiest to violate, is the support or opposition of candidates for political office. Under the regulations, participation in a political campaign includes, but is not limited to publishing or distributing written or printed statements or making oral statements for or against a candidate.[21] Thus, an organization which campaigns on behalf of school board candidates is not exempt.[22] Nor is an organization which is formed exclusively for the purpose of influencing the nomination and election of individuals for public office.[25] In *Hammerstein v. Kelly*,[24] a medical society, which in its newsletter referred to candidates favorable to the society's position on socialized medicine, was found to have engaged in a campaign in support of a candidate.

A "candidate for public office" is broadly defined in Reg. § 1.501(c)(3)-1(c)(iii) as "an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state or local." This language is such that in some cases, it may be difficult to determine at what point in time a given person actually becomes a candidate. Caution must therefore be exercised.

Unlike the situation with respect to the substantiality problem, the prohibition against campaigning appears to be absolute. If there is any exception at all, it falls in the realm of voter education. The IRS has held that the objective reporting of positions and voting records of candidates does not constitute campaigning. A report is not objective if it focuses only on issues of interest to the organization.[25] In a subsequent ruling, it was held that a listing of the voting record on a narrow range of issues by all members of Congress was not campaigning, where there was only a limited distribution of the list, its publication was not timed to coincide with any election, and there was no special designation of which members of Congress were currently engaged in an election campaign.[26]

D. Primary Objective May Only Be Obtained By Legislation

The final situation in which an organization may be deemed an "action organization" is where its primary goal can only be obtained by legislation and it campaigns for the attainment of such goal. Examples of organizational activities that fit within this framework are those concerning national defense and taxation. A group which advocates changes in the tax laws

(continued on page 28)

would not be exempt since the only way such change could occur would be through legislation.[27] It is questionable whether this same argument would be applicable to an environment, housing, health and welfare, commerce or similar organizations.

III. A Section 501(h) Election

In light of the above, it is clear that an organization's tax exempt status is both coveted and easily susceptible to revocation. A relatively recent amendment to the code, has, however, offered some hope to § 501(c)(3) organizations, at least so far as the substantial activities test is concerned. I.R.C. § 501(h), added in 1976, allows qualified organizations that elect to come under the subsection to expend a calculable amount to influence legislation without running afoul of the proscription against substantial legislative activity. Qualified organizations entitled to elect under § 501(h) include educational institutions, hospital and medical research organizations, organizations supporting government schools, and public charities.[28]

Assuming that the group is a qualifying organization for purposes of § 501(h), only "lobbying expenditures" are covered. These are defined in § 501(h)(2)(A) as expenditures for the purpose of influencing legislation [as defined in § 4911(d)]." Pursuant to § 4911(d), "influencing legislation" means:

> A. Any attempt to influence an legislation through an attempt to affect the opinions of the general public or any segment thereof, and
>
> B. Any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation.

§ 4911(d)(2) created numerous exceptions from the term "influencing legislation":

> Exceptions—For purposes of this section, the term "influencing legislation," with respect to an organization, does not include—
>
> (A) making available the results of non-partisan analysis, study or research;
>
> (B) providing of technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or agency.

IV. Recommendations

1. Organize Documents and Forms.

It is crucial that all incorporation documents, minutes, federal and state forms are in order and up to date. Since this subject is being given considerable attention by the IRS at this time any inquiry will be greatly affected by the impression given by the orderlines of all of the legal documents of the corporation. This is extremely important.

2. Delineate Activities.

A checklist of activities should be prepared. This list should then be weighed against the law that is set forth in the above discussion. Additionally, it should be reviewed carefully and a conclusion derived pursuant to how the organization presently stands relative to these regulations.

3. Revise Activities Accordingly

A revised direction of the organization should be accomplished if necessary. The gravamen of the organization's activities should be in terms of public education and fostering of higher standards.

Conclusion

In our democracy, more interest groups than ever before are currently seeking to express their ideas, thereby affecting the promulgation of law and public policy. It is the 501(c)(3) organization which must be highly cognizant of its own activities so that it can safeguard its tax exempt status. The 1986 Tax Reform Act has dampered the incentive for contributors to donate to the 501(c)(3) entity. So as to not incur tax liability and thereby squander precious revenue/contributions, the 501(c)(3) organization *must* prudently expend time and money so that it does not cross the amorphous tax liability border thus becoming a tax liable entity.

NOTES

1 See I.R.C. § 170(a) (income tax), § 2055(a) (estate tax), and § 2522(a) (gift tax).

2 *See American United Inc. v. Walters*, 447 F.2d 1169, 1177 (D.C. Cir. 1973), *rev'd sub nom. Alexander v. Americans United, Inc.*, 416 U.S. 752 (1974).

3 *See e.g., Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849, 854 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973).

4 500 F.2d 1133 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1197 (1975).

5 *Haswell*, 500 F.2d at 1142.

6 470 F.2d 849 (10th Cir.), *cert. denied*, 414 U.S. 864 (1973).

7 Rev. Rul. 73-440, 1973-2 C.B. 177.

8 *See League of Women Voters of the United States v. United States*, 180 F. Supp. 379 (Ct. Cl. 1960), *cert. denied*, 364 U.S. 822 (1960).

9 *Haswell*, 500 F.2d at 1138.

10 Rev. Rul. 64-195, 1964-2, C.B. 138.

11 Rev. Rul. 70-449, 1970-2 C.B. 112.

12 *Id.*

13 Treas. Reg. § 53.4945-2(c)(i)(i)(1980).

14 Treas. Reg. § 53.4945-2(d)(3)(1980).

15 Treas. Reg. § 53.4945-2(d)(4)(1980).

16 *See Seasongood v. Commissioner*, 227 F.2d 907 (6th Cir. 1955) (five percent not substantial) *of St. Louis Trust Co. v. United States*, 372 F.2d 427 (8th Cir. 1967); *Professional Standards Reveiw v. Commissioner*, 74 T.C. 240 (1980); *Virginia Professional Standards Review Foundation v. Blumenthal*, 466 F. Supp. 1164 (D.D.C. 1979).

17 *See e.g., League of Women Voters of the United States v. United States*, 100 F. Supp. 379 (Ct. Cl. 1960), *cert. denied*, 364 U.S. 822 (1960); *Kuper v. Commissioner*, 332 F.2d 562 (3d. Cir. 1964), *cert. denied*, 379 U.S. 920 (1964).

18 *See Roberts Dairy Co. v. Commissioner*, 195 F.2d 948 (8th Cir. 1952), *cert. denied*, 344 U.S. 865 (1952); *Accord Church By Mail, Inc. v. Commissioner*, 765 F.2d 1387 (9th Cir. 1985).

19 *Haswell*, 500 F.2d at 1142.

20 *Id.* at 1145.

21 Treas. Reg. § 1.50(c)(3)-1(c)(3)(iii).

22 Rev. Rul. 67-71, 1967-1 C.B. 125.

23 Rev. Rul. 74-21, 1974-1 C.B. 14.

24 235 F. Supp. 60 (E.D. Mo. 1964).

25 Rev. Rul. 78-248, 1978-1 C.B. 154.

26 Rev. Rul. 80-282, 1980-2 C.B. 178.

27 *See* Rev. Rul. 62-71, 1962-1 C.B. 85.

28 *See* I.R.C. §§ 170(b)(1)(A)(ii), (iii), (iv), and 509 (a)(2).

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