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## Legal Alert—Lobbying Restrictions for 501(c) (3) Charities

While many charities may wish to further their endeavors by lobbying elected officials to legislate in favor of their admirable causes, too much of this activity could eliminate a 501(c)(3) organization's tax exempt status and subject it to unwanted taxes. But - within certain limits - it is possible to safely participate. Generally, charities are prohibited from devoting more than an insubstantial portion of their activities to attempting to influence legislation, or lobbying. For many organizations, the limitations only apply if the organization aims for legislators to adopt or defeat specific proposed legislation while other activities are unrestricted. This guide is designed to help charities understand the basic rules about lobbying restrictions for 501(c) (3) organizations and to preserve their tax exempt status if they do engage in lobbying efforts.

There are two tests for determining whether the time and resources dedicated to lobbying are excessive: the Substantial Part Test and the Expenditure Test. The Substantial Part Test is a vague test, while the Expenditure Test allows an organization to safely allocate certain dollar amounts to lobbying activities without penalty. A recognized 501(c) (3) tax exempt organization must affirmatively elect for the Expenditure Test to apply; if no election is made the Substantial Part Test is the default test. An example of how each test could apply is included at the end of this guide. While it won't be appropriate in every case, organizations that wish to engage in any lobbying should consider an election to avoid the legal gray areas of the Substantial Part Test.

### Expenditure Test

Internal Revenue Code Sections 501(h) and 4911 (and corresponding regulations) were designed to provide charitable organizations some certainty regarding the permissible limit of their lobbying activities. An organization affirmatively elects for the Expenditure Test to apply by filing a Form 5768 (Election/Revocation of Election by an Eligible Section 501(c) (3) Organization to Make Expenditures to Influence Legislation). Once the Form is filed, the election is made and it is effective for the current and all subsequent tax years until the organization revokes the election.

Only the following types of organizations may use the Expenditure Test:

- Educational organizations,
- Hospitals and medical research organizations,
- Supporting organizations of state colleges and universities, and
- Public charities that are publicly supported (see Treasury Regulations Sections 1.170A-9(e) and 1.509(a)-3).

The following types of organizations may not use the Expenditure Test:

- Churches, their integrated auxiliaries (generally, with more than a mere affiliation to the church; see Treasury Regulations Section 1.6033-2(h)), and members of groups that have any church or integrated auxiliary as members,

- Private foundations, and
- Organizations exclusively operated for testing for public safety.

If an electing organization maintains its lobbying expenditures within certain limits, there are no adverse consequences to its limited lobbying activity. For purposes of the Expenditure Test, the limits only apply if the organization attempts to influence *specific legislation* (described in more detail below). If the organization devotes too much of its financial resources to lobbying to influence specific proposed legislation, two tiers of sanctions apply under the Expenditure Test:

- 1) A 25% excise tax is imposed on the following amounts (on a year-by-year basis):
  - *Lobbying expenditures* in excess of the “*lobbying nontaxable amount*,” and
  - *Grass roots expenditures* in excess of the “*grass roots nontaxable amount*.”
- 2) Loss of tax exempt status for exceeding the following ceiling amounts (based on a 4-year average):
  - 150% of the “*lobbying nontaxable amount*,” and
  - 150% of the “*grass roots nontaxable amount*.”

The “*lobbying nontaxable amount*” is determined according to a sliding scale based on the organization’s *exempt purpose expenditures* (illustrated in the table below), and the “*grass roots nontaxable amount*” is 25% of the lobbying nontaxable amount (not necessarily 25% of the actual amount spent on lobbying). The permissible grass roots expenditure amounts are considered a portion of the corresponding lobbying expenditure amounts. In other words, an organization cannot spend its grass roots ceiling amount on top of its lobbying ceiling amount.

	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
<b>Exempt purpose expenditures</b>  (“EPE”)	<b>Lobbying nontaxable amount</b>  25% excise tax imposed on lobbying expenditures over this amount	<b>Lobbying ceiling</b>  (150% of Column A)  Loss of tax exempt status if lobbying expenditures exceed this amount	<b>Grass roots nontaxable amount</b>  25% excise tax imposed on grass roots expenditures over this amount	<b>Grass roots ceiling</b>  (150% of Column C)  Loss of tax exempt status if grass roots expenditures exceed this amount
<b>Up to \$500K</b>	20% of EPE	30% of EPE	5% of EPE	7.5% of EPE
<b>\$500K to \$1M</b>	\$100,000 + 15% of (EPE-\$500,000)	\$150,000 + 22.5% of (EPE-\$500,000)	\$25,000 + 3.75% of (EPE-\$500,000)	\$37,500 + 5.625% of (EPE-\$500,000)
<b>\$1M to \$1.5M</b>	\$175,000 + 10% of (EPE-\$1M)	\$262,500 + 15% of (EPE- \$1M)	\$43,750 + 2.5% of (EPE-\$1M)	\$65,625 + 3.75% of (EPE-\$1M)
<b>Over \$1.5M</b>	\$225,000 + 5% of (EPE-\$1.5M)	\$337,500 + 7.5% of (EPE- \$1.5M)	\$56,250 + 1.25% of (EPE-\$1.5M)	\$84,375 + 1.875% of (EPE- \$1.5M)

The terminology used to describe the Expenditure Test is explained further below.

Exempt purpose expenditures. Total amounts paid or incurred by the organization to accomplish the organization's charitable, religious, scientific, educational, and literary purposes, including (i) administrative expenditures for such purposes, and (ii) expenditures paid or incurred for the purpose of influencing legislation (whether or not related to charitable, religious, scientific, educational, or literary purposes). Exempt purpose expenditures generally include fundraising expenditures except amounts paid or incurred to or for a separate fundraising unit of the organization or one or more other organizations if such amounts are paid primarily for fundraising.

Lobbying expenditures. Expenditures for the purpose of *influencing legislation*. Lobbying expenditures do not include uncompensated time spent by volunteers.

Influencing legislation.

- Any attempt to influence *legislation* through an attempt to affect the opinions of the general public or any segment thereof ("*grass roots lobbying communication*"), and
- 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 ("*direct lobbying communication*").

Legislation. *Action* with respect to bills, resolutions or similar items by Congress, any state legislature, any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. Action does not include any actions by executive, judicial or administrative bodies or by school boards, housing authorities, sewer and water districts, zoning boards, or other similar federal, state or local special purpose bodies, whether elective or appointive.

Action. The introduction, amendment, enactment, defeat, or repeal of bills, resolutions, or similar items.

Grass roots lobbying communication. Communication with a member of the general public that (i) refers to *specific legislation*, and (ii) reflects a view on such legislation, and (iii) encourages the recipient of the communication to take action with respect to such legislation by doing at least one the following:

- Stating that the recipient should contact a legislator, an employee of a legislative body, or any other governmental official or employee who may participate in the formulation of legislation if the principal purpose of urging such contact is to influence legislation,
- Stating the address, telephone number or similar information of a legislator or employee of a legislative body,
- Providing a petition, tear-off postcard or similar material for the recipient to communicate with a legislator, an employee of a legislative body, or any other governmental official or employee who may participate in the formulation of legislation if the principal purpose of urging such contact is to influence legislation, or
- Specifically identifying one or more legislators who will vote on the legislation as (i) opposing the communication's view with respect to the legislation; (ii) being undecided with respect to the legislation; (iii) being the recipient's representative in the legislature; or (iv) being a member of the legislative committee or subcommittee that will consider the legislation.<sup>1</sup> Merely naming the main

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<sup>1</sup>This type of communication may, in some circumstances, come within the exception to lobbying for nonpartisan study, analysis or research.

sponsor of the legislation for purposes of identifying the legislation does not itself constitute a grass roots lobbying communication.

Direct lobbying communication. Must (i) refer to *specific legislation*, and (ii) reflect a view on such legislation.

Specific legislation. Includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes. In the case of referendums, ballot initiatives, constitutional amendments, and similar items that are placed upon a ballot by means of petition signed by a required number of voters, an item becomes specific legislation when the petition is first circulated among voters for signature.

Exceptions to influencing legislation. *Influencing legislation* does not include:

- Making available the results of nonpartisan analysis, study, or research. This is primarily for educational purposes. A communication that makes available such results and advocates a particular viewpoint may still come within this exception so long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. The mere presentation of unsupported opinion, however, does not qualify as “nonpartisan analysis, study or research.”
- Providing technical advice or assistance (where such advice would otherwise constitute influencing legislation) to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision.
- Appearances before, or communications to, any legislative body with respect to a possible decision by such body that might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization.
- Communication between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members, other than communication (i) to directly encourage the member to attempt to influence legislation through communication with a member or employee of a legislative body or with a government official who may participate in the formulation of the legislation, or (ii) to directly encourage the member to urge persons other than members to attempt to influence legislation.
- Any communication with a governmental official or employee, other than (i) a communication with a member or employee of a legislative body (where such communication would otherwise constitute influencing legislation), or (ii) a communication the principal purpose of which is to influence legislation.

### **Substantial Part Test**

Three types of “action” organizations cannot be tax-exempt under Section 501(c) (3): (i) an organization that attempts to influence legislation as a substantial part of its activities, (ii) an organization that only may achieve its primary objective by enacting or defeating proposed legislation and that advocates for that result, and (iii) an organization that participates in a campaign for or against a candidate for public office. However, an organization may advocate to adopt or reject legislation (at any level of government) as an insubstantial part of its activities without losing its exempt status even if it does not make a Section 501(h) election. The Substantial Part Test determines whether the legislative activity is substantial or insubstantial.

While there are no clear rules for the Substantial Part Test, courts have considered these factors to determine whether legislative activity is substantial or insubstantial:

- Time devoted to the activity,
- Expenditures for the activity,
- Nature of the activity, and
- How significant the legislation is to the organization's purposes.

Legislative activity for purposes of the Substantial Part Test includes contacting legislators to propose, support or oppose legislation (or urging the public to do so). Using the factors listed above, individuals' time and energy is considered along with the amount of money spent on the activity (unlike the Expenditure Test which only measures financial expenditures).

The consequences for devoting a substantial part of a charity's activities to lobbying are that the charity loses its exempt status and must pay a 5% tax on its lobbying expenditures.<sup>2</sup> The 5% tax may be imposed on a manager of the organization as well, if the manager agreed to the expenditure knowing it would likely cause the organization to lose its exempt status. The IRS requires non-electing organizations to include detailed reports of lobbying activity in their annual reports so it may properly evaluate the activities. Because of the uncertain application, harsh consequences, and administrative burden associated with the Substantial Part Test, a charity that devotes any measurable time and resources to lobbying should consider making the Section 501(h) election.

This guide summarizes Sections 501(h) and 4911 and contains general descriptions of important considerations. It is presented for informational purposes only, is not legal advice, and should not be relied upon as such. The Regulations contain extensive refinements of the meaning and applicability of all the terms discussed in this summary, including further exceptions and numerous examples. These Regulations (and if necessary IRS rulings and judicial decisions) should be consulted, with the advice of counsel experienced in the area, to determine the applicability of these rules to specific activities by an exempt organization that may constitute lobbying activities because each situation is different. Organizations that engage in lobbying also should be aware of any related state and local requirements.

### **Example**

To illustrate the Expenditure Test and the Substantial Part Test, consider a small hypothetical organization called Goodwork, Inc. that spends \$500,000 annually toward improving education in several communities. After strategizing with the management team, Goodwork wished to devote some resources to defeat specific proposed local legislation that would negatively impact Goodwork's ability to operate in its communities. Several volunteers were available to make phone calls to constituents and legislators. The volunteers placed signs around town to educate the local population about the proposed legislation and provide specific instructions for contacting legislators to defeat the proposed new rules. Goodwork employees spent weeks designing and producing talking points and the signs, which cost about 4% of the annual budget (including salaries, supplies and the signs). Goodwork provided space for some volunteers to make their calls over the course of four months, which cost another 1% of the annual budget. The team of volunteers was extensive and their work came in waves. In all, volunteers spent hundreds of hours over the four months placing signs and making calls. Goodwork employees continued meanwhile to do their good work related to improving education and only had to attend to minor issues and questions that came up with coordinating the volunteers (which was largely handled using a simple online calendar).

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<sup>2</sup>The tax does not apply to (i) organizations that make the Section 501(h) election, (ii) are disqualified from making the election, (iii) or are private foundations (a different tax applies to private foundations).

If Goodwork has not made the Section (h) election, the Substantial Part Test will apply to determine whether the legislative activities below constitute a substantial or insubstantial part of Goodwork’s overall activities:

- Time devoted to strategizing, producing and placing the signs and placing phone calls,
- Money spent on salaries, materials and rent to strategize, produce and place signs, provide space for volunteers to make calls, and manage the volunteers,
- The nature of strategizing, making and placing signs and making phone calls to local constituents and legislators, and
- The significance of the legislation to Goodwork’s purposes.

In this example, the money spent on strategizing, producing signs, renting space and managing volunteers is somewhere north of 5% of the annual budget. That modest figure seems to indicate the activity may not be a substantial part of Goodwork’s overall activities. But the extensive team of volunteers spending hundreds of hours to contact constituents and legislators about the specific legislation – and the dire consequences for Goodwork if the legislation passes – indicate that the activity is a very significant part of its overall activities. Given the uncertain outcome under the Substantial Part Test, Goodwork may prefer to make the Section 501(h) election.

If Goodwork makes the Section 501(h) election during the current tax year, it may spend the following amounts on lobbying and grass roots activities with no adverse tax consequences:

<b>Exempt purpose expenditures</b>	<b>Lobbying nontaxable amount</b>	<b>Lobbying ceiling</b>	<b>Grass roots nontaxable amount</b>	<b>Grass roots ceiling</b>
\$500,000	\$100,000	\$150,000	\$25,000	\$37,500

To avoid unwanted taxes, Goodwork needs to be sure that the cost of the salaries, signs and rental space for volunteers that are used to contact constituents directly remain under \$25,000. If Goodwork reaches that limit, it still may spend an additional \$75,000 contacting legislators directly before it bumps up against the overall lobbying nontaxable amount. As this example illustrates, Goodwork has quite a bit more flexibility and certainty if it makes the Section 501(h) election.

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