LIMITATIONS ON POLITICAL AND LOBBYING ACTIVITIES OF CHARITABLE ORGANIZATIONS

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The Internal Revenue Code imposes a number of technical requirements and restrictions on the political and legislative activities of charitable organizations. This memorandum is intended as a brief, general overview to guide organization managers in fulfilling their duties. The law in this area is very complex, however, and this memorandum should not be used as a substitute for specific legal advice.

I. DISTINCTIONS BETWEEN PUBLIC CHARITIES AND PRIVATE FOUNDATIONS

Charities are exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. All Section 501(c)(3) organizations fall into one of two categories: public charities and private foundations. Public charities generally have their own program activities, whereas private foundations for the most part are grantmaking organizations. Public charities include organizations such as churches, schools and hospitals, publicly supported organizations, and "supporting organizations." Private foundations, on the other hand, typically derive their funding from limited sources, such as corporate, individual or family donations or bequests. The tax rules that apply to these two types of charities differ significantly, and it is essential for an organization to determine at the outset into which category it falls. If in doubt, consult legal counsel or an accounting professional. This memorandum considers separately the rules applying to the two types of Section 501(c)(3) organizations.

II. RESTRICTIONS ON PUBLIC CHARITIES

A. Prohibition Against Political Activity. No Section 501(c)(3) organization, whether a private foundation or a public charity, may participate in *any* political campaign on behalf of (or in opposition to) any candidate for public office. This prohibition is absolute, and violating it may cause the organization to lose its exempt status and/or become subject to special penalty excise taxes. The prohibited activity includes, but is not limited to, publishing or distributing written statements or making oral statements on behalf of or in opposition to a candidate, and paying salaries or expenses of campaign workers.

B. Limits on Legislative Activities ("Lobbying").

1. Generally. Political activity, i.e., engaging in campaigns for public office, is distinguished from attempts to influence legislation. An organization engages in attempts to influence legislation (commonly referred to as "lobbying") if it contacts legislators -- or urges the public to do so -- for the purpose of proposing, supporting or opposing legislation. A public charity may engage in lobbying, but only if those activities do not constitute a "substantial" portion of the organization's activities. If the IRS determines that a public charity has engaged in substantial attempts to influence legislation, the organization's exemption may be revoked. Other types of tax-exempt organizations, e.g., social welfare organizations qualifying under Section 501(c)(4), are not subject to limitations on legislative activities.

2. "Substantiality" Test. It is unclear when lobbying activity will be deemed to constitute a "substantial" portion of an organization's activities. There is no precise standard. One court has held that the expenditure of more than five percent (5%) of an organization's "time and effort" for lobbying activity is "substantial."

C. Section 501(h) Election.

1. Generally. Public charities (other than churches) may make an election under Section 501(h) to become subject to a more objective standard for lobbying activities than the "substantiality" test. Section 501(h) provides specific dollar limits on lobbying expenditures. An organization making the election may spend up to 20% of the first $500,000 of its annual operating budget on lobbying. (Only 25% of that amount may be spent in "grassroots" lobbying, however, as defined below.) As an organization's annual budget increases over $500,000, the percentage that may be spent on lobbying decreases. There is an absolute annual maximum on lobbying expenditures of $1 million, which is reached at an annual budget of $17 million. If an organization exceeds its limit in any year, it will be subject to an excise tax of 25% on the excess amount. An organization that has made the Section 501(h) election may lose its tax exemption on the basis of excessive lobbying only if the organization exceeds its permitted expenditures by 150% over a four-year period.

2. Advantages of Election. The principal advantage of the Section 501(h) election is that it avoids the ambiguity of the vague "substantiality" test. Only expenditures for lobbying are limited under Section 501(h); an electing organization may use volunteers for lobbying activities to an unlimited extent. The election also allows an organization to take advantage of specific exceptions to what constitutes lobbying under the tax law. In general, the Section 501(h) election allows an organization to plan lobbying expenditures with much greater certainty regarding the tax result. In addition, the excise tax that applies to excessive lobbying expenditures of an electing organization is much less harsh than the loss of tax-exempt status that can apply to a non-electing organization. An organization that anticipates any regular attempts to influence legislation is generally well-advised to make the Section 501(h) election.

3. Making the Election. An organization makes the election by filing Form 5768 with the IRS. The form can be filed at any time during the taxable year, and once filed is valid for that year and all subsequent years unless the organization revokes the election.

4. Defining "Attempts to Influence Legislation" under Section 501(h).

a. "Legislation." "Legislation" includes action by the Congress, state legislature, local council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure. It includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes. It does not, however, include executive action, judicial processes, or the work of administrative agencies such as school boards, housing authorities, sewer and water districts, and zoning boards, whether elective or appointive. Attempts to influence the actions of regulatory agencies accordingly are not lobbying, even where the agency is primarily concerned with promulgating regulations to effectuate legislative mandates.

b. Direct Lobbying Communication. Attempts to influence legislation include "direct" lobbying, defined as communications with any member or employee of a legislative body or any governmental official or employee who may participate in formulating legislation, if the principal purpose of the communication is to influence legislation. A communication with a legislator or governmental official will be treated as a direct lobbying communication if it: (1) refers to specific legislation; and (2) reflects a view regarding the legislation.

c. Grass Roots Lobbying Communication.

(1) Generally. Attempts to influence legislation also include "grass roots" lobbying communications. These are communications that attempt to affect the opinion of the general public or a segment of the public, and that: (1) refer to specific legislation; (2) reflect a view regarding the legislation; and (3) encourage the recipient to "take action."

(2) Call to Action. A communication encourages the recipient to take action if it: (1) encourages the recipient to contact a legislator; (2) gives the address, telephone number or other contact information for the legislator; (3) provides a petition or tear-off postcard for the recipient to communicate with the legislator; or (4) specifically identifies one or more legislators who will vote on the legislation. Paid mass media advertisements appearing within two weeks of a vote on a highly publicized piece of legislation will be presumed to constitute grass roots lobbying if the advertisement reflects a view and encourages communication with legislators, even if it does not encourage the recipient to take action.

5. Exception to Definition of "Attempts to Influence Legislation."

a. Nonpartisan Analysis, Study or Research. A charity may engage in and provide the public or legislators with the results of its "nonpartisan analysis, study or research," defined as an independent and objective exposition of a particular subject matter. The communication may advocate a particular position, so long as it presents sufficient facts to allow the audience to form an independent opinion or conclusion. A charity may use "any suitable means," including broadcasts, speeches, and written presentations to distribute the results of its nonpartisan analysis, study or research. The distribution may not be limited to, or directed toward persons who are interested solely in one side of a particular issue. If the communication directly encourages the recipient to take action with respect to specific legislation, i.e., by encouraging the recipient to contact a legislator, by giving the address, telephone number or other contact information for a legislator, or providing a petition or tear-off postcard for the recipient to communicate with a legislator, then it will not qualify for this exception.

b. Technical Advice or Assistance. An organization that has developed a particular expertise in a given area may be called upon to render technical advice or assistance to a legislative committee or subcommittee. Provided that the invitation to do so is issued in writing by the committee or subcommittee, rather than an individual member, the organization's response to that request will not constitute lobbying activity.

c. "Self Defense." An electing organization may appear before, or communicate with any legislative body with respect to a possible decision of that body which might affect the organization's existence, its powers and duties, its tax-exempt status, or the deductibility of contributions to it.

d. Examinations and Discussions of Broad Social, Economic and Similar Problems. The participation in, or sponsorship of, public discussion on issues of general concern will not constitute lobbying, provided that such discussion does not address the merits of a specific legislative proposal, and does not directly encourage participants to take action with respect to legislation.

III. RESTRICTIONS ON PRIVATE FOUNDATIONS

A. Prohibition Against Taxable Expenditures.

1. General Rule. Private foundations are prohibited from making any "taxable expenditures." Violations may result in penalty taxes on both foundations and foundation managers. Taxable expenditures include both engaging in any campaign for public office and any attempts to influence legislation.

2. Imposition of Tax. A private foundation that makes a "taxable expenditure" is subject to an initial tax of 20% on each expenditure. In addition, an initial tax of 5% (up to $10,000) is imposed on any foundation manager who knowingly and willingly agreed to the expenditure. If the expenditure is not corrected, an additional penalty of 100% of the amount of the expenditure is imposed on the foundation, and a tax of 50% (up to $20,000) is imposed on any foundation manager who refuses to make the correction. Whenever possible, correction must be made by recovery of the taxable expenditure.

B. Prohibition Against Political Activity. As noted above, all Section 501(c)(3) organizations, including all private foundations, are prohibited from engaging in any political campaign on behalf of (or in opposition to) any candidate for public office, and may lose their tax exemption for violating this rule. In addition, any amounts that a private foundation expends in political activities are taxable expenditures.

C. Prohibition Against Attempts to Influence Legislation.

1. Generally. A private foundation may not make <u>any</u> expenditure in attempts to influence legislation. (A private foundation is not eligible to make the election described above under Section 501(h).) This prohibition extends to both direct and grass roots lobbying communications. Any such expenditure may disqualify the foundation from exemption, and will also constitute a taxable expenditure, potentially subjecting the foundation and its managers to excise taxes. Private foundations may, however, meet with legislators and communicate with the public on issues if no legislation (or proposed legislation) is pending. As noted above, actions by executive, judicial or administrative bodies, e.g., school boards, housing authorities and zoning boards, are not considered legislation.

2. Exceptions. Exceptions to the definition of attempts to influence legislation, similar to those described above under the Section 501(h) election for public charities, also apply to private foundations. These include exceptions for: (1) nonpartisan analysis, study or research; (2) technical advice or assistance; (3) self defense; and (4) broad social, economic or similar problems. Private foundations can accordingly undertake these activities without restriction.

3. Implications for Grantmaking. Private foundations make grants to organizations, including Section 501(c)(3) public charities, that are subject to less stringent restrictions on lobbying activities than are the foundations. This requires foundations to exercise caution in grantmaking.

a. General Support Grants. A grant to a Section 501(c)(3) public charity for general support will not constitute lobbying, even if the grant recipient engages in lobbying, so long as the grant is not earmarked for lobbying. Any grant agreement or transmittal

letter should state that the grant funds are not designated for use in any activity that may constitute lobbying. (The grant agreement or letter need not, however, prohibit use of the funds for lobbying.) The foundation's knowledge that the grantee engages in some lobbying does not cause the grant to constitute lobbying.

b. Project Grants. Project grants to Section 501(c)(3) organizations raise additional issues. The foundation should require that the grant applicant provide the foundation with a budget for the grant that specifically identifies any lobbying components. The foundation's grant must not exceed the non-lobbying portion of the budget.

c. Grants to Non-Charities. Any grant to a recipient that is not a Section 501(c)(3) organization must be subject to a written grant agreement, which must specifically prohibit use of the grants funds for lobbying.