

A Primer on Lobbying for Public Charities and Private Foundations
for
Indiana Grantmakers Alliance
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Outline of Discussion Material

I. Overview of Exempt Organizations and the Lobbying Restriction

A. Charitable Organizations

1. Organizations that are exempt from the payment of federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”), are prohibited from devoting any “substantial part of [their] activities [to] carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in [Code section 501(h)].”
 - a. Note the more restrictive provisions for private foundations (see Part V of this outline)
 - b. Note the more extensive provisions for member organizations (see Part IV of this outline)
2. Code section 501(h) provides limits on expenditures for lobbying activities as a means of determining whether an organization is staying within the bounds prescribed by Code section 501(c)(3).
3. Section 1.501(c)(3)-1(c)(3)(ii) of the United States Treasury Regulations (the “Treasury Regulations” or “Treas. Regs.”) provides that an organization will run afoul of the lobbying restrictions in Code section 501(c)(3) “if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise. For this purpose, an organization will be regarded as attempting to influence legislation if the organization –

- (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.

The term ‘legislation,’ as used in this subdivision, includes 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. An organization will not fail to meet the operational test merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation. An organization for which the expenditure test election of section 501(h) is in effect for a taxable year will not be considered [a prohibited] ‘action’ organization by reason of this paragraph . . . for that year if it is not denied exemption from taxation under section 501(a) by reason of section 501(h).”

II. The Limits of Permissible Lobbying: Two Alternative Tests

A. The “Substantial Part” Test

1. Legal Definition: see above (Code section 501(c)(3))
2. Advantages
 - c. No separate filing is required (as it is under Code section 501(h))
 - d. A small group of 501(c)(3) organizations may be ill-suited to the 501(h) election: those with big budgets and small percentages of lobbying expenses that still exceed the absolute dollar limit under Code section 501(h), because of the sizes of their budgets (\$1 million absolute cap if “exempt purpose expenditures” exceed \$17 million per year)
3. Disadvantages
 - a. Vague; lacks certainty and specificity; makes it difficult to plan levels of legislative activity (especially in the area of expenditures)
 - b. If a charity exceeds this limit, it will immediately place its tax-exempt status in jeopardy (rather than the intermediate step of a tax, as under Code section 501(h))

- i. A rolling four-year average is used under Code section 501(h), and revocation is implemented only if the limits are exceeded by 50 percent, on average, over the four years (Treas. Reg. section 1.501(h)-3(b))
 - ii. Under the “substantial part” test, exemption could be lost as a result of one bad year
 - c. IRS examinations under this standard are not limited to an evaluation of expenditures, but may include consideration of other non-financial factors
 - d. Unlike under Code section 501(h), volunteer-driven legislative activities (without accompanying expenditures) count toward the “substantial part” limit
4. Reporting Requirements: **Form 990, Schedule C, Part II-B (see attached copy)**

B. The 501(h) Election

1. Who can Make the Election? (Code section 501(h)(3)-(5))
 - a. Organizations that may make the election:
 - i. Schools (Code section 170(b)(1)(A)(ii))
 - ii. Exempt hospitals (Code section 170(b)(1)(A)(iii))
 - iii. Organizations supporting government schools (Code section 170(b)(1)(A)(iv))
 - iv. Publicly supported organizations (Code sections 170(b)(1)(A)(vi) and 509(a)(2))
 - v. Certain supporting organizations (Code section 509(a)(3), but not those that support 501(c)(4), (5), or (6) organizations)
 - b. Organizations that may not make the election:
 - i. Private foundations (Code section 509(a))
 - ii. Churches (Code section 170(b)(1)(A)(i))

- iii. Integrated auxiliaries of churches or of conventions or associations of churches
- iv. Members of an affiliated group of organizations (as defined in Code section 4911(f)(2)) if one or more members of the group is a church or an integrated auxiliary of a church (or of a convention or association of churches)

2. Expenditure Limits

- a. Total lobbying expenditures: limited by the following calculation (and, in all cases, limited to \$1 million per year) on a rolling 4-year average calculation (Code section 4911(c)(2) and Treas. Reg. section 1.501(h)-3(c)(7)):
 - i. no more than 20% of the first \$500,000 in “exempt purpose expenditures” as defined below (i.e., \$100,000 out of \$500,000)
 - ii. no more than 15% of the second \$500,000 in “exempt purpose expenditures” (i.e., total of \$175,000 out of \$1,000,000);
 - iii. no more than 10% of the third \$500,000 in “exempt purpose expenditures” (i.e., total of \$225,000 out of \$1,500,000); and
 - iv. no more than 5% of “exempt purpose expenditures” above \$1.5 million (capped at \$1,000,000 in total lobbying expenditures, which you hit at \$17,000,000 in “exempt purpose expenditures”)
- b. Grass Roots Lobbying (defined below): limited to 25% of total lobbying expenditure limit, regardless of amount of direct lobbying expenditures (Code section 4911(c)(4))
 - i. Grass roots lobbying is distinct from direct lobbying (again, see definition below)
 - ii. For example: if total lobbying expenditure limit is \$10,000 according to the formula under Code section 4911(c)(2), then the grass roots lobbying limit is \$2,500 – even if the organization does not make any direct lobbying expenditures

- c. “Exempt purpose expenditures” are defined as “the total of the amounts paid or incurred by [an] organization to accomplish purposes described in [Code] section 170(c)(2)(B) (relating to religious, charitable, educational, etc., purposes).” (Code section 4911(e)(1)(A))
 - i. Includes administrative expenses (Code section 4911(e)(1)(B)(i))
 - ii. Includes all lobbying expenditures (Code section 4911(e)(1)(B)(ii))
- d. Lobbying expenditures are defined comprehensively: they include “all costs of preparing a direct or grass roots lobbying communication,” and they include:
 - i. Amounts paid or incurred as current or deferred compensation for an employee’s services attributable to the direct or grass roots lobbying communication; and
 - ii. The allocable portion of administrative, overhead, and other general expenditures attributable to the direct or grass roots lobbying communication.

Treas. Reg. section 56.4911-3(a)(1).
- e. “Mixed-purpose” expenditures: allocation rules (Treas. Reg. section 56.4911-3(a)(2))
 - i. Nonmembership communications (i.e., communications to an audience of which not more than half are members)
 - (A) Must include all costs attributable to nonlobbying parts of the communication that are on the same specific subject as the lobbying portion of the message
 - (B) Generally, a portion of communication will be regarded as “on the same specific subject as the lobbying message” if that portion discusses an activity or specific issue that would be directly affected by the “specific legislation” (defined below) discussed by the lobbying portion of the message

- (C) Discussion of the background or consequences of the specific legislation (or of an activity or specific issue affected by the specific legislation) will be regarded as on the same specific subject as the lobbying portion of the message
 - ii. Membership communications (i.e., communications to an audience of which more than half are members): a more lenient allocation rule (Treas. Reg. section 56.4911-3(a)(2)(ii))
 - (A) The organization “must make a reasonable allocation between the amount expended for the lobbying purpose and the amount expended for the nonlobbying purpose.”
 - (B) See also general discussion of communications with members (below and in Treas. Reg. section 56.4911-5)
 - f. Record keeping: Track time and costs diligently for 501(h) purposes
 - i. Employee time
 - ii. Photocopies
 - iii. Website costs
 - iv. Email services
 - v. Faxes
 - vi. Postage
 - vii. Messenger services
 - viii. Printing
3. Advantages and Disadvantages: revisit lists under “substantial part” test, with reversed perspective

4. Penalties for Exceeding the Limits: Taxes and Revocation
 - a. Taxes
 - i. If an organization exceeds its 4-year average (the 4 years are the current year and the 3 preceding years, per Treas. Reg. section 1.501(h)-3(c)(7)), it must pay a tax equal to 25% of the excess expenditures (Code section 4911(a)(1))
 - ii. If an organization exceeds its total lobbying expenditure limit and its grass roots lobbying expenditure limit for the 4-year period, its tax will be equal to 25% of the greater excess amount (Code section 4911(b))
 - b. Revocation of Exemption
 - i. Exempt status may be revoked if lobbying expenditures exceed the permitted amounts by more than 50 percent over a 4-year period
 - ii. The 25% excise tax also would apply in this case (Code section 4911(a)(2))
5. Election, Revocation, and Re-Election: **Form 5768 (see attached copy)**
 - a. Filing Form 5768 will make Code section 501(h) applicable to the organization beginning with the year of filing and for all subsequent tax years until the organization revokes its election (including the year in which the election is revoked) (Code section 501(h)(6))
 - b. An organization may revoke its 501(h) election by filing the same form (Form 5768), and the revocation will be effective beginning with the tax year after the form is filed (Code section 501(h)(6)(B))
 - c. An organization may re-elect under Code section 501(h), but the re-election can be effective no earlier than the tax year following the first year in which the revocation took effect (Treas. Reg. section 1.501(h)-2(d)(2))
6. Reporting Requirements: **Form 990, Schedule C, Part II-A (see attached copy)**

III. Defining “Lobbying” for Purposes of the Lobbying Rules

A. Background: Defining “Legislation” for Purposes of the Lobbying Rules

1. Code section 4911(e)(2): “The term ‘legislation’ includes action with respect to Acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure.”
2. Under the definition found in the Code and the Treasury Regulations, “legislation” does not include actions by judicial, executive, and administrative bodies (such as school boards, zoning boards, and courts)
3. The Treasury Regulations make reference to “specific legislation” in their definition of direct and grass roots lobbying (Treas. Reg. section 56.4911-2(b)(1)-(2)). “Specific legislation” is defined in Treas. Reg. section 56.4911-2(d)(1)(ii) to include both of the following:
 - a. Legislation that has already been introduced in a legislative body; and
 - b. A specific legislative proposal (even if not yet introduced in a legislative body) that the organization either supports or opposes (such as a measure that is pending in another jurisdiction).

In cases of referenda, ballot initiatives, constitutional amendments, or other measures placed on the ballot by voter petition, an item becomes “specific legislation” when the petition is first circulated among voters for signature. Id.

B. What Constitutes “Lobbying”?

1. Direct Lobbying Communication: defined in Treas. Reg. section 56.4911-2(b)(1) as “any attempt to influence any legislation through communication with: (A) Any member or employee of a legislative body; or (B) Any government official or employee (other than a member or employee of a legislative body) who may participate in the formulation of the legislation, but only if the principal purpose of the communication is to influence legislation.”
 - a. Required element: Must refer to “specific legislation” as defined above (Treas. Reg. section 56.4911-2(b)(1)(ii)(A))
 - b. Required element: Must reflect a view on such legislation (Treas. Reg. section 56.4911-2(b)(1)(ii)(B))

2. Grass Roots Lobbying: defined in Treas. Reg. section 56.4911-2(b)(2)(i) as “any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof.”
- a. Required element: Must refer to “specific legislation” as defined above (Treas. Reg. section 56.4911-2(b)(2)(ii)(A))
 - b. Required element: Must reflect a view on such legislation (Treas. Reg. section 56.4911-2(b)(2)(ii)(B))
 - c. Required element: Must encourage the recipient of the communication to take action with respect to such legislation (Treas. Reg. section 56.4911-2(b)(2)(ii)(C))
 - d. The requisite “call to action” must be either a “direct encouragement” or an “indirect encouragement” to take action. (This distinction matters under the exception for nonpartisan analysis, study, or research discussed below.)
 - e. Examples of “direct encouragement” to take action include the following (Treas. Reg. section 56.4911-2(b)(2)(iii)(A)-(C)):
 - i. Stating that the recipient should contact a legislator or an employee of a legislative body, or should contact any other government official or employee who may participate in the formulation of legislation (but only if the principal purpose of urging contact with the government official or employee is to influence legislation);
 - ii. Stating the address, telephone number, or similar information of a legislator or an employee of a legislative body; or
 - iii. Providing a petition, tear-off postcard, or similar material for the recipient to communicate with a legislator or an employee of a legislative body (or with any other government official or employee who may participate in the formulation of legislation), but only if the principal purpose of facilitating contact with the government official or employee is to influence legislation.
 - f. “Indirect encouragement” to take action includes specifically identifying who will vote on the legislation as (i) opposing the communication’s view, (ii) being undecided, (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 (but not identifying the main sponsor of the legislation)
(Treas. Reg. section 56.4911-2(b)(2)(iii)(D))

C. Activities That Do Not Constitute Lobbying

1. Nonpartisan Analysis, Study, or Research: Must pass two tests (Treas. Reg. section 56.4911-2(c)(1))
 - a. The content test: The communication must be “an independent and objective exposition of a particular subject matter, including any activity that is ‘educational’ . . . ‘nonpartisan analysis, study, or research’ may advocate a particular position or viewpoint 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 an unsupported opinion, however, does not qualify” (Treas. Reg. section 56.4911-2(c)(1)(ii))
 - b. The distribution test: The results of such analysis, study, or research must be made “available to the general public or a segment or members thereof or to governmental bodies, officials, or employees.” (Treas. Reg. section 56.4911-2(c)(1)(i))
 - c. If the communication contains a “direct” call to action (as defined above in the definition of grass roots lobbying communications), then the communication cannot qualify for the “nonpartisan analysis, study, or research” exception. (Treas. Reg. section 56.4911-2(c)(vi))
2. Examinations and Discussions of Broad Social, Economic, and Similar Problems (Treas. Reg. section 56.4911-2(c)(2))
 - a. This exception includes public discussions and communications with members of legislative bodies or governmental employees, the general subject of which is also the subject of legislation before a legislative body, so long as:
 - i. The discussion does not address itself to the merits of a specific legislative proposal; and
 - ii. The discussion does not directly encourage participants to take action with respect to legislation.
 - b. Example: organization convenes a roundtable discussion with legislators and others to discuss social or economic issues that are the subject of specific legislative proposals, so long as the merits of

such proposals are not discussed and the participants are not encouraged to take action with respect to such proposals.

3. Requests for Technical Advice or Assistance: covers an organization's provision of technical advice or assistance to a governmental body or committee (or a subdivision of either) in response to a written request from the body, committee, or subdivision (Treas. Reg. section 56.4911-2(c)(3))
 - a. Request must be made in the name of the requesting governmental body, committee, or subdivision, rather than in the name of an individual member thereof (Treas. Reg. section 53.4945-2(d)(2)(i))
 - b. "Technical advice or assistance" may be given as a result of knowledge or skill in a given area (Treas. Reg. section 53.4945-2(d)(2)(ii))
4. "Self-Defense" Communications (Treas. Reg. section 56.4911-2(c)(4))
 - a. This exception only applies to communications with regard to an organization's existence, powers, duties, tax-exempt status, or the deductibility of contributions to it

IV. Special (and more lenient) Rules for Communications with Members

- A. The definition of a "member" for purposes of these rules includes the following (Treas. Reg. section 56.4911-5(f)(1)):
 1. One who pays dues or makes a contribution of more than a nominal amount;
 2. One who makes a contribution of more than a nominal amount of time; and
 3. Is one of a limited number of "honorary" or "life" members who have more than a nominal connection with the organization and who have been chosen for a valid reason unrelated to the organization's dissemination of information to its members (such as length of service to the organization or involvement in activities forming the basis of the organization's exemption)

Thus, the definition of "member" under these rules is broader than the definition of a member under Indiana nonprofit corporation law.

- B. Communications directed exclusively to the organization's members
1. Such a communication does not constitute "lobbying communications" if:
 - a. The specific legislation to which the communication refers is of direct interest to the organization and its members;
 - b. The communication does not directly encourage the member to engage in direct lobbying (either individually or through the organization); and
 - c. The communication does not directly encourage the member to engage in grass roots lobbying (either individually or through the organization).

Treas. Reg. section 56.4911-5(b).
 2. Such a communication constitutes a direct lobbying communication if it directly encourages the member to engage in direct lobbying (either individually or through the organization) (Treas. Reg. section 56.4911-5(c))
 3. Such a communication constitutes a grass roots lobbying communication if it directly encourages the member to engage in grass roots lobbying (either individually or through the organization), whether or not it directly encourages the member to engage in direct lobbying (Treas. Reg. section 56.4911-5(d))
- C. Communications primarily to members (i.e., to an audience of which more than half are members)
1. Such a communication does not create lobbying expenditures if it does not directly encourage readers to engage in either direct lobbying or grass roots lobbying (Treas. Reg. section 56.4911-5(e)(4))
 2. The cost of such a communication must be allocated between expenditures for direct lobbying and grass roots lobbying (including all costs of preparing all the "direct lobbying" material, plus all mechanical and distribution costs attributable to such material) if it directly encourages readers to engage (individually or through the organization) in direct lobbying, but does not directly encourage them to engage in grass roots lobbying (Treas. Reg. section 56.4911-5(e)(2))
 - a. The amount allocable as a grass roots expenditure is the total lobbying expenditure (as defined above) multiplied by the percentage of the recipients of the communication who are not

members of the organization (including libraries). (For purposes of this rule, the percentage of “nonmembers” is treated as zero unless it is greater than 15% of the total distribution.)

- b. The amount allocable as a direct lobbying expenditure is the total lobbying expenditure (as defined above) minus the amount allocable as a grass roots expenditure (as calculated above)
3. The cost of such a communication will be deemed a grass roots expenditure to the extent that the communication encourages readers to engage (individually or collectively, whether through the organization or otherwise) in grass roots lobbying (whether or not it also encourages readers to engage in direct lobbying), including all costs of preparing the “grass roots lobbying” material and all mechanical and distribution costs attributable to such material (Treas. Reg. section 56.4911-5(e)(3))

V. Private Foundations and Grantmaking Activities

A. General Restriction on Private Foundation Lobbying Expenditures (Code section 4945(d)(1))

1. The general rule that charitable organizations can engage in some lobbying activities does not apply to private foundations
2. Generally, any amount paid or incurred by a private foundation to “to carry on propaganda, or otherwise to attempt, to influence legislation” constitutes a taxable expenditure (Code section 4945(d)(1))
 - a. An expenditure is an “attempt to influence legislation” if it is for a “direct lobbying communication” or a “grass roots lobbying communication” as these terms are defined above. (Treas. Reg. section 53.4945-2(a)(1))
3. The following do not constitute taxable expenditures (Treas. Reg. sections 53.4945-2(d)(1)-(4)):
 - a. Nonpartisan Analysis, Study, or Research (see discussion above)
 - b. Requests for Technical Advice or Assistance (see discussion above)
 - c. “Self-Defense” Communications (see discussion above)

- d. Examinations and Discussions of Broad Social, Economic, and Similar Problems (see discussion above)

B. Funding by Private Foundations to Public Charities that Engage in Lobbying

- 1. The Prohibition on Earmarking Grants for Lobbying (Treas. Reg. section 53.4945-2(a)(6) and the general context of “taxable expenditures” under Code section 4945(d))
 - a. A private foundation may not “ earmark” funds to a public charity to be used in an attempt to influence legislation
 - b. A grant is “ earmarked” if it is given pursuant to an agreement (oral or written) that the grant will be used for specific purposes (Treas. Reg. section 53.4945-2(a)(5)(i))
 - c. Under these rules, so long as a grant by a private foundation is not “ earmarked” as described above, a private foundation will not have made a taxable expenditure even if the public charity actually uses the funds granted by a private foundation for lobbying
- 2. “ Specific project grants” by a private foundation to a public charity are not “ taxable expenditures” if:
 - a. The grants are not earmarked for lobbying by the public charity; and
 - b. The total amount of such grants by the private foundation in a given year does not exceed that year’s amount budgeted by the grantee for activities of the project that are not attempts to influence legislation
 - i. A private foundation may rely on a grantee’s budget unless the private foundation doubts the reliability of the documents or the facts and circumstances give the private foundation reason to doubt their reliability

Treas. Reg. section 53.4945-2(a)(6)(ii)-(iii).

VI. Funding by Public Charities to Other Public Charities that Engage in Lobbying

- A. The Treasury Regulations do not address grants from one public charity to another public charity

- B. Private Letter Ruling 200943042: In 2009, the IRS issued a private letter ruling (a “PLR”) that offers guidance for grantmaking public charities that have made the 501(h) election.
1. Although PLRs are only binding precedent for the party involved, they can serve as valuable tools to discern how the IRS may rule in similar situations in the future.
 2. In PLR 200943042, the IRS concluded that “the standard for public charities should be no more stringent than that which applies to private foundations.” Accordingly, the IRS ruled as follows with respect to a grantmaking public charity that had made the Code section 501(h) election:
 - a. General support grants from the grantmaking public charity to another public charity may be treated as non-lobbying expenditures as long as the grant is not earmarked for “lobbying” as defined in Code section 4911(d) and the corresponding Treasury Regulations;
 - b. A grant restricted to a specific project of a public charity is not, solely by virtue of that restriction, earmarked for lobbying;
 - c. A project grant to a public charity will not be considered “earmarked for lobbying” if the grant amount, combined with the grantor’s other grants for that project during the year, do not exceed the non-lobbying portion of the budget of the funded project and the grantor does not doubt, or have reason to doubt, the budget information provided by the recipient public charity; and
 - d. If a project grant from the grantor public charity to the public charity exceeds the non-lobbying portion of the project budget, then the grantor must treat the amount by which the grant exceeds the non-lobbying amount of the budget as a lobbying expenditure.

VII. Resources from Indiana Grantmakers Alliance

- A. The Indiana Grantmakers Alliance (the “Alliance”) monitors activities at the Indiana statehouse and in Congress that are relevant to tax-exempt organizations. Updates regarding legislation that may be of interest to Alliance members are posted on the Alliance’s website when Congress and the General Assembly are in session.
- B. Alliance members have access to committee listings which provide the names of the individuals serving on standing committees in the Indiana House and Senate. These contacts will be helpful if your organization is interested in taking action with respect to specific proposed legislation.