

P. LOBBYING ISSUES

by

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1. Introduction

The last two years have witnessed a flurry of legislative activity regarding the lobbying activities of tax-exempt organizations. Concerns have been raised regarding the extent of their lobbying and whether additional limitations should be imposed. Last year, in response to some of these concerns, the Lobbying Disclosure Act of 1995 was enacted, to become effective January 1, 1996. 2 U.S.C. 1601 *et seq.* In addition to requiring organizations that engage in lobbying to register and report on their activities, the Act provides that IRC 501(c)(4) organizations that engage in lobbying are not eligible to receive Federal funds as an award, grant, or loan.¹ Debate concerning further, non-tax legislation continues.

Nevertheless, as Miriam Galston has noted in "Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities," 71 *Tex. L. Rev.* 1269 (1993), the primary vehicle for regulating organizations' legislative activities is the Internal Revenue Code. In her article, Professor Galston observes that the Code creates four separate and very different regulatory "regimes" regarding lobbying. *Id.* at 1275-81.

The first regime, which applies to IRC 501(c)(3) public charities, permits these organizations to lobby so long as they do not devote a "substantial part" of their activities to attempting to influence legislation. This system has two subsets, which employ different tests of substantiality. The older, enacted in 1934, applies facts and circumstances criteria to determine "substantial part." The newer was introduced in 1976, by the enactment of IRC 501(h) and IRC 4911. IRC 501(h) provides that certain public charities may make an election and have their lobbying activities governed by expenditure tests in lieu of being subject to the IRC 501(c)(3) "substantial part" test. If the expenditure limits are exceeded, a tax under IRC 4911 will be imposed or, if the limits are exceeded by 150 percent over a defined period, exempt status will be lost. The tests are discussed in Parts 2 and 3.

The second regime applies to IRC 501(c)(3) private foundations. Under this regime, any expenditures incurred for lobbying activities are treated as taxable expenditures under IRC 4945(d)(1) and subject to the tax imposed by IRC 4945(a). Part 4 discusses this topic.

The third regime involves other federally tax-exempt organizations. Outside of IRC 501(c)(3), there is no specific provision of IRC 501(c) that restricts lobbying activities. Consequently, the only limit imposed on the lobbying activities of non-IRC 501(c)(3) organizations is that the lobbying activities must be germane to the accomplishment of the organization's exempt purpose. As a result, the organization's sole activity in support of its exempt purpose may be lobbying without jeopardizing its tax exemption. This topic is discussed in Part 5.

¹ See Robert A. Boisture, "What Charities Need to Know to Comply with the Lobbying Disclosure Act of 1995," 13 *EOTR* 35 (Jan. 1996) and Miriam Galston, "Simpson's Lobbying Provision: More Bark than Bite," 13 *EOTR* 45 (Jan. 1996) for descriptions of the provisions and effects of the Lobbying Disclosure Act.

The fourth regime concerns the lobbying expenditures of businesses. These rules are set forth in IRC 162. Until recently, this was not a subject that particular concerned exempt organizations. Now, however, because of the lobbying disallowance provisions of the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993), exempt organizations also must consider the provisions that disallow deductions for lobbying by businesses. Part 6 discusses this topic.

2. Lobbying Activities of IRC 501(c)(3) Nonelecting Public Charities

A. Legislative and Regulatory History

(1) The Pre-Statutory Era

Prior to 1934, there was no specific statutory restriction on the lobbying activities of charities. Early regulations, however, provided that organizations "formed to disseminate controversial or partisan propaganda" were not "educational" within the meaning of the statute. Treas. Reg. 45, art 517 (1919 ed.); T.D. 2831, 21 Treas. Dec. Int. Rev. 285 (1919). The import of the regulation became the subject of litigation concerning the deductibility of a contribution or bequest to an organization. The deduction was disallowed in some cases. See Herbert E. Fales, 9 B.T.A. 828 (1927) (contributions to various temperance organizations); Joseph M. Price, 12 B.T.A. 1186 (1928) (contribution to the Civic Fund of the City Club of New York); Slee v. Commissioner, 42 F.2d 184 (1930), aff'g 15 B.T.A. 710 (1929) (contribution to the American Birth Control League); Henriette T. Noyes, 31 B.T.A. 121 (1934) (contribution to a women voters' league); Vanderbilt v. Commissioner, 48 F.2d 360 (1st Cir. 1937) (bequest to the National Women's Party). In other cases, the deduction was allowed. See Weyl v. Commissioner, 48 F.2d 811 (2nd Cir. 1931), rev'g 18 B.T.A. 1092 (1930) (contribution to the League for Industrial Democracy); Cochran v. Commissioner, 78 F.2d 176 (4th Cir. 1935), rev'g 30 B.T.A. 1115 (1934) (contribution to the World League Against Alcoholism). In one case, a contribution to an organization was allowed, while another, to a cognate organization, was disallowed. Leubuscher v. Commissioner, 54 F.2d 998 (2d Cir. 1932), modifying 30 B.T.A. 1022 (1930) (bequest to two organizations to teach the ideas of Henry George relative to the single tax on land).²

² Commentators differ on the overall import of these decisions. Dean E. Sharp, "Reflections on the Disallowance of Income Tax Deductions for Lobbying Expenditures," 39 B.U. L. Rev. 365, 387 (1959), simply notes that these cases, as well as cases decided after 1934, "are in conflict." Others have deduced a trend. William H. Lehrfeld, "The Taxation of Ideology," 19 Cath. U. L. Rev. 52, 59 (1969), emphasizes the controversial nature of the organization's agenda; he concludes that "[o]nly the meek inherited the tax exemption." Tommy F. Thompson, "The Availability of the Federal Educational Tax Exemption for Propaganda Organizations," 18 U.C. Davis L. Rev. 487, 498-501 (1985), contends that the determining factor in these cases was whether the organization attempted to influence legislation. (Thompson also states, at 498 n. 29, that "no evidence suggests that the Service actively discriminated against organizations that advocated extreme viewpoints, or in favor of organizations that advocated mainstream viewpoints. The evidence suggests that the Service did in fact apply the standard strictly and evenhandedly.") Laura B. Chisholm, "Exempt Organization Advocacy: Matching the Rules to the Rationales," 63 Ind. L.J. 201, 216 n. 78, after noting Mr. Lehrfeld's and Professor Thompson's analyses, concludes: "With a few exceptions, the cases seem to support the [legislative activity] contention at least as convincingly as they support the proposition that advocacy per se or controversiality was the basis for denial of exemption or deductibility."

Of all these cases, Slee is paramount. In Slee, the organization at issue, the American Birth Control League, gave free medical services to married women, collected and distributed information about birth control, and sought to enlist the support and cooperation of legislators in repealing and amending statutes preventing birth control. Judge Learned Hand, writing for a unanimous court, dismissed the controversial nature of the League's program as irrelevant: "We cannot discriminate unless we doubt the good faith of the enterprise." Slee, at 185. Instead, he focused on the League's legislative activity:

*Political agitation as such is outside the statute, however innocent the aim, though it adds nothing to dub it "propaganda," a polemical word used to decry the publicity of the other side. Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them. Id.*³

Immediately after this statement, however, Judge Hand made a distinction:

*Nevertheless, there are many charitable, literary and scientific ventures that as an incident to their success require changes in the law. A charity may need a special charter allowing it to receive larger gifts than the general laws allow. . . . A society to prevent cruelty to children, or animals, needs the positive support of law to accomplish its ends. . . . We should not think that a society of booklovers or scientists was less "literary" or "scientific," if it took part in agitation to relax the taboos upon works of dubious propriety, or to put scientific instruments on the free lists. All such activities are mediate to the primary purpose, and would not, we should think, unclass the promoters. **The agitation is ancillary to the end in chief, which remains the exclusive purpose of the association.** Trinidad v. Sagrada Orden, 263 U.S. 578, 44 S. Ct. 204, 68 L. Ed. 458 [1924]. Id. (Emphasis added.)⁴*

The League, however, did not come within this exception because there was no evidence that its legislative activity was "confined solely to relieving its hospital work from legal

³ This holding was reflective of the common law regarding lobbying in England and in Massachusetts, but not in any other jurisdiction. See Girard Trust Co. v. Commissioner, 122 F.2d 108, 113-114 (Clark, J., dissenting); Elias Clark, "The Limitation on Political on Political Activities: A Discordant Note in the Law of Charities," 46 Va. L. Rev. 439, 447-448 (1960). Professor Clark, who is critical of the decision because it "assumes the validity of the restriction without attempting to justify it by argument or authority," nevertheless notes: "Later courts have accepted the principle as settled." Id. at 446-447.

⁴ The citation of Trinidad is an obvious reference to the Court's observation in that case that the exemption statute "says nothing about the source of the income, but makes the destination the ultimate test of exemption." Trinidad, at 581. The practical result of the Court's statement was that an organization could qualify for tax exempt status so long as the income was used for exempt purposes; its source was irrelevant. This became known as the "destination of income" test, and was the pervading standard for congruence with charitable exemption until the passage of the unrelated business income tax and the feeder organization rules in the Revenue Act of 1950.

obstacles.” Id. Therefore, contributions to the League were not deductible. This disallowance, accordingly, was based not upon the controversial nature of the League’s activities, nor upon its attempts to influence legislation per se; instead, it was based upon the assumption (actually, the lack of evidence to refute the assumption) that its legislative activities went beyond its charitable purposes.⁵

What Slee proclaims is an analog to Trinidad’s “destination of income” test -- a “destination of lobbying” test. As will be discussed in the next section, this did not become the precise formulation of the statutory restriction on lobbying; nevertheless, Slee served as the basis of what was to follow.

(2) The Lobbying Restriction

In 1934, the limitation on the lobbying activities of IRC 501(c)(3) organizations, requiring that “no substantial part of an organization’s activities constitute carrying on propaganda or otherwise attempting to influence legislation,” became part of the statute. Revenue Act of 1934. The legislative history is sparse.

What we do know is that the Senate Finance Committee staff drafted the provision and that it was added to the Revenue Act of 1934 as a floor amendment.⁶ We also know that Senator David Reed, the ranking minority member of the Committee and the provision’s apparent sponsor, was dissatisfied with its formulation:

There is no reason in the world why a contribution made to the National Economy League should be deductible as if it were a charitable contribution if it is a selfish one made to advance the personal interests of the giver of the money. That is what the committee was trying to reach; but we found great difficulty in phrasing the amendment. I do not reproach the draftsmen. I think we gave them an impossible task; but this amendment goes much further than the committee intended to go. 78 Cong. Rec. 5,861 (1934).

It is not clear, however, to what extent Senator Reed was speaking for the entire Committee. If the Committee were so dissatisfied with the provision, they could have tabled it -- contributions to most charities are unselfishly motivated. Likewise, if the Congress or the Administration felt that the critical issue was that more prevention of cruelty societies and crippled children’s organizations would be affected by its enactment than “selfish” organizations,

⁵ Judge Hand’s decision made no mention of the Treasury regulation. The Board of Tax Appeals decision, in contrast, discussed it. Slee, 15 B.T.A. at 715.

⁶ The provision also contained a restriction on “participation in partisan politics.” The provision, however, was dropped in conference, so that only the lobbying restriction remained. H.R. Conf. Rep. No. 73-1385, 73d Cong., 2d Sess. 3-4 (1934). In explaining its deletion, one of the House managers, Representative Samuel B. Hill stated, “We were afraid this provision was too broad.” 73 Cong. Rec. 7,831 (1934).

it would not have become law. One suspects that the provision was enacted simply because there was a general sentiment that lobbying by charities should be restricted.⁷ This is not to doubt that the "selfish/unselfish" formula was what Senator Reed wanted drafted, nor that, as he stated, the Committee staff tried to draft it but found it impossible.⁸ However, the reference to the National Economy League seems to indicate that the Senator had embarked on a personal crusade that may not have been taken too seriously by his colleagues, who seized the opportunity to enact a broader restriction.⁹

⁷ The Committee considered, and rejected, application of the provision to restrict contributions to war veterans' associations. Id. at 5,861 (remarks of Senator Pat Harrison, chairman of the Committee).

⁸ The National Economy League is discussed in note 9. Senator Reed's view of the League as selfishly motivated was not universally shared. For example, in an editorial, the New York Times praised the League chairman's (and, by implication, the League's) "patriotism, disinterestedness, and loyalty." "Useful Service," April 27, 1933, at 16. The impossibility of starting with the National Economy League and drafting a "selfish/unselfish" standard is apparent.

⁹ Senator Reed had been one of the leaders of the considerable number of "Old Guard" Republicans during the Harding, Coolidge, and Hoover administrations. After the 1932 election, however, their numbers had been drastically reduced, as had Reed's influence. A 1933 Newsweek portrait of the Senator, Reed: Hamiltonian, Mellon Attorney, and Penn. Senator, May 6, 1933, at 18-19, presents him as a beleaguered figure, having virtually no influence and being subjected to the abuse of the acid-tongued Senator Harrison. By the time he was denouncing his own bill on the Senate floor, his situation had worsened. He was locked in a nasty primary battle for renomination; the election occurred less than two months after his floor speech; the outcome was in doubt. His opponent was his ideological opposite, the Governor of Pennsylvania, Gifford Pinchot, a leader of the Progressive wing of the Republican Party. (In addition to their ideological differences, they detested each other: Harold Ickes observed that they had always fought "like two tomcats sitting on a fence." Arthur M. Schlesinger, Jr., The Coming of the New Deal, 346 (1959).) Pinchot was not Reed's only problem; he was also opposed by an organization that would appear to have been his natural ally, the National Economy League.

The National Economy League was one of the short-lived phenomena of the 1930's. Organized in 1932, apparently in reaction to the Bonus March, after two years of prominence, it vanished. A "revolt of the haves," dedicated to a radical reduction in government expenditures, its leadership was anything but obscure, however. Its chief spokesman was Admiral Richard Byrd (who served as chairman until he decided to travel to the Antarctic); Nicholas Murray Butler was its honorary chairman; its original six member advisory board consisted of a former President (Calvin Coolidge), a defeated candidate for the Presidency (Alfred E. Smith), two former Secretaries of State (Elihu Root and Newton D. Baker), General of the Armies John W. Pershing, and Admiral Williams Sowden Sims. "Byrd Quits as Head of Economy Group," N.Y. Times, April 26, 1933, at 5. Mr. Lehrfeld, supra, at 63, states that it had been accorded charitable status, and the right to receive tax-deductible contributions, in a ruling letter dated November 3, 1933. Soon thereafter, it submitted its own economic program to the President and Congress. The New York Times gave front page treatment to the event and printed the text of the entire program. "Roosevelt Warned Our Debt Will Rise 4 Billion in Year," Dec. 18, 1933, at 1.

The extent of benefits to war veterans was the League's foremost concern. It repeatedly urged that benefits be limited only to those wounded in war. (Appropriations to the Veterans Administration was no small budgetary matter. In praising the League's stand, the New York Times noted that the appropriations "had reached a point where they accounted for one-third of the entire cost of the Federal government, aside from service on the national debt." "Useful Service," April 26, 1933, at 16.) However, this position brought the League into conflict with Senator Reed, who also made the veterans' benefits his chief concern. Lurching unexpectedly leftward, outflanking Pinchot and even Roosevelt, in January 1934, Reed sponsored legislation to restore benefits cut the year before. "Reed Leads Fight on Veterans' Cuts," N. Y. Times, Jan. 9, 1934, at 5. The League responded by presenting its own plan and excoriating Reed's. "Plan to Simplify Veteran Aid Urged," N. Y. Times, Feb. 19, 1934, at 4. Reed's

It is widely accepted that the 1934 legislation represents a codification of the Slee position and a rejection of the strict Treasury point of view, as embodied in the 1919 regulation.¹⁰ As a general statement, this is true. However, there is a significant difference between the two approaches, and it is not simply that the Congress did not share Judge Hand's distaste for the word "propaganda." Rather, the tests used by the two approaches are different. Slee's "destination of lobbying" approach is a purpose test; the legislation's "no substantial part" language signifies an activities test. Different results may be reached from this distinction -- under the "no substantial part" test, contributions to the American Birth Control League would remain deductible, regardless of the purpose of its legislative endeavors, if such lobbying were not "substantial;" conversely, if the prevention of cruelty societies' legislative activities were "substantial," deductibility would be lost regardless of the lobbying purpose.¹¹ Regulations

stratagem was successful both as legislation and as the substantive centerpiece of his primary campaign. As Arthur Krock noted in his post-primary analysis of Reed's victory over Pinchot: "Before stripping for the fray, Mr. Reed took the precaution of getting into the money distributing class himself by leading a successful battle against the administration for added benefits and restored government pay. . . . This equipped him with at least half of Santa Claus's whiskers." "Republicans See Renewed Party in Victory of Reed," N. Y. Times, May 18, 1934, at 24.

The remainder of 1934 was not kind to either the League or the Senator. On July 23, less than three months after the effective date of the lobbying restriction, the ruling letter to the League was cancelled. Lehrfeld, supra, n. 2, at 64. On November 6, Senator Reed was defeated by Joseph F. Guffey, who became the first Democratic Senator elected from Pennsylvania in 60 years.

¹⁰ See, e.g., Hearings on H. Res. 217 Before Special Committee to Investigate Tax-Exempt Foundations and Comparable Organizations, House of Representatives, 83d Cong., 2d Sess. part 1, 433 (1954) (statement of Assistant Commissioner (Technical) Norman A. Sugarman) and G.C.M. 34289 (May 8, 1970).

¹¹ Slee's purpose formulation still resonates in IRC 501(c)(3). Rev. Rul. 80-278, 1980-2 C.B. 175, holds that an organization that institutes and maintains environmental litigation as a party plaintiff operates exclusively for charitable purposes within the meaning of IRC 501(c)(3). In reaching this conclusion, Rev. Rul. 80-278 states:

In determining whether an organization meets the operational test, the issue is whether the particular activity undertaken by the organization is appropriately in furtherance of the organization's exempt purpose, not whether that particular activity in and of itself would be considered charitable.

* * *

Therefore, in making the determination of whether an organization's activities are consistent with exemption under section 501(c)(3) of the Code, the Service will rely on a three-part test. The organization's activities will be considered permissible under section 501(c)(3) if:

- (1) *The purpose of the organization is charitable;*
- (2) *the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions; and*
- (3) *the activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.*

written after the enactment of the lobbying restriction did not elaborate upon the statute. Reg. 86.101(6)-1 (as amended in 1935). The current "action" organization regulations were proposed early in 1959 (24 FR 1420 (Feb. 26, 1959)), and adopted later that year by T.D. 6391 (24 FR 5217 (June 26, 1959)).

(3) Subsequent Statutory Developments

As part of the Tax Reform Act of 1976, Congress enacted IRC 501(h) and IRC 4911 to provide a second test for determining the amount of allowable lobbying. These provisions are discussed in Part 3 of this article. In addition, Congress enacted IRC 504 to provide, with certain exceptions, that IRC 501(c)(3) organizations that lose exempt status due to excessive lobbying may not at any time thereafter be treated as IRC 501(c)(4) organizations. IRC 504 is discussed in Part 5.

In 1987, House Ways and Means Oversight Subcommittee Chairman J.J. Pickle announced that he was initiating an investigation into the lobbying and electioneering activities of IRC 501(c) organizations. The particular focus of concern was the National Endowment for the Preservation of Liberty (NEPL), an IRC 501(c)(3) organization. The organization reportedly received funds from the Iran-Contra arms sales and used the proceeds both to finance conservative Congressional candidates in the 1986 campaign and to run negative advertisements about Congressional incumbents who opposed aid to the Nicaraguan Contras. NEPL also engaged in a considerable amount of grass roots lobbying to garner support for Contra aid.¹²

The hearings resulted in the enactment of several statutes. One of these, IRC 4912, concerns the lobbying activities of nonelecting public charities. For years beginning after December 22, 1987, certain organizations whose IRC 501(c)(3) status is revoked because of substantial lobbying activities are subject to a five percent excise tax imposed by IRC 4912 on their "lobbying expenditures," for the year of loss of the exemption. "Lobbying expenditure" is defined in IRC 4912(d)(1) as any amount paid or incurred by a charitable organization in carrying on propaganda or otherwise attempting to influence legislation.¹³

What distinguishes lobbying activity from litigation activity, therefore, is lobbying activity, regardless of its purpose, is expressly restricted by statute, whereas litigation activity is tested on the basis of whether the particular purpose of the activity is in furtherance of the particular organization's IRC 501(c)(3) purposes.

¹² For a history of the 1987 legislation, see Chisholm, *supra*, n. 2, at 203-204.

¹³ H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1631 (1987) explains the reason for the provision:

The committee concluded that revocation of exempt status may be ineffective in the case of certain charitable organizations as a penalty or as a deterrent to engaging in more than insubstantial lobbying activities, particularly if the organization ceases operations after it has diverted all its tax-deductible contributions and exempt income to improper purposes but before it has been audited and any income tax liability has been assessed. Accordingly, the committee believes that in such cases the sanction of revocation of tax-exempt status should be supplemented by an excise tax, just as under present law excise taxes apply where a public charity electing under section

IRC 4912 also imposes a similar tax at the same rate on any manager of the organization who willfully and without reasonable cause consented to making the lobbying expenditures knowing the expenditures would likely result in the organization's no longer qualifying under IRC 501(c)(3). There is no limit on the amount of this tax that may be imposed against either the organization or its managers.

IRC 4912(c)(2)(C) excepts private foundations from the IRC 4912 taxes because their lobbying expenditures are already subject to the tax imposed by IRC 4945. In addition, the IRC 4912 taxes are not imposed on any organization that has elected to be subject to the lobbying limitations of IRC 501(h) (IRC 4912(c)(2)(A)) or on churches and church-related organizations that are not eligible to make the IRC 501(h) election (IRC 4912(c)(2)(B)).

(4) The Constitutional Issue

In Regan v. Taxation with Representation of Washington, 461 U.S. 540 (1983), the Court addressed the question of whether the IRC 501(c)(3) restriction on lobbying violates constitutional guarantees.

Regan v. Taxation with Representation of Washington was foreshadowed by Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972); cert. denied, 414 U.S. 864 (1973), where the Tenth Circuit dismissed a claim that the IRC 501(c)(3) prohibition on lobbying and political activities was an unconstitutional restriction on the organization's freedom of speech. In so doing, the court stated:

In light of the fact that tax exemption is a privilege, a matter of grace rather than right, we hold that the limitations contained in section 501(c)(3) withholding exemption from nonprofit corporations do not deprive Christian Echoes of its constitutionally guaranteed right of freedom of speech. The taxpayer may engage in all such activities without restraint, subject, however, to withholding of the exemption, or, in the alternative, the taxpayer may refrain from such activities and obtain the privilege of exemption. . . . The congressional purposes evidenced by the 1934 and 1954 amendments are clearly constitutionally justified in keeping with the separation and neutrality principles particularly applicable in this case and, more succinctly, the principle that the government shall not subsidize, directly or indirectly, those organizations whose substantial activities are directed toward the accomplishment of legislative goals or the election or defeat of particular candidates. 470 F.2d at 857.

501(h) exceeds the permitted lobbying expenditures or where a private foundation engages in any political lobbying activities.

Taxation With Representation of Washington (TWR) attacked the IRC 501(c)(3) lobbying restriction not only on the ground that it violated the freedom of speech guarantee of the First Amendment, but also on the ground that it violated the equal protection language of the Fifth Amendment's Due Process Clause. The latter argument was based on the contention that those veterans organizations which qualify for exempt status under IRC 501(c)(19) and for deductible contributions under IRC 170(c)(3) are permitted to lobby; therefore, organizations qualifying for exemption under IRC 501(c)(3) and for deductible contributions under IRC 170(c)(2) should be permitted to lobby as well.

The Supreme Court unanimously held that the IRC 501(c)(3) restriction on lobbying activities violates neither the freedom of speech guarantee of the First Amendment nor the equal protection doctrine of the Fifth Amendment. Concerning the First Amendment issue, the Court stated that this aspect of the case was controlled by its decision in Cammarano v. United States, 358 U.S. 498 (1959). In Cammarano (which is discussed in Part 6, below), the Court upheld a Treasury Regulation (antecedent to the passage of IRC 162(e)), that denied business expense deductions for lobbying activities.

As to TWR's equal protection claim, the Court stated that the general rule of statutory classifications is that such classifications are valid if they bear a rational relation to a legitimate governmental purpose, and that "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes." 461 U.S. at 547. The Court noted that while statutes are subject to a higher level of scrutiny if they interfere with the exercise of a fundamental right, such as freedom of speech, the IRC 501(c)(3) legislative restriction does not infringe upon freedom of speech; therefore, the statutory distinction in treatment of IRC 501(c)(3) and IRC 501(c)(19) organizations need only have a rational basis. The Court found such a basis by concluding:

It is not irrational for Congress to decide that tax exempt charities such as TWR should not further benefit at the expense of taxpayers at large by obtaining a subsidy for lobbying.

It is also not irrational for Congress to decide that, even though it will not subsidize substantial lobbying by charities generally it will subsidize lobbying by veterans organizations. . . . Our country has a long standing policy of compensating veterans for their past contributions by providing them with numerous advantages. This policy has "always been deemed to be legitimate." Personnel Administrator v. Feeney, 442 U.S. 256, 279 n. 25 (1979). Id. at 550-551.

B. Specific Issues

(1) The Meaning of "Legislation"

1. What is the general meaning of the term "legislation?"

Reg. 1.501(c)(3)-1(c)(3)(ii) provides that the term "legislation" 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."

2. What is the meaning of "action" as used in the phrase "action by the Congress?"

Reg. 1.501(c)(3)-1(c)(3)(ii) does not elaborate on the precise meaning of the word "action." In this situation, however, one should consider the meaning of the phrase "action by the Congress" for purposes of IRC 4911(e).¹⁴ In IRC 4911(e), the phrase "action . . . by the Congress" is used in the definition of the term

"legislation" and the term "legislation" is used to delineate the extent to which certain organizations described in IRC 501(c)(3) may conduct certain types of lobbying activities.

IRC 4911(e)(2) provides that, for purposes of IRC 4911, "[t]he 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." In IRC 4911(e)(3), Congress limited the meaning of the term "action," as that term is used in IRC 4911, to the "introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items."

G.C.M. 39694 (Jan. 21, 1988) notes that it is unclear whether the phrase "action by the Congress" as used in the regulations implementing the lobbying restriction of IRC 501(c)(3) for nonelecting public charities is also limited to the introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items. Nevertheless, G.C.M. 39694 concludes that the administration of, and compliance with, IRC 501(c)(3), IRC 501(h), IRC 4911, and IRC 4945 would be best effectuated by the application of a single definition of "action by the Congress" as a phrase referring to the introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items.

The common denominator among Acts, bills, and resolutions is the fact that all are items that are voted upon by a legislative body. Resolutions differ from Acts in that they are a formal expression of opinion by a legislative body that has only a temporary effect or no effect at all as a legal matter. G.C.M. 39694, discussing 77 C.J.S. "Resolution" § 1 (1952); Black's Law

¹⁴ Prior to amendment in 1990, the regulations under IRC 4945 also referred to "action by the Congress" in defining legislation. Reg. 53.4945-2(a)(1) now expressly adopts the definition of legislation in the IRC 4911 regulations.

3. What is meant by "resolutions or similar matters?"

Dictionary 1178 (5th ed. 1979). Therefore, the determining factor in whether an action is a "similar matter" is not the legal effect of the action, but whether it is an item voted upon by a legislative body.

4. Does the term "legislation" include the Senate's vote on Executive Branch nominees?

Yes. The confirmation vote comes within the category of a "similar item" since it is an item voted upon by a legislative body as discussed above. It is similar to a resolution, but is stronger than a resolution since it has a final force and effect. Notice 88-76, 1988-2 C.B. 392 (lobbying on confirmation vote on nominee for

federal judgeship constitutes attempting to influence legislation for purposes of IRC 501(c)(3), IRC 4911, and IRC 4945(d)). See also Reg. 56.4911-2(b)(4)(ii)(B), Example (6) (mailing requesting recipients to write to Senators on the Senate Committee that will consider a nomination for a cabinet level post is a grass roots lobbying communication).

5. Does the term "legislation" include actions by administrative bodies?

Reg. 1.501(c)(3)-1(c)(3)(ii) limits the definition of legislation to actions by legislatures or by the public through referendum, initiative, constitutional amendment, etc. The implication that actions by administrative bodies do not constitute legislation is made explicit in the regulations under IRC 4911.

Reg. 56.4911-2(d)(3) provides that legislation does not include actions by executive, judicial, or administrative bodies. Reg. 56.4911-2(d)(4) provides that the term "administrative bodies" includes school boards, housing authorities, sewer and water districts, zoning boards, and other similar Federal, State, or local special purpose bodies, whether elective or appointive. Accordingly, an organization would not be influencing legislation for purposes of IRC 4911, if it proposed to a Park Authority that it purchase a particular tract of land for a new park, even though such an attempt would necessarily require the Park Authority eventually to seek appropriations to support a new park.¹⁵

¹⁵ Reg. 56.4911-2(d)(4) nevertheless concludes that, in such a case, the organization would be influencing legislation if it provided the Park Authority with a proposed budget to be submitted to a legislative body, unless such submission is described by one of the exceptions to influencing legislation.

6. Does the term "legislation" include zoning matters?

The consideration of zoning matters varies from jurisdiction to jurisdiction. As noted above, zoning boards may be considered administrative bodies whose actions will not constitute "legislation" within the meaning of IRC 501(c)(3). However, where zoning issues are

under the jurisdiction of legislators, who express their will in the form of an Act, etc., the matter is within the purview of the term "legislation." See Rev. Rul. 67-6, 1967-1 C.B. 135, which holds that a historical preservation association engaged primarily in reviewing zoning variances may not qualify for recognition of exemption under IRC 501(c)(3) "since the association as a substantial part of its activities is engaged in attempts to influence local **legislative** representatives with respect to the association's programs." (Emphasis added.)

7. Is the term "legislation" limited to actions by Federal, State, and local legislatures?

No. Although the regulations refer specifically to Federal, state and local legislative bodies, the term "legislation" contemplates foreign as well as domestic laws. Rev. Rul. 73-440, 1973-2 C.B. 177. As with domestic governments, the critical issue here is whether there is a legislative body involved. Furthermore,

legislative actions by Indian tribal governments also may be considered legislation since these governments are treated as State governments pursuant to IRC 7871.

8. Is there a distinction between "good" legislation and "bad" legislation?

For purposes of IRC 501(c)(3), there is no distinction between "good" legislation and "bad" legislation. For example, Rev. Rul. 67-293, 1967-2 C.B. 185, holds that an organization substantially engaged in promoting legislation to protect or otherwise benefit animals is not exempt under IRC 501(c)(3) even though the legislation

it advocates may be beneficial to the community. See also Rev. Rul. 67-6, *supra*. This is in accord with a dictum of the Supreme Court to the effect that the statutory restriction on attempts to influence legislation simply "made explicit" a longstanding judicial principle that "political agitation as such is outside the statute, however innocent the aim." *Cammarano v. United States*, 358 U.S. 498, 512 (1959), citing *Slee*, *supra*. For a direct holding, see *Kuper v. Commissioner*, 332 F.2d 562 (3rd Cir. 1964), *cert. denied*, 379 U.S. 920 (1964). In *Kuper*, the Third Circuit stated that "it is immaterial . . . that the legislation advocated from time to time was intended to promote sound government and was for the benefit of all citizens rather than in the interests of a limited or selfish group." *Id.* at 563. Likewise, in *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1107 (1975), the Court of Claims concluded:

An organization that engages in substantial activity aimed at influencing legislation is disqualified from a tax exemption, whatever the motivation. The applicability of the influencing legislation clause is not affected by the selfish and unselfish motives and interests of the organization, and it applies to all

organizations whether they represent private interests or the interests of the public. Id. at 1142.

See also 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).

(2) Attempts to Influence Legislation

1. What activities are “attempts to influence legislation?”

Attempts to influence legislation are not limited to direct communications to members of the legislature (“direct” lobbying). Indirect communications through the electorate or general public (“grass roots” lobbying) also constitute attempts to influence legislation. Of course,

whether a communication constitutes an attempt to influence legislation is determined on the basis of the facts and circumstances surrounding the communication in question. Both direct and grass roots lobbying are nonexempt activities subject to the IRC 501(c)(3) limitation on substantial legislative action.¹⁶ Reg. 1.501(c)(3)-1(c)(3)(ii).¹⁷

Reg. 1.501(c)(3)-1(c)(3)(ii) also provides that, more generally, advocating the adoption or rejection of legislation constitutes an attempt to influence legislation for purposes of the IRC 501(c)(3) lobbying restriction. This provision was tested in the case of Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972); cert. denied, 414 U.S. 864 (1973). Christian Echoes National Ministry published articles and produced radio and television broadcasts that urged recipients to become involved in politics and to write to their representatives in Congress to urge that they support prayer in public schools and oppose foreign aid. The organization argued that attempts to influence legislation would occur only if legislation were actually pending. The Tenth Circuit concluded that the regulation properly interpreted the statute, and that the organization was engaged in attempting to influence legislation, even if legislation was not pending.

2. What is an “action organization?”

The IRC 501(c)(3) regulations provide that an organization is not operated exclusively for exempt purposes if it is an “action” organization. Reg. 1.501(c)(3)-1(c)(3) uses the term “action” organizations to describe both organizations that

¹⁶ For IRC 501(c)(3) purposes, the distinction between direct and indirect lobbying becomes important for public charities making the IRC 501(h) lobbying election. As discussed in Part 3, there are separate limits for total lobbying and for indirect lobbying. In addition, certain communications made to members are not considered attempts to influence legislation, while other communications to members are considered lobbying.

¹⁷ The regulation, with its specific inclusion of grass roots lobbying, makes clear that the portion of the decision in Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955), that limited “attempting to influence legislation” to direct appeals to the legislature is not reflective of the statute.

attempt to influence legislation and organizations that intervene in political campaigns.

For purposes of the lobbying restriction, an organization is an "action" organization on either of two distinct grounds. The first occurs if a substantial part of the organization's activities involves attempting to influence legislation. Reg. 1.501(c)(3)-1(c)(3)(ii) states that an organization will be regarded as attempting to influence legislation if it does the following:

- (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 second ground is found in Reg. 1.501(c)(3)-1(c)(3)(iv), which provides that an organization is an "action" organization if it has the following two characteristics:

- (A) Its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and
- (B) It advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public.

In determining whether an organization has these two characteristics, all of the surrounding facts and circumstances, including the articles and all activities of the organization, are to be considered.

3. How is nonpartisan analysis distinguished from attempts to influence legislation?

Under IRC 501(c)(3), there are certain circumstances where nonpartisan analysis, study, or research of matters pertaining to legislation may be educational and will not constitute attempts to influence legislation.¹⁸ This occurs where the material is available to the public, governmental bodies, officials, and employees,

and where the organization does not advocate the adoption or rejection of legislation. See Reg. 1.501(c)(3)-1(c)(3)(iv). Several revenue rulings discuss this issue.

¹⁸ In *Haswell v. U.S.*, 500 F.2d 1133, 1144 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975), the Court of Claims explained what "nonpartisan" means as follows:

"Nonpartisan," as used in the statute and regulations, need not refer to organized political parties. Nonpartisan analysis, study, or research is oriented to issues and requires a fair exposition of both sides of the issue involved.

In Rev. Rul. 64-195, 1964-2 C.B. 138, an IRC 501(c)(3) organization that conducted educational activities relating to the law, legal education, and lawyers became interested in the question of court reform in the particular state in which it was organized. A constitutional amendment requiring revision of the state's court system was agreed to by the state legislature and submitted to the public for approval. The organization embarked upon a program of study, research, and assembly of the materials necessary to make an evaluation of the legislation. Experts were assembled and employed to conduct an extensive analysis of all materials relating to court reform in the United States and a detailed study and analysis of the pertinent existing case and statutory law of the state. The organization did not expend any funds or otherwise participate in any campaign to present the bills or persuade the public to vote for the amendment. The revenue ruling finds that the organization clearly did not expend funds or participate in any way in the presentation of any proposed bills to the State legislature or advocate either approval or disapproval of the proposed constitutional amendment by the electorate. Instead, the organization's involvement with court reform consisted of the study, research, and assembling of materials on a nonpartisan basis and the dissemination of such materials to the public. Accordingly, the revenue ruling concludes that the organization is not an "action" organization as that term is defined in Reg. 1.501(c)(3)-1(c)(3). Therefore, this activity does not affect its IRC 501(c)(3) status.

In contrast, the IRC 501(c)(4) organization described in Rev. Rul. 68-656, 1968-2 C.B. 216, drafted legislation and presented petitions supporting such legislation. These activities placed the organization beyond the purview of engagement in nonpartisan analysis, study, or research of matters pertaining to legislation; it had crossed over into attempting to influence legislation.¹⁹

In Rev. Rul. 70-79, 1970-1 C.B. 127, an organization was created to assist local governments of a metropolitan region by studying and recommending regional policies directed at the solution of mutual problems. Although some of the plans and policies formulated by the organization could only be carried out through legislative enactments, the organization did not direct its efforts or expend funds in making any legislative recommendations, preparing prospective legislation, or contacting legislators for the purpose of influencing legislation. Rev. Rul. 70-79 holds that the organization qualifies for IRC 501(c)(3) status because of the educational nature of its activities and because it abstained from advocating the adoption of any legislation or legislative action to implement its findings.

¹⁹ The facts described in Rev. Rul. 64-195 and Rev. Rul. 68-656 bear a distinct resemblance to the facts litigated in Dulles v. Johnson, 273 F. 2d 362 (2d Cir. 1959). In Dulles, the Second Circuit found that bequests to various Bar Associations were deductible from the taxable estate under the predecessor statute to IRC 2055, in part because "the legislative recommendations of the Associations . . . are designed to improve court procedure and or to clarify some technical matter of substantive law. They are not intended for the economic aggrandizement of a particular group or to promote some larger principle of governmental policy." Id. at 367. Rev. Rul. 64-195 also reaches a favorable conclusion, but on the basis of the absence of advocacy. By implication, therefore, it rejects the Dulles basis -- the nature of the legislation. Rev. Rul. 64-195, accordingly, is yet another repudiation of the "good/bad" or "selfish/unselfish" analysis.

The organization described in Rev. Rul. 70-79 can be distinguished from the organization discussed in Rev. Rul. 62-71, 1962-1 C.B. 85. The latter organization is a corporation formed for the purpose of supporting an educational program with regard to a particular doctrine or theory. It was the announced policy of the organization to promote its philosophy by educational methods as well as by the encouragement of political action. Most of the publications disseminated by the organization, together with a substantial part of its other activities, dealt with the theory advocated. This theory or doctrine can be put into effect only by legislative action.

Rev. Rul. 62-71 concludes that while the portion of the organization's activities that consisted of engaging in nonpartisan analysis, study and research and making the results thereof available to the public, when considered alone, may be classified as educational within the meaning of IRC 501(c)(3), the organization was primarily engaged in not only teaching but advocating the adoption of a particular doctrine or theory that can become effective only by the enactment of legislation. Since the primary objective of the organization can be attained only by legislative action, a step that the organization encouraged or advocated as a part of its announced policy, as opposed to merely engaging in nonpartisan analysis, study and research and making the results thereof available to the public, it is an "action" organization as that term is defined in Reg. 1.501(c)(3)-1(c)(3) of the regulations. Accordingly, the organization does not qualify for IRC 501(c)(3) exempt status.

In addition, it should be noted that activities which appear by themselves to be educational in nature may, in fact, be part of a broader purpose to influence specific legislative action. For example, in the case of Roberts Dairy Company v. Commissioner, 195 F.2d 948 (8th Cir. 1952), cert. denied, 344 U.S. 865 (1952), the organization prepared and distributed materials to inform its members and the public of certain tax disparities between business organizations. The court, apparently looking beyond the actual material distributed, held that since the ultimate objective was the revision of the tax laws, the organization was attempting to influence legislation.

4. May appearances before legislative committees constitute attempts to influence legislation?

Generally, if an organization appears before a legislative committee to discuss legislation, that action will be an attempt to influence legislation. However, attempting to influence legislation does not include such appearances when the organization appears before legislative committees in response to official requests for testimony. The Service has ruled

that a university's exemption would not be jeopardized when, in response to an official request, it sent representatives who could advise a Congressional committee on the possible effects of specific legislation. See Rev. Rul. 70-449, 1970-2 C.B. 111, where the Service concludes that "attempts to influence legislation as described in the regulations imply an affirmative act and require something more than a mere passive response to a Committee invitation." While stating that the legislative history is silent on this point, the Service concludes that "it is unlikely that

Congress, in framing the language of this provision, intended to deny itself access to the best technical expertise available on any matter with which it concerns itself.”²⁰

5. May requests to executive bodies constitute attempts to influence legislation?

As noted above, legislation does not include actions by executive bodies. Therefore, requesting executive bodies to take some action would generally not constitute attempting to influence legislation. This is not the case where the organization requests the executive bodies to support or oppose legislation. Requesting

executive bodies to support or oppose legislation is included in the purview of “attempting to influence legislation.” Rev. Rul. 67-293, 1967-2 C.B. 185; Roberts Dairy Company v. Commissioner, 195 F.2d 948 (8th Cir. 1952), cert. denied, 344 U.S. 865 (1952); American Hardware and Equipment Company v. Commissioner, 202 F.2d 126 (4th Cir. 1953), cert. denied, 346 U.S. 814 (1953).

6. May lobbying activities of individuals be attributable to IRC 501(c)(3) organizations?

Where an IRC 501(c)(3) organization is involved, it is frequently necessary to determine whether a lobbying activity is attributable to the organization or merely the act of an individual. The Service has developed attribution rules to fit a number of situations. Questions involving lobbying activity, political campaign activity, and

illegal activity have provided a body of administrative law that may be used to address issues of attribution.

As is noted in G.C.M. 34631 (Oct. 4, 1971) and G.C.M. 39414 (Feb. 29, 1984), principles of agency law apply to this determination. A further discussion of the standards used is found in G.C.M. 34523 (June 11, 1971), which addresses actions attributable to colleges and universities in considering their exempt status:

Only actions by the exempt organization can disqualify it from 501(c)(3) status. Since organizations act through individuals, it is necessary to distinguish those activities of individuals done in an official capacity from those that are not. Only official acts can be attributed to the organization. Provision is made in the articles of organization by which a school is created, by its bylaws, and by other valid and proper means, for delegating authority and

²⁰ Publication of Rev. Rul. 70-449 was approved in G.C.M. 34289 (May 3, 1970). G.C.M. 34289 furnished a second rationale, i.e., the 1969 enactment of IRC 4945, with the exceptions for nonpartisan analysis, technical advice, and self-defense, was intended to restate, rather than revise, the existing definition of attempting to influence legislation. The same conclusion is expressed in G.C.M. 36127 (Jan. 2, 1975). Rev. Rul. 70-449 did not adopt this position, however; instead, as noted above, the revenue ruling states that the legislative history is silent on this point. As to whether the self-defense exception applies to nonelecting public charities, the Service has not published a precedential document adopting the favorable conclusion of G.C.M. 34289.

responsibility for operating the school to various people; trustees, administrators, faculty members, student leaders, etc. Each are assigned various tasks. The school is responsible for their acts in discharging these assigned duties. Their personal activities (those not associated with official duties) are not attributable to the school, and are, therefore, not relevant to an investigation of the school's qualification for 501(c)(3) status.

Actions by a person in excess of his official authority should not, as a rule, be considered those of the school. If the school allows such usurpation of authority to go unchallenged, however, it impliedly ratifies the act.

G.C.M. 34631, in considering the effect of possibly illegal activities by members of an organization, makes the following observation:

We caution, however, that actions of [the organization's] members and officers do not always reflect on the organization. Only (1) acts by [the organization's] officials under actual or purported authority to act for the organization, (2) acts by agents of the organization within their authority to act, or (3) acts ratified by the organization, should be considered as activities of the organization.

The activities of individuals who are not officials of the organization may also be attributed to an organization. In G.C.M. 39414, the political campaign activities of individual members were attributed to an IRC 501(c)(3) organization. The organization's publication stated that the organization would be sending members to work on political campaigns, members working on political campaigns identified themselves as representing the organization, the organization paid some of the costs incurred by members working on political campaigns, and officials of the organization knew about the members' political activities on behalf of the organization and made no effort to prevent the members' political activities.

On the other hand, in Rev. Rul. 72-513, 1972-2 C.B. 246, the legislative activities of a student newspaper did not jeopardize the exemption of the sponsoring university, despite the fact that the university provided office space and financial support for the publication of the student newspaper and made available several professors to serve as advisors to the staff. The student newspaper provided training for students in various aspects of newspaper publication (including editorial policy) and was distributed primarily to students of the university. Editorial policy was determined by the student editors and not by the university or the faculty advisors. A statement on the editorial page clearly indicated that the views expressed were those of the students and not of the university. The revenue ruling concludes that the legislative activities of the student editors are not attributable to the university despite the university's provision of support to the newspaper.

(3) Limits on Attempts to Influence Legislation**1. When are attempts to influence legislation considered substantial?**

A determination of whether attempts to influence legislation constitute a “substantial” portion of an organization’s total activities is a factual one and there is no simple rule as to what amount of activities is substantial. An often cited case on the subject, Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955), is of limited help.

Seasongood held that attempts to influence legislation that constituted five percent of total activities were not substantial. The case presents limited guidance because the court’s view of what set of activities were to be measured is no longer supported by the weight of precedent. Moreover, it is not clear how the court arrived at the five percent figure.

Most cases have either tended to avoid any attempt at percentage measurement of activities or, at least, have stated that a percentage test is not conclusive. Thus, in Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1974), the Tenth Circuit rejected the use of a percentage test to determine whether activities were substantial, stating that “[a] percentage test to determine whether activities were substantial obscures the complexity of balancing the organization’s activities in relation to its objectives and circumstances.” In Haswell v. United States, 500 F.2d 1133 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975), the Court of Claims cited percentage figures in support of its determination that an organization’s lobbying activities were substantial. (The amount of the organization’s expenditures for lobbying activities ranged from 16.6 percent to 20.5 percent of total expenditures during the four years at issue.) While the court stated that a percentage test is only one measure of substantiality (and not, by itself, determinative), it held that these percentages were a strong indication that the organization’s purposes were no longer consistent with charity.

G.C.M. 36148 (Jan. 28, 1975) characterized the substantiality issue as a “problem [that] does not lend itself to ready numerical boundaries.” The G.C.M. then stated:

Moreover, the percentage of the budget dedicated to a given activity is only one type of evidence of substantiality. Others are the amount of volunteer time devoted to the activity, the amount of publicity the organization assigns to the activity, and the continuous or intermittent nature of the organization’s attention to it. All such factors have a bearing on the relative importance of the activity, and should be given due consideration in determining whether its conduct is reconcilable with the requirement that it operate exclusively for exempt purposes.

We therefore think that the Service should not adopt a percentage of total expenditures test for the substantiality of nonexempt activities conducted by exempt organizations. We also think that ten percent would be unjustifiably high, even if a percentage test

were merely adopted for use as a threshold for more intensive auditing in which the Service can give due consideration to the relative importance of volunteer services and the like.

Nevertheless, while neither the Service nor the courts have adopted a percentage test for determining whether a substantial part of an organization's activities consist of lobbying, some guidance can be derived from Seasongood and Haswell. Under Seasongood, a five percent safe harbor has been frequently applied as a general rule of thumb regarding what is substantial. Similarly, lobbying activities that exceed the roughly 16 to 20 percent range of total activities found in Haswell are generally considered substantial. (Compare these percentages to the sliding scale of percentage of expenditures allowed to organizations that elect to be governed by IRC 501(h) as discussed below.)

2. May supporting activities also be considered attempts to influence legislation?

In determining whether an organization has engaged in attempts to influence legislation as a substantial activity, it is sometimes difficult to determine what supporting activities should be included with the proscribed attempts to influence legislation. This is often a problem where an organization has some activities that are

admittedly educational. Frequently, much effort is devoted to research, discussion, and similar activities. The problem is how much of these back-up activities should be considered part of the attempts to influence legislation. In League of Women Voters of the United States v. United States, 180 F. Supp, 379 (Ct. Cl. 1960), cert. denied, 364 U.S. 882 (1960), the time spent in discussing public issues, formulating and agreeing upon positions, and studying them preparatory to adopting a position was taken into account and compared with the other activities in determining the substantiality of the attempts to influence legislation. Attempting to influence legislation does not necessarily begin at the moment the organization first addresses itself to the public or to the legislature. See also Kuper v. Commissioner, 332 F.2d 562 (3d Cir. 1964), cert. denied, 379 U.S. 920 (1964). Furthermore, all facts and circumstances must be considered in determining whether the lobbying activities of an IRC 501(c)(3) organization are substantial, not just the amount of expenditures made.

3. Lobbying Activities of IRC 501(c)(3) Electing Public Charities

A. Legislative and Regulatory History

(1) Enactment of the Statutes

During the period from 1934 to 1976, the lobbying limitation was subject to increasing public criticism. The passage of IRC 162(e) in 1962, permitting a business expense deduction for direct lobbying expenses, led to the argument that equal treatment should be given to charitable organizations. Meanwhile, the courts were having a difficult time measuring the "substantiality" of these activities.

Congress enacted IRC 501(h) and IRC 4911 as part of the Tax Reform Act of 1976.²¹ These provisions were intended to remedy some of the problems that had arisen under existing law by setting specific permissible expenditure limits. The Joint Committee on Taxation, in its General Explanation of the Tax Reform Act of 1976, 1976-3 C.B. (Vol. 2) 419-420, explains the reasons for enactment of these statutes:

The language of the lobbying provision was first enacted in 1934. Since that time neither Treasury regulations nor court decisions gave enough detailed meaning to the statutory language to permit most charitable organizations to know approximately where the limits were between what was permitted by the statute and what was forbidden by it. The vagueness was, in large part, a function of the uncertainty in the meaning of the terms "substantial part" and "activities."

Many believed that the standards as to the permissible level of activities under prior law were too vague and thereby tended to encourage subjective and selective enforcement.

Except in the case of private foundations, the only sanctions available under prior law with respect to an organization which exceeded the limits on permitted lobbying were loss of exempt status under section 501(c)(3) and loss of qualification to receive charitable contributions. Some organizations (particularly organizations which had already built substantial endowments) could split up their activities between a lobbying organization and a charitable organization. For such organizations, these sanctions may have had little effect, and the lack of effect may have tended to discourage enforcement effort.

For other organizations which could not split up their activities between a lobbying organization and a charitable organization and which had to continue to rely on the receipt of deductible contributions to carry on their exempt purposes, loss of section 501(c)(3) status could not be so easily compensated for and constituted a severe blow to the organization.

The Act is designed to set relatively specific expenditure limits to replace the uncertain standards of prior law, to provide a more rational relationship between the sanctions and the violation of standards, and to make it more practical to properly enforce the

²¹ For an account of the progress of the legislation until its enactment, see Bruce R. Hopkins, The Law of Tax-Exempt Organizations, 310-312 (4th ed. 1993). For another history, written just before passage of the legislation, see Pepper, Hamilton & Sheetz, "Legislative Activities of Charitable Organizations Other Than Private Foundations," in 5 Commission on Private Philanthropy and Public Needs, Research Papers, 2917, 2926-2928 (1975).

law. However, these new rules replace prior law only as to charitable organizations which elect to come under the Standards of the Act. The new rules also do not apply to churches and organizations affiliated with churches, nor do they apply to private foundations; prior law continues to apply to these organizations. The Act provides for a tax of 25 percent of the amount by which the expenditures exceed the permissible level. Revocation of exemption is reserved for those cases where the excess is unreasonably great over a period of time.

At the same time, Congress enacted IRC 504.²² This provision provided, with certain exceptions, that IRC 501(c)(3) organizations that lose exempt status due to excessive lobbying may not at any time thereafter be treated as IRC 501(c)(4) organizations. IRC 504 is discussed in Part 5.

(2) Overview of the Statutes

Eligible public charities (listed in IRC 501(h)(4)) may elect to be governed by the IRC 501(h) substantiality test. Non-electing organizations (whether eligible or not) will be subject to the ordinary facts and circumstances substantiality test of IRC 501(c)(3) as discussed above.

IRC 501(h) establishes a sliding scale of permissible “lobbying nontaxable amounts.” Nontaxable amounts are computed for both total and grass roots lobbying. These amounts are deemed insubstantial, and expenditures under the nontaxable amounts will result in neither tax nor revocation. Expenditures in excess of the nontaxable amounts are “excess lobbying expenditures.” An excise tax under IRC 4911 is imposed on excess lobbying expenditures. If lobbying expenditures exceed both the permitted total lobbying amount and the grass roots amount, the IRC 4911 tax is imposed on whichever excess is greater. “Affiliated” organizations generally are treated as a single organization for purposes of computing lobbying expenditures. IRC 501(h) applies for taxable years beginning after December 31, 1976.

For IRC 501(c)(3) organizations that elect to be covered by IRC 501(h), lobbying may cause revocation of exempt status only if the amounts spent on lobbying “normally” exceed 150 percent of either of the nontaxable amounts over a four year period. Therefore, the tests of whether an organization is an “action” organization, set forth in Reg. 1.501(c)(3)-1(c)(3), should not be used to determine whether an organization that has made the IRC 501(h) election has engaged in substantial lobbying activities.

²² Prior to 1969, IRC 504 had provided a rule against unreasonable accumulations by charities. This provision was repealed as part of the Tax Reform Act of 1969 and replaced with IRC 4942, which applies only to private foundations.

(3) History of the Regulations

In 1986, proposed regulations were published to implement the provisions of IRC 501(h) and IRC 4911. 51 FR 40211 (Nov. 5, 1986). Controversy ensued. The particular areas of concern were the definition of grass roots lobbying and the allocation rules.

As the individuals who had primary responsibility for drafting the 1988 proposed regulations, James J. McGovern, Paul G. Accetura, and Jerome P. Walsh Skelly, observe in "The Revised Lobbying Regulations, A Difficult Balance," 41 Tax Notes 1426, 1428 (Dec. 26, 1988) (hereinafter "McGovern 1988"): "The nonprofit community was effectively mobilized by a number of umbrella groups and their constituent members." The Service and Congress received more than ten thousand letters from charities and their members requesting withdrawal of the proposed regulations. These comments were generated by concerns that the regulations were overly restrictive and would have a "chilling effect" on charities' involvement in the policy making process.²³

Members of Congress also expressed concern. Sixteen members of the Senate Finance Committee wrote a letter asking the Service to withdraw the proposed regulations. The letter stated that the proposed regulations "appear to introduce ambiguity about what activities constitute lobbying by such groups, and we believe that may restrict lobbying in ways not intended by the 1976 Act." "Congressional Tax Writers Seek Withdrawal of Proposed Regs on Lobbying by Tax-Exempt Groups," 34 Tax Notes 929 (Mar. 2, 1987). House Ways and Means Committee Chairman Dan Rostenkowski also requested that the proposal regulations be withdrawn, suggesting that the Service consult with an advisory group comprised of representatives of the public and private sector. He emphasized, however, that he would "strongly resist any suggestion that the pending controversy be settled legislatively by the Congress." See "McGovern 1988" at 1428.

While the Service did not withdraw the 1986 proposed regulations, it publicly stated in an information release, IR-87-49 (April 9, 1987), that it would reconsider key portions of the regulations. Two days of public hearings were held in 1987. In June 1987, the Service announced the establishment of a Commissioner's Exempt Organizations Advisory Group (as had been suggested by Mr. Rostenkowski). At public meetings held on September 17, 1987, and February 26, 1988, possible revisions to the 1986 proposed regulations were discussed with this Advisory Group. Substantial revisions to the regulations were published in proposed form in

²³ For example, approximately 200 organizations signed an Independent Sector position statement asking that the rules be permanently withdrawn. "Opposition to IRS Lobbying Rules Solidifies: Senate Tax Writers Join Cause," Daily Tax Report (BNA) No. 29, at G-5 (Feb. 13, 1987). Similarly, OMB Watch, an IRC 501(c)(4) organization formed to monitor activities of the Office of Management and Budget and other executive agencies, asked readers to contact Congress to tell the Service to withdraw these regulations "through passing a bill, a sense of Congress resolution, an appropriations rider denying funds to the IRS for any work on or enforcement of these regulations, or any other method Congress thinks best." "Congressional Support Sought for Protest of IRS Lobbying Proposal," Daily Tax Report (BNA) No. 15, at G-1 (Jan. 23, 1987). In addition, OMB Watch held community briefings throughout the country "to educate people about the proposed rules and encourage a grass roots campaign to force IRS to withdraw them." Id.

1988. 53 FR 51826 (Dec. 23, 1988). Messrs. McGovern, Accetura, and Walsh Skelly, "The Final Lobbying Regulations: A Challenge for Both the IRS and Charities," 48 Tax Notes 1305, 1306 (Sept. 3, 1990); 3 EOTR 766, 767 (Sept. 1990) (hereinafter "McGovern 1990"), explained the approach of the 1988 proposed regulations as follows:

The 1988 proposed regulations were an attempt to address charities' legitimate concerns without eliminating the statutory limits and thus opening the Service up to charges of failing to fulfill its statutory mandate. To accomplish this, the Service crafted a number of bright-line objective rules. Like all bright-line objective rules, these rules are imperfect: in certain cases, the rules will inevitably permit expenditures to be treated as nonlobbying even though the public would probably consider those expenditures to be clear examples of lobbying.

In contrast to the reception accorded the 1986 proposed regulations, the publication of the 1988 proposed regulations resulted in less than 100 written comments. The comments were almost uniformly favorable. The 1988 proposed regulations were discussed with the Commissioner's Exempt Organizations Advisory Group at a public meeting held on January 10, 1989, and a formal public hearing was held on April 3, 1989. The final regulations were published in 1990 and contained few technical changes from the 1988 proposed regulations. They were made effective as of the date of publication. T.D. 8308, 55 FR 35579 (Aug. 31, 1990).

B. Specific Issues

(1) The IRC 501(h) Election

1. What organizations may make an election under IRC 501(h)?

IRC 501(h)(3) provides that the provisions of IRC 501(h) will apply to any eligible IRC 501(c)(3) organization that has elected to have those provisions apply.²⁴ To be eligible to make the IRC 501(h) election, the IRC 501(c)(3) organization must be an organization described in

IRC 501(h)(4) and it must not be a disqualified organization described in IRC 501(h)(5). The IRC 501(c)(3) organizations described in IRC 501(h)(4) are as follows:

- (1) Educational institutions as described in IRC 170(b)(1)(A)(ii);

²⁴ The Service's records indicate that, as of April 1996, 6,087 organizations have made the election by filing Form 5768 over the past five years. The IRC 501(c)(3) population eligible to make the election, as of March 1, 1996, is approximately 452,000 organizations.

In contrast, during that same time period, 2,407 organizations checked "yes" to the "attempted to influence legislation" question (Question 1, Part III of Schedule A, Form 990), but did not file Form 5768.

- (2) Hospitals and medical research organizations as described in IRC 170(b)(1)(A)(iii);
- (3) Organizations that support government schools as described in IRC 170(b)(1)(A)(iv);
- (4) Organizations publicly supported by charitable contributions as described in IRC 170(b)(1)(A)(vi);
- (5) Organizations publicly supported by admissions, sales, etc. related to their exempt purpose as described in IRC 509(a)(2); and
- (6) Organizations that are public charities because they are a supporting organization described in IRC 509(a)(3) of an IRC 501(c)(3) organization that is described in IRC 509(a)(1) or IRC 509(a)(2).

2. What organizations may not use the IRC 501(h) election?

IRC 501(c)(3) organizations may not elect to be covered by the provisions of IRC 501(h) if they are not described under IRC 501(h)(4) or if they are disqualified under IRC 501(h)(5). The organizations that are ineligible to make an IRC 501(h) election are as follows:

- (1) Churches or conventions or associations of churches as described in IRC 170(b)(1)(A)(i);
- (2) Integrated auxiliaries of a church or convention or association of churches (IRC 508(c) and IRC 6033);
- (3) Organizations described in IRC 501(c)(3) and affiliated with at least one church or convention or association of churches or an integrated auxiliary (an "affiliated group" within the meaning of IRC 4911(f)(2));
- (4) Organizations that are public charities because they are a supporting organization described in IRC 509(a)(3) of certain organizations exempt under IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6);
- (5) Organizations engaged in testing for public safety and thus described in IRC 509(a)(4); and

- (6) Private foundations.

3. Why are churches precluded from making an election under IRC 501(h)?

Churches, along with church-related organizations, were precluded from making an election under IRC 501(h) at their own request. The Joint Committee on Taxation, in its General Explanation of the Tax Reform Act of 1976, 1976-3 C.B. (Vol. 2) 415-416, notes that church groups expressed concern that any restriction on their lobbying activities might violate their rights under the First Amendment. More particularly, the church groups were concerned that including them among the class of organizations eligible to elect might imply Congressional ratification of the decision in Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1973), which held that the limitations on lobbying were constitutionally valid and that First Amendment rights in the face of such limitations were not absolute.

By disqualifying churches and church-related organizations from making the election, Congress sought to remain neutral on the constitutional issue; in fact the Joint Committee on Taxation's Explanation explicitly states: "So that unwarranted inferences may not be drawn from the enactment of this Act, the Congress states that its actions are not to be regarded in any way as an approval or disapproval of the decision [in Christian Echoes], or of the reasoning in any of the opinions leading to that decision." Id. at 420.

4. How is an election under IRC 501(h) made?

An eligible IRC 501(c)(3) organization may make an IRC 501(h) election for any taxable year of the organization beginning after December 31, 1976, other than the first taxable year for which a voluntary revocation of the election is effective. Voluntary revocations are discussed below. The election is made by filing a completed Form 5768, *Election/Revocation of Election by an Eligible Section 501(c)(3) Organization to Make Expenditures to Influence Legislation*, with the appropriate Internal Revenue Service Center.

5. When is an election under IRC 501(h) effective?

Under IRC 501(h)(6), the election is effective with the beginning of the taxable year in which the Form 5768 is filed. For example, an eligible organization with the calendar year as its taxable year files Form 5768 making the IRC 501(h) election on December 31, 1996. The organization's IRC 501(h) election is effective for its taxable year beginning January 1, 1996. Once the IRC 501(h) election is made, it is effective (without again filing Form 5768) for each succeeding taxable year for which the organization is an eligible organization and which begins before a notice of revocation is filed. Reg. 1.501(h)-2(a).

A newly created organization may submit Form 5768 to elect the expenditure test under IRC 501(h) at the time it submits its Form 1023, *Application for Recognition of Exemption under*

6. When may a newly created organization make an election under IRC 501(h)?

*Section 501(c)(3) of the Internal Revenue Code.*²⁵ If the organization is determined to be eligible under IRC 501(h), the election will be effective with the beginning of the taxable year in which the Form 5768 is filed. However, if the organization is determined by the Service not to be eligible to make an IRC 501(h) election, the

election will not be effective and the substantial part test will apply from the effective date of its IRC 501(c)(3) classification. Reg. 1.501(h)-2(c).

7. How may an organization voluntarily revoke its IRC 501(h) election?

An organization may voluntarily revoke an expenditure test election by filing a notice of voluntary revocation (Form 5768) with the appropriate Service Center. IRC 501(h)(6)(B), a voluntary revocation is effective with the beginning of the first taxable year after the taxable year in which the notice is filed.

For example, an eligible organization with the calendar year as its taxable year files Form 5768 revoking its IRC 501(h) election on May 31, 1996. The organization's IRC 501(h) election remains in effect for its taxable year beginning January 1, 1996, but is no longer in effect for its taxable year beginning January 1, 1997. When an organization voluntarily revokes its election, the substantial part test of IRC 501(c)(3) (as discussed above) will apply with respect to the organization's activities in attempting to influence legislation beginning with the taxable year for which the voluntary revocation is effective. Reg. 1.501(h)-2(d)(1).

8. May an organization that voluntarily revoked its election make the election again?

An organization that voluntarily revokes its election under IRC 501(h) may make the IRC 501(h) expenditure test election again. However, the new election may be effective no earlier than the taxable year following the first taxable year for which the voluntary revocation is effective. Reg. 1.501(h)-2(d)(2).

Reg. 1.501(h)-2(d)(3) furnishes the following example:

X, an organization whose taxable year is the calendar year, plans to voluntarily revoke its expenditure test election effective beginning with its taxable year 1985. X must file its notice of voluntary revocation on Form 5768 after December 31, 1983, and before January 1, 1985. If X files a notice of voluntary revocation on December 31, 1984, the revocation is effective beginning with its taxable year 1985. The organization may again elect the

²⁵ The organization may submit its Form 5768 to the appropriate key district office as long as its application for recognition of IRC 501(c)(3) exemption is being considered by that office.

expenditure test by filing Form 5768. Under Reg. 1.501(h)-2(d)(2), the election may not be made for taxable year 1985. Under Reg. 1.501(h)-2(a), a new expenditure test election will be effective for taxable years beginning with taxable year 1986, if the Form 5768 is filed after December 31, 1985, and before January 1, 1987.

9. May an IRC 501(h) election be involuntarily revoked?

If, while an election under IRC 501(h) by an eligible organization is in effect, the organization ceases to qualify as an eligible organization, its election is automatically revoked. The revocation is effective with the beginning of the first full taxable year for which it is

determined that the organization is not an eligible organization. If an organization's expenditure test election is involuntarily revoked but the organization continues to be described in IRC 501(c)(3), the substantial part test of IRC 501(c)(3) will apply with respect to the organization's activities in attempting to influence legislation beginning with the first taxable year for which the involuntary revocation is effective.²⁶ Reg. 1.501(h)-2(e).

(2) Limits on Lobbying Expenditures

1. What are "excess lobbying expenditures"?

As previously noted, a tax is imposed under IRC 4911(a)(1) on the excess lobbying expenditures of public charities that have elected to be covered by IRC 501(h). The tax imposed is equal to 25 percent of the amount of the organization's excess lobbying expenditures for

the taxable year. IRC 4911(a)(2) provides that, for purposes of IRC 4911, the term "excess lobbying expenditures" for a taxable year means the greater of the following amounts:

- (A) The amount by which the lobbying expenditures made by the organization during the taxable year exceed the lobbying nontaxable amount for such organization during such taxable year, or
- (B) The amount by which the grass roots expenditures made by the organization during the taxable year exceed the grass roots nontaxable amount for such organization for such taxable year.

IRC 4911(c)(2) provides that the nontaxable amount of lobbying expenditures is the lesser of \$1,000,000 or an amount determined under a sliding scale, set forth in the statute, of percentage of exempt purpose expenditures. The nontaxable amount of grassroots lobbying

²⁶ The situations contemplated here include, for example, an IRC 501(c)(3) public charity that becomes a private foundation or a public charity that continues to be described in IRC 501(c)(3) but becomes a supporting organization of an IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6) entity.

2. What are the nontaxable amounts?

expenditures is 25 percent of the nontaxable amount of lobbying expenditures. IRC 4911(c)(4). The following table sets forth the nontaxable amounts:

Exempt Purpose Expenditures	Total Nontaxable	Grass Roots Nontaxable
Up to \$500,000	20%	5%
\$500,000 to \$1,000,000	\$100,000 + 15% of excess over \$500,000	\$25,000 + 3.75% of excess over \$500,000
\$1,000,000 to \$1,500,000	\$175,000 + 10% of excess over \$1,000,000	\$43,750 + 2.5% of excess over \$1,000,000
\$1,500,000 to \$17,000,000	\$225,000 + 5% of excess over \$1,500,000	\$56,250 + 1.25% of excess over \$1,500,000
Over \$17,000,000	\$1,000,000	\$250,000

3. What are the lobbying and grass roots ceiling amounts?

An IRC 501(c)(3) organization that has made the election to be covered by IRC 501(h) will not be denied exemption due to substantial lobbying activities unless it normally makes lobbying or grass roots expenditures in excess of the applicable ceiling amounts. The applicable ceiling amounts for lobbying expenditures is 150 percent of the lobbying nontaxable amount for the base years (IRC 501(h)(2)(B)) and for grass roots expenditures is 150 percent of the grassroots lobbying nontaxable amount for the base years (IRC 501(h)(2)(D)).

In general, the term "base years" means the determination year and the three taxable years immediately preceding the determination year.²⁷ The base years, however, do not include any taxable year preceding the taxable year for which the organization is first treated as described in IRC 501(c)(3). Reg. 1.501(h)-3(c)(7).

Reg. 1.501(h)-3(b)(2), however, provides a special exception for an organization's first election. Under this exception, for the first, second, or third consecutive determination year for which an organization's first expenditure test election is in effect, the organization will not be denied exemption from tax by reason of IRC 501(h) if, taking into account as base years only those years for which the expenditure test election is in effect the following conditions are met:

- (A) The sum of the organization's lobbying expenditures for such base years does not exceed 150 percent of the sum of its lobbying nontaxable amounts for the same base years; and

²⁷ A taxable year is a "determination year" if it is a year for which the expenditure test election is in effect, other than the taxable year for which the organization is first treated as described in IRC 501(c)(3). Reg. 1.501(h)-3(c)(8).

- (B) The sum of the organization’s gross roots expenditure for those base years does not exceed 150 percent of the sum of its gross roots nontaxable amounts for such base years.

Thus, the mere fact that an organization pays tax under IRC 4911 does not indicate that it will lose its exemption under IRC 501(c)(3). On the contrary, using the election and occasionally paying the tax, if necessary, was designed to allow that leeway.

4. How are these rules applied?

Reg. 1.501(h)-3(e) provides a number of examples illustrating how excess lobbying expenditures are calculated, how the tax imposed by IRC 4911(a)(1) is calculated, and how the determination is made concerning whether the

electing public charity is denied exempt status under IRC 501(c)(3) because of its lobbying activities.

One example involves an organization whose taxable year is the calendar year that has been recognized as an IRC 501(c)(3) organization for a number of years prior to making the expenditure test election under IRC 501(h) effective for taxable year 1979. The organization has not revoked the election. The following table contains information used in this example.

Year	Exempt purpose expenditures (EPE) (dollars)	Calculation	Lobbying nontaxable amount (LNTA) (dollars)	Lobbying expenditures (LE) (dollars)	Gross roots nontaxable amount (25% of LNTA) (dollars)	Gross roots expenditures (dollars)
1979	700,000	(20% of \$500,000 + 15% of \$200,000 =)	130,000	120,000	32,500	30,000
1980	800,000	(20% of \$500,000 + 15% of \$300,000 =)	145,000	100,000	36,250	60,000
1981	800,000	(20% of \$500,000 + 15% of \$300,000 =)	145,000	100,000	36,250	65,000
1982	900,000	(20% of \$500,000 + 15% of \$400,000 =)	160,000	150,000	40,000	65,000
Total	3,200,000		580,000	470,000	145,000	220,000

In this example, the organization is liable for the tax imposed under IRC 4911 for 1980, 1981, and 1982 because its gross roots expenditures exceeded its gross roots nontaxable amount in each of those years, even though its total lobbying expenditures did not exceed the lobbying nontaxable amount. The tax imposed by IRC 4911(a) for 1980 is \$5,937.50 which is equal to 25 percent of \$13,750 (the difference between \$60,000 and \$36,250). For 1981, the tax is \$7,187.50 and for 1982, the tax is \$6,250. For the tax years 1979, 1980, and 1981, the organization meets the special exception under Reg. 1.501(h)-3(b)(2). However, for the taxable year 1982, the total gross roots expenditures for the base years (1979 through 1982) exceeds the gross roots ceiling amount of \$217,500 (150 percent of \$145,000). Consequently, for the taxable year 1983, the organization is denied tax exemption as an organization described in IRC 501(c)(3). The organization must again apply for recognition of exemption pursuant to Reg. 1.501(h)-3(d) for taxable years after 1983. Reg. 1.501(h)-3(e), Example (2).

Another example concerns an organization, whose taxable year is the calendar year, that made its IRC 501(h) election effective for its taxable year 1977, the first year it was treated as an organization described in IRC 501(c)(3). The organization has not revoked the election. The following table contains information used in this example.

Taxable Year	Exempt purpose expenditures (EPE) (dollars)	Calculation	Lobbying nontaxable amount (LNTA) (dollars)	Lobbying expenditures (LE) (dollars)	Grass roots nontaxable amount (25% of LNTA) (dollars)	Grass roots expenditures (dollars)
1977	700,000	(20% of \$500,000 + 15% of \$200,000 =)	130,000	182,000	32,500	30,000
1978	800,000	(20% of \$500,000 + 15% of \$300,000 =)	145,000	224,750	36,250	35,000
Subtotal	1,500,000		275,000	406,750	68,750	65,000
1979	900,000	(20% of \$500,000 + 15% of \$400,000 =)	160,000	264,000	40,000	50,000
Totals	2,400,000		435,000	670,750	108,750	115,000

In this example, the organization is liable for the tax imposed under IRC 4911 in 1977, 1978, and 1979 because its total lobbying expenditures exceed its lobbying nontaxable amount in each of those years. Although its grass roots lobbying expenditures exceeded its grass roots lobbying nontaxable amount in 1979, the tax is calculated based on the excess lobbying expenditures in all three years since that amount is greater. The tax for 1977 is 25 percent of the difference between \$182,000 and \$130,000 (\$13,000). The tax for 1978 is \$19,937.50 and the tax for 1979 is \$26,000. Pursuant to Reg. 1.501(h)-3(c)(8), the organization is not required to determine if it continues to qualify for IRC 501(c)(3) exempt status for 1977 since that is its first year as an IRC 501(c)(3) organization. For 1978, the total lobbying expenditures and grass roots expenditures for the organization's base years (1977 and 1978) do not exceed 150 percent of its lobbying nontaxable amount or its grass roots nontaxable amount. However, for 1979, the total lobbying expenditures of the organization for its base years (1977 through 1979) do exceed \$652,500 (150 percent of \$435,000). As a result, for the taxable year 1980, the organization is denied tax exemption as an organization described in IRC 501(c)(3). The organization must again apply for recognition of exemption pursuant to Reg. 1.501(h)-3(d) for taxable years after 1980. Reg. 1.501(h)-3(e), Example (3).

(3) Exempt Purpose Expenditures

1. What are “exempt purpose expenditures?”

Reg. 56.4911-4 provides rules under IRC 4911(e) for determining an electing public charity’s “exempt purpose expenditures.” The regulation also provides that, in determining exempt purpose expenditures, no expenditure shall be counted twice by an organization.

Under Reg. 56.4911-4(b), amounts paid or incurred by an organization that are exempt purpose expenditures include the following:

- (A) Amounts paid or incurred to accomplish a purpose enumerated in IRC 170(c)(2)(B) including certain transfers made by the organization;
- (B) Amounts paid or incurred as current or deferred compensation for an employee’s services in connection with an IRC 170(c)(2)(B) purpose;
- (C) The allocable portion of administrative overhead and other general expenditures attributed to accomplishing IRC 170(c)(2)(B) purposes;
- (D) All lobbying expenditures;
- (E) Amounts paid or incurred for activities that are not considered lobbying because they are described in Reg. 56.4911-2(c), *e.g.*, nonpartisan analysis, study, and research, or member communications described in Reg. 56.4911-5 that are not lobbying expenditures;
- (F) A reasonable allowance for exhaustion, wear and tear, obsolescence or amortization, of assets to the extent used for one or more of the above purposes computed on a straight-line basis;²⁸ and
- (G) Certain fundraising expenditures (but see IRC 4911(e)(1)(C) and Reg. 56.4911-4(c)(3) and Reg. 56.4911-4(c)(4)).

2. What are not “exempt purpose expenditures?”

Under Reg. 56.4911-4(c), exempt purpose expenditures do not include the following types of expenditures:

- (A) Amounts paid or incurred that are not described in Reg. 56.4911-4(b);

²⁸ For this purpose, an allowance for depreciation will be treated as reasonable if based on a useful life that would satisfy IRC 321(k)(3)(A) as in effect on January 1, 1985.

- (B) The amounts of any transfer described in Reg. 56.4911-4(e);
- (C) Amounts paid to or incurred for a "separate fundraising unit" of the organization or of an affiliated organization;²⁹
- (D) Amounts paid to or incurred for any person not an employee, or any organization not an affiliated organization, if paid or incurred primarily for fundraising, but only if such person or organization engages in fundraising, fundraising counselling or the provision of similar advice or services;
- (E) Amounts paid or incurred chargeable to a capital account, determined in accordance with the principles that apply under IRC 263 or IRC 263A, with respect to an unrelated trade or business;
- (F) Amounts paid or incurred for a tax that is not imposed in connection with the organization's efforts to accomplish an IRC 170(c)(2)(B) purpose, such as taxes imposed under IRC 511(a)(1) and IRC 4911(a); and
- (G) Amounts paid or incurred for the production of income.³⁰

3. When are transfers exempt purpose expenditures?

There are two types of transfers that will be treated as an exempt purpose expenditure. The first is a transfer made to an organization described in IRC 501(c)(3) in furtherance of the transferor's exempt purposes that is not earmarked for any purpose other than one

described in IRC 170(c)(2)(B). Therefore, a payment of dues by a local or state organization to, respectively, a state or national organization that is described in IRC 501(c)(3) is considered an exempt purpose expenditure of the transferor to the extent it is not otherwise earmarked.

²⁹ Reg. 56.4911-4(f)(2) provides that, for this purpose, a separate fundraising unit of any organization must consist of either two or more individuals a majority of whose time is spent on fundraising for the organization, or any separate accounting unit of the organization that is devoted to fundraising. Furthermore, for this purpose, amounts paid to or incurred for a separate fundraising unit include all amounts incurred for the creation, production, copying, and distribution of the fundraising portion of a separate fundraising unit's communication. (For example, an electing public charity that has a separate fundraising unit may not count the cost of postage for a separate fundraising unit's communication as an exempt purpose expenditure even though, under the electing public charity's accounting system, that cost is attributable to the mailroom rather than to the separate fundraising unit.)

³⁰ For purposes of this section, amounts are paid or incurred for the production of income if they are paid or incurred for a purpose or activity that is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its charitable, educational or other purpose or function constituting the basis for its exemption under IRC 501. For example, the costs of managing an endowment are amounts that are paid or incurred for the production of income and are thus not exempt purpose expenditures. Fundraising expenditures are not, for purposes of this section, amounts that are paid or incurred for the production of income. Instead, the determination of whether fundraising costs are exempt purpose expenditures must be made with reference to IRC 4911(e)(1)(C), Reg. 56.4911-4(b)(8), Reg. 56.4911-4(c)(3), and Reg. 56.4911-4(c)(4).

Reg. 56.4911-4(d)(2). The second type is a "controlled grant," but only to the extent of the amounts that are paid or incurred by the transferee that would be exempt purpose expenditures if paid or incurred by the transferor.³¹ Reg. 56.4911-4(d)(3).

On the other hand, Reg. 56.4911-4(e) provides that three types of transfers cannot be considered exempt purpose expenditures. The first type is a transfer made to a member of any affiliated group (as defined in Reg. 56.4911-7(e)) of which the transferor is a member. Reg. 56.4911-4(e)(2).

The second type is a transfer that the Commissioner determines artificially inflates the amount of the transferor's or transferee's exempt purpose expenditures. The regulation provides that this determination generally will be made if a substantial purpose of a transfer is to inflate those exempt purpose expenditures. When this determination is made, the transfer will not be considered an exempt purpose expenditure of the transferor; rather, it will be an exempt purpose expenditure of the transferee to the extent that the transferee expends the transfer in the active conduct of its charitable activities or attempts to influence legislation. Standards similar to those found in Reg. 53.4942(b)-1(b) (relating to operating foundations) may be applied in determining whether the transferee has expended amounts in the "active conduct" of its charitable activities or attempts to influence legislation. Reg. 56.4911-4(e)(3).

The third type is a transfer that is not a "controlled grant" and is made to an organization not described in IRC 501(c)(3) that does not attempt to influence legislation. Reg. 56.4911-4(e)(4).

4. How are exempt purpose expenditures determined?

Reg. 56.4911-4(g) illustrates the provisions relating to the determination of exempt purpose expenditures by discussing the example of an organization that is an exempt organization described in IRC 501(c)(3) organized for the purpose of rehabilitating alcoholics. The

organization elected to be subject to the provisions of IRC 501(h) in 1981. For 1981, the organization had expenditures as indicated in the following chart. Those expenditures are included in its exempt purpose expenditures to the extent indicated.

³¹ Reg. 56.4911-4(f)(3) defines a "controlled grant" as a grant made by an organization eligible to elect the expenditure test to an organization not described in IRC 501(c)(3) that meets the following requirements:

- (i) The donor limits the grant to a specific project of the recipient that is in furtherance of the donor's (nonlobbying) exempt purposes; and
- (ii) The donor maintains records to establish that the grant is used in furtherance of the donor's (nonlobbying) exempt purposes.

Description	Total (dollars)	Includible (dollars)
Cost of real estate purchased for use as half-way house for alcoholics, attributable to the following:		
Land	30,000	
Building	200,000	
Depreciation (based on 40-year useful life)		5,000
Expenses of operating its half-way house	170,000	170,000
Administrative expenses of the organization allocated to the operation of its half-way house	95,000	95,000
Depreciation and allowances for equipment	10,000	10,000
Expenses related to attempts to influence legislation (lobbying expenditures)	40,000	40,000
Amounts paid to Z by the Organization for fundraising	35,000	
Total	580,000	320,000

Thus, for 1981, the organization’s exempt purpose expenditures total \$320,000. This amount includes both the direct costs of operating the half-way house as well as the administrative costs allocable to its operation. It also includes all lobbying expenses in full. Only depreciation computed on a straight-line basis is included in exempt purpose expenditures. The cost of capital expenditures (the land and building) is not included in exempt purpose expenditures. In addition, the \$35,000 paid by the organization for fundraising is not included in the exempt purpose expenditures total.

(4) Direct Lobbying and Grass Roots Lobbying

1. What are lobbying expenditures?

its expenditures during that year for direct lobbying communications (“direct lobbying expenditures”) plus its expenditures during that year for grass roots lobbying communications (“grass roots expenditures”).

For public charities that elect to be covered by IRC 501(h), lobbying expenditures are expenditures made for the purpose of influencing legislation (as defined in IRC 4911(d)). IRC 501(h)(2)(A). An electing public charity’s lobbying expenditures for a year are the sum of

2. What is the distinction between “direct” and “grass roots” lobbying?

participate in the formulation of the legislation, but only if the principal purpose of the

“Direct” lobbying involves attempts to influence legislation through communication with any member or employee of a legislative body. It also involves attempts to influence legislation through communication with any government official or employee (other than a member or employee of a legislative body) who may

communication is to influence legislation.³² IRC 4911(d)(1)(B); Reg. 56.4911-2(b)(1)(i). “Grass roots” lobbying involves attempts to influence legislation through an attempt to affect the opinions of the general public or any segment of the public. IRC 4911(d)(1)(A); Reg. 56.4911-2(b)(2)(i).

3. What is “legislation?”

Reg. 56.4911-2(d)(1)(i) provides that “legislation” includes action by the Congress, any state legislature, any local council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure. (See the discussion regarding the meaning of “action of the Congress” for purposes of the lobbying restriction for nonelecting charities.) “Legislation” includes a proposed treaty required to be submitted by the President to the Senate for its advice and consent from the time the President’s representative begins to negotiate its position with the prospective parties to the proposed treaty.

4. What is “specific legislation?”

Under Reg. 56.4911-2(d)(1)(ii), “specific legislation” includes both legislation that has already been introduced in a legislative body and specific legislative proposals that the organization either support or oppose. In the case of a referendum, ballot initiative, constitutional amendment, or other measure that is placed on the ballot by petitions signed by a required number or percentage of voters, an item becomes “specific legislation” when the petition is first circulated among voters for signature.

Prior to amendment in 1990, the regulations under IRC 4945 provided that “attempts to influence legislation” included communications “with respect to legislation being considered by, or to be submitted imminently to, a legislative body.” Reg. 53.4945-2(a)(1) (1990). When the regulations under IRC 4911 were finalized, the standard “to be submitted imminently” was not used in Reg. 56.4911-2(d)(1)(ii) and it was deleted from the IRC 4945 regulations. As the Preamble to the regulations explains, a temporal standard is inappropriate and underinclusive given the nature of the legislative process. For example, long before many specific legislative proposals are formally introduced as a bill, they are subject to intensive scrutiny, debate, and controversy. Moreover, effective lobbying could prevent a bill from ever being introduced. Consequently, reference to legislation proposed or adopted in one state that urges its adoption in another state constitutes a specific legislative proposal in the other state even though no such bill has been introduced there. Reg. 56.4911-2(d)(1)(iii), Example (2).

Legislation may be identified either by its formal name or by a term that has been widely used in connection with specific pending legislation, *e.g.*, “the President’s plan for a drug-free America.” Reg. 56.4911-2(b)(4)(ii)(B), Example (1). Legislation may also be identified merely by its content and effect. See Reg. 56.4911-2(d)(1)(iii), Example (1).

³² In this regard, Reg. 56.4911-2(b)(4)(i), Example (4), notes that a letter sent to an administrative agency proposing standards for regulations implementing recently enacted legislation is not a lobbying communication.

5. What is a direct lobbying communication?

A communication with a legislator or government official will not be treated as a direct lobbying communication in accordance with Reg. 56.4911-2(b)(1) unless it both refers to "specific legislation" and reflects a view on such legislation. Reg. 56.4911-2(b)(1)(ii). Therefore,

a position letter on a pending bill prepared by an organization's employee and distributed to members of Congress or personal contacts by the employee with members of Congress or their staffs to seek support for the organization's position on the bill would constitute direct lobbying. Reg. 56.4911-2(b)(4)(i), Example (1). In contrast, a letter sent to a member of Congress requesting that she write an administrative agency regarding proposed regulations recently published by that agency and also requesting that she state her support for a particular type of permit granted by the agency is not a direct lobbying communication. Reg. 56.4911-2(b)(4)(i), Example (2). Similarly, sending a paper to a state legislator on a particular state's environmental problems that does not reflect a view on any specific legislation that the organization either supports or opposes likewise is not a direct lobbying communication. Reg. 56.4911-2(b)(4)(i), Example (3).

6. May some, but not all, of the expenses associated with a study be treated as direct lobbying expenditures?

Yes. The regulations furnish an example of an organization that researched, prepared, and printed a safety code for electrical wiring. The organization sold the code to the public and it was widely used by professionals in the installation of electrical wiring. A number of states have codified all, or part, of the code of standards as mandatory safety standards. On

occasion, the organization lobbied state legislators for passage of the code of standards for safety reasons. Because the primary purpose of preparing the code of standards was the promotion of public safety and the standards were specifically used in a profession for that purpose, separate from any legislative requirement, the research, preparation, printing and public distribution of the code of standards is not an expenditure for a direct (or grass roots) lobbying communication. However, costs, such as transportation, photocopying, and other similar expenses, incurred in lobbying state legislators for passage of the code of standards into law are expenditures for direct lobbying communications. Reg. 56.4911-2(b)(4)(i), Example (5).

7. Will news media reports convert a communication from direct to grass roots lobbying?

In some situations, the news media may report that an organization has communicated with the legislature in support or opposition to particular legislation. The mere fact that the organization's position on the legislation has been reported in the news media, and therefore communicated to the general public, does not

convert it into a grass-roots lobbying communication. The communication remains a direct lobbying communication. Reg. 56.4911-2(b)(4)(i), Example (6).

8. May indirect communications with a legislator that express a view on legislation not constitute direct lobbying?

Yes, such a situation is set forth in Reg. 56.4911-2(b)(4)(i), Example (7). In the example, an organization monthly newsletter contained an editorial column that referred to and reflected a view on specific pending bills. One of the newsletter's 10,000 nonmember subscribers is a legislator. The editorial column in the newsletter copy sent to the legislator is not a

direct lobbying communication because the newsletter is sent to her in her capacity as a subscriber rather than her capacity as a legislator.³³

9. What is a "grass roots" lobbying communication?

Reg. 56.4911-2(b)(2)(ii) sets forth a three-part test for determining whether communications with the general public will be treated as grass roots lobbying communications. The communication will be considered a grass roots lobbying communication only if it meets all

three of the following requirements:

- (A) The communication refers to specific legislation;
- (B) The communication reflects a view on such legislation; and
- (C) The communication encourages the recipient of the communication to take action with respect to such legislation.

The third element (requiring the communication to encourage the recipient to take action) is commonly referred to as the "call to action" requirement. Essentially, what this requirement means is that no matter how clearly an organization identifies the specific legislation and comments on the merits of that legislation (for example, "passage of S. 549 would mean the end of civilization as we know it") when it communicates with the general public, the absence of any further statement that encourages the recipient to take action would mean that the communication

³³ The example notes, however, that the editorial column may be a grass roots lobbying communication if it encourages recipients to take action with respect to the pending bills it refers to and on which it reflects a view. A further cautionary note is set forth in Reg. 56.4911-2(b)(4)(i), Example (8), which states that if one of the legislator's staff members sees the editorial and requests additional information, and the organization responds with a letter that refers to and reflects a view on specific legislation, the letter would be a direct lobbying communication unless it is within one of the exceptions (such as the exception for nonpartisan analysis, study or research). (The letter would not be within the scope of the exception for technical advice or assistance because the letter is not in response to a written request from a legislative body or committee.)

could not be considered a grass roots lobbying communication. The lack of such a requirement was one of the major complaints directed at the 1986 proposed regulations.³⁴

10. Are all communications to the general public "grass roots"?

As noted above, unless a communication with the general public meets all three of the Reg. 56.4911-2(b)(2)(ii) requirements, it will not be a grass roots lobbying communication. Furthermore, in certain cases, a communication that does meet all three of the requirements may not be a grass roots lobbying communication. Reg. 56.4911-2(b)(1)(iii) provides that, solely for

³⁴ The definition of grass roots lobbying was by far the most controversial part of the 1986 proposed regulations. The 1986 proposed definition of grass roots lobbying was patterned after a test set forth in proposed IRC 162(e) regulations published in 1980. 45 FR 78167, 78169 (Nov. 25, 1980). (Those proposed regulations have not been finalized.) Under the 1986 definition, grass roots lobbying included any communication that met the following requirements:

- (A) The communication pertains to legislation being considered by a legislative body, or seeks or opposes legislation;
- (B) The communication reflects a view with respect to the desirability of the legislation (for this purpose, a communication that pertains to legislation but expresses no explicit view on the legislation shall be deemed to reflect a view on legislation if the communication is selectively disseminated to persons reasonably expected to share a common view of the legislation); and
- (C) The communication is communicated in a form and distributed to individuals as members of the general public, that is, as voters or constituents, as opposed to a communication designed for academic, scientific, or similar purposes. A communication may meet this test even if it reaches the public only indirectly, as in a news release submitted to the media. 51 FR 40211, 40222 (Nov. 5, 1986).

IRC 501(c)(3) public charities strenuously contended that the definition of grass roots lobbying was overly broad and included many communications that were not lobbying. In particular, they objected that communications were treated as grass roots lobbying even where the communications did not include some sort of "call to action." They also contended that the definition arbitrarily concluded that a discussion of legislation reflected a view solely on the basis of its dissemination.

At the second meeting of the Commissioner's Exempt Organizations Advisory Group, February 26, 1988, Service, Chief Counsel, and Treasury representatives stated they were considering revisions to the proposed regulations that would include a "call to action" requirement and would otherwise create rules different from those under IRC 162(e). All of the Group's members that spoke on the subject stated that a "call to action" requirement should be adopted. As to the issue of severing the IRC 4911 and 4945 proposed regulations from the proposed regulations under IRC 162(e), three of the Group's eighteen members dissented, stating they saw no reason for a difference in treatment. The remainder of the Group felt that a reading of the legislative histories discloses that the policy issues are different, as are the fiscal issues -- the consideration under IRC 162(e) is to police the tax base, whereas the exempt organization provisions regulate a segment of society that is entitled to more protection under the First Amendment than businesses. "Minutes [of] Commissioner's Exempt Organization's Advisory Group, February 25-26, 1988," *EOTR*, Jan. 1989, 7, 12-15.

The 1988 proposed regulations, as well as the final regulations, thus accommodated the concerns of charities by (1) creating rules different from those proposed in IRC 162(e), (2) removing the "dissemination" criterion, (3) adding a definition of "specific legislation," and (4) requiring a "call to action."

purposes of IRC 4911, where a communication refers to and reflects a view on a measure that is the subject of a referendum, ballot initiative or similar procedure, the general public in the State or locality where the vote will take place constitutes the legislative body, and individual members of the general public are considered legislators. Accordingly, if such a communication is made to one or more members of the general public in that state or locality, the communication is a direct lobbying communication (unless it comes under the exception for nonpartisan analysis, study or research (discussed below)).³⁵

11. What is meant by “encourages the recipient to take action?”

Reg. 56.4911-2(b)(2)(iii) provides a definition of encouraging a recipient to take action with respect to legislation. To be considered a “call to action,” a communication must do any one of the following:

- (A) The communication states that the recipient should contact an individual described in Reg. 56.4911-2(b)(1)(i);
- (B) The communication states the address, telephone number, or similar information of a legislator or an employee of a legislative body;
- (C) The communication provides a petition, tear-off postcard or similar material for the recipient to communicate with any individual described in Reg. 56.4911-2(b)(1)(i); or
- (D) The communication specifically identifies one or more legislators who will vote on the legislation as: opposing the organization’s view with respect to the legislation; being undecided with respect to the legislation; being the recipient’s representative in the legislature; or being a member of the legislative committee or subcommittee that will consider the legislation. Merely naming the main sponsor(s) of the legislation for purposes of identifying the legislation will not constitute encouraging the recipient to take action.

³⁵ “McGovern 1990” Tax Notes at 1311; EOTR at 771, discusses the rather tangled considerations that were brought to bear on this issue:

One factor that doubtless motivated the Service to carefully consider the issue in developing the final regulations was concern that the lobbying restriction not become a prohibition on influencing legislation, including legislation subject to defeat or approval at the ballot box. Because of the more restrictive limit on grass roots lobbying, and because of the inherently high costs of reaching voters (particularly in large states such as California), treating such lobbying as grass roots lobbying could amount to an effective prohibition, rather than the intended limitation. Accordingly, given the slight ambiguity in the statute, the final regulations treat such lobbying as direct lobbying.

Therefore, adding an exhortation such as “oppose S. 549” to the previously discussed example (“passage of S. 549 would mean the end of civilization as we know it”) would not affect the analysis. The statement still would not constitute grass roots lobbying because the exhortation does not reach the level of specificity set forth in the above paragraphs.

Furthermore, there is a distinction to be observed here. Communications described in paragraphs (A) through (C) not only “encourage,” but also “directly encourage” the recipient to take action with respect to legislation. Communications described in paragraph (D), however, do not “directly encourage” the recipient to take action with respect to legislation. Therefore, a communication would “encourage” the recipient to take action with respect to legislation, but not “directly encourage” such action, if the communication does no more than identify a legislator who will vote on the legislation as opposing the organization’s view with respect to the legislation. Reg. 56.4911-2(b)(2)(iv). Communications that encourage the recipient to take action with respect to legislation but that do not directly encourage the recipient to take action with respect to legislation may be within the exception for nonpartisan analysis, study or research and thus not be grass roots lobbying communications. Reg. 56.4911-2(c)(1)(vi). The distinction also assumes importance in the rules regarding membership communications. Reg. 56.4911-5(f)(6).

Legislators may be identified by name or by specific reference, e.g., “the junior Senator from State Z.” Reg. 56.4911-2(b)(4)(ii)(C), Example (6). However, a more general reference, e.g., “most of the Senators from the Farm Belt states are inexplicably in favor of the bill,” would not identify a legislator. Reg. 56.4911-2(b)(4)(ii)(C), Example (7).

12. Must volunteer activity costs be treated as lobbying costs?

Reg. 56.4911-2(b)(4)(ii)(C), Example (8), discusses an organization that trains volunteers to go door-to-door to seek signatures for petitions to be sent to legislators in favor of a specific bill. When the organization asks the volunteers to contact others and urge them to sign the petitions,

it encourages those volunteers to take action in favor of the specific bill. The organization does not reimburse the volunteers for their time and expenses. Any costs incurred by the volunteers in carrying on this activity are not lobbying or exempt purpose expenditures made by the organization. Furthermore, the volunteers may not deduct their out-of-pocket expenditures. See IRC 170(f)(6). However, the organization’s costs of soliciting the volunteers’ help and its costs of training the volunteers are grass roots expenditures. In addition, the costs of preparing, copying, distributing, etc., the petitions (and any other materials on the same specific subject used in the door-to-door signature gathering effort) are grass roots expenditures.

Nevertheless, as noted in Reg. 1.501(h)-3(e), Example (5), the fact that numerous unpaid volunteers conduct lobbying activities with no reimbursement on behalf of an electing public charity will not be considered in determining whether the organization has engaged in substantial lobbying for purposes of its exemption under IRC 501(c)(3). Unlike the test for nonelecting public charities where such activities would be considered, the test under IRC 501(h) is solely based upon expenditures.

(5) Exceptions

i. Nonpartisan Analysis

1. What is the exception for nonpartisan analysis?

Pursuant to IRC 4911(d)(2)(A) and Reg. 56.4911-2(c)(1)(i), engaging in nonpartisan analysis, study, or research and making the results of such work available to the general public, or a segment or members thereof, or to governmental bodies, officials, or employees will not constitute

a direct lobbying communication under Reg. 56.4911-2(b)(1) or a grass roots lobbying communication under Reg. 56.4911-2(b)(2).

2. What is "nonpartisan analysis, study, or research?"

Reg. 56.4911-2(c)(1)(ii) provides that "nonpartisan analysis, study, or research" means an independent and objective exposition of a particular subject matter, including any activity that is "educational" within the meaning of Reg. 1.501(c)(3)-1(d)(3). Thus, "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, as opposed to the mere presentation of unsupported opinion.

3. May a communication that contains a "call to action" come within the exception?

Reg. 56.4911-2(c)(1)(vi) provides that a communication that reflects a view on specific legislation is not within the nonpartisan analysis, study, or research exception if the communication directly encourages the recipient to take action with respect to such legislation. As set forth above, directly encouraging a recipient to take

action with respect to legislation means that the communication:

- (A) States that the recipient should contact legislators;
- (B) States a legislator's address, telephone number, etc.; or
- (C) Provides a petition, tear-off postcard or similar material for the recipient to communicate with a legislator.

Note, however, that a communication would encourage the recipient to take action with respect to legislation, but not directly encourage such action, if the communication does no more than specifically identify one or more legislators who will vote on the legislation as: (1) opposing the organization's view with respect to the legislation; (2) being undecided with respect to the legislation; (3) being the recipient's representative in the legislature; or (4) being a member of the legislative committee or subcommittee that will consider the legislation.

Reg. 56.4911-2(c)(1)(vii), Examples (8) and (9), provide illustrations of the difference between “encouraging” and “directly encouraging.” In Example (8), an analysis of a pending bill study names certain undecided Senators on the Senate committee considering the bill. Although the study meets the three part test for determining whether a communication is a grass roots lobbying communication, the study is within the exception for nonpartisan analysis, study or research, because it does not directly encourage recipients of the communication to urge a legislator to oppose the bill. In Example (9), the facts are identical except that the study concludes: “You should write to the undecided committee members to support this crucial bill.” The study is not within the exception for nonpartisan analysis, study or research because it directly encourages the recipients to urge a legislator to support a specific piece of legislation.

4. How may nonpartisan analysis results be distributed?

Reg. 56.4911-2(c)(1)(iv) provides that an organization may choose any suitable means to distribute the results of its nonpartisan analysis, study, or research, including oral or written presentations, with or without charge. This includes distribution of reprints of speeches,

articles and reports; presentation of information through conferences, meetings and discussions; and dissemination to the news media, including radio, television and newspapers, and to other public forums. However, such communications may not be limited to, or be directed toward, persons who are interested solely in one side of a particular issue.

5. What happens when results are distributed in a series?

Normally, whether a publication or broadcast qualifies as “nonpartisan analysis, study, or research” is determined based upon each presentation. However, if the results are presented as a series prepared or supported by the organization and the series as a whole meets the

standards of Reg. 56.4911-2(c)(1)(ii), then any individual presentation within the series is not a direct or grass roots lobbying communication even though such individual presentation does not, by itself, meet the standards for “nonpartisan analysis, study, or research.” Whether a presentation is considered part of a series will depend upon all the facts and circumstances of each particular situation. However, with respect to broadcast activities, all broadcasts within any period of six consecutive months will ordinarily be eligible to be considered as part of a series. Reg. 56.4911-2(c)(1)(iii).

Nevertheless, if an electing organization times or channels a part of a series in a manner designed to influence the general public or the action of a legislative body with respect to a specific legislative proposal, the expenses of preparing and distributing such part of the analysis, study, or research will be expenditures for a direct or grass roots lobbying communications, as the case may be. An example of such a circumstance is set forth in Reg. 56.4911-2(c)(1)(vii), Example (7). In the example, an organization presented within a period of six consecutive months a two-program television series relating to a pesticide issue. The organization arranges for the first program, which contains information, arguments, and conclusions favoring legislation, to be televised at 8:00pm on a Thursday. It arranges for the second program, which opposes such legislation, to be televised at 7:00am on a Sunday. The example concludes that

the organization's presentation is not within the exception for nonpartisan analysis, study, or research, since the organization disseminated its information in a manner prejudicial to one side of the legislative controversy since the program favoring the legislation was aired at a more convenient viewing time than the second program.

6. What is the rule concerning "subsequent use"?

Reg. 56.4911-2(c)(1)(v) provides that even though an activity is initially within the exception for nonpartisan analysis, study, or research, subsequent grass roots lobbying use may cause it to be treated as a grass roots lobbying communication that is not within this exception.

However, subsequent use will never cause any analysis, study, or research to be considered a direct lobbying communication.

According to Reg. 56.4911-2(b)(2)(v), certain communications or research materials that are initially not grass roots lobbying communications under the three-part definition may be treated as such due to subsequent use of the materials for grass roots lobbying. However, this occurs only if the materials are considered "advocacy communications or research materials."

7. What are "advocacy communications or research materials"?

"Advocacy communications or research materials" are communications or materials that both refer to and reflect a view on specific legislation but that do not, in their initial format, contain a direct encouragement for recipients to take action with respect to the specific legislation. Reg. 56.4911-2(b)(2)(v)(B). Therefore, the

subsequent use rules do not embrace such items as assemblages of raw data.

An example of an "advocacy communication" is described in Reg. 56.4911-2(c)(vii), Example (8). That example discusses an organization that distributes a study that indicates a pending bill is an appropriate remedy for problems discussed in the study and identifies certain senators who are undecided with regard to the bill. As discussed above, while this communication encourages the recipient to take action with respect to the legislation, it does not directly encourage such action. Since the study does refer to and reflect a view on the legislation without directly encouraging action with respect to that legislation, it is an advocacy communication. However, the communication discussed in Reg. 56.4911-2(c)(vii), Example (4), would not be considered an advocacy communication. In that example, an organization publishes a newsletter that contains notices and impartial summaries of proposed legislation. Although the newsletter refers to specific legislation, it does not reflect a view on that legislation.

Advocacy communications or research materials may be treated as grass roots lobbying communications when they are subsequently accompanied by a direct encouragement for recipients to take action with respect to legislation. For example, if the study discussed in Reg. 56.4911-2(c)(vii), Example (8), were subsequently distributed with a letter stating "You should write to the undecided committee members to support this crucial bill," the study itself could be treated as a grass roots lobbying communication. However, the advocacy

8. When will “advocacy communications” become grass roots lobbying?

communications or research materials themselves will not be treated as grass roots lobbying communications unless the organization’s primary purpose in undertaking or preparing the advocacy communications or research materials was not for use in lobbying. If no such primary nonlobbying purpose is shown to exist, all expenses of

preparing and distributing the advocacy communications or research materials will be treated as grass roots expenditures. Reg. 56.4911-2(b)(2)(v)(C).

9. How is the primary purpose determined?

Reg. 56.4911-2(b)(2)(v)(E) sets forth a safe harbor for determining the primary purpose of an organization when it undertakes or prepares advocacy communications or research materials. It states that the activity’s primary purpose will not be considered to be for use in lobbying if the

organization makes a substantial nonlobbying distribution of the advocacy communications or research materials (without the direct encouragement to action) prior to or contemporaneously with the use of those materials with the direct encouragement to action. In determining whether a distribution is substantial, all of the facts and circumstances will be considered, including the normal distribution pattern of similar nonpartisan analyses, studies, or research by that and similar organizations.³⁶

If the organization does not meet the safe harbor because the nonlobbying distribution of advocacy communications or research materials is not substantial, Reg. 56.4911-2(b)(2)(v)(G) provides that all of the facts and circumstances must be weighed to determine whether the organization’s primary purpose in preparing the advocacy communications or research materials was for use in lobbying. One factor that is particularly relevant is the extent of the organization’s nonlobbying distribution of the advocacy communications or research materials, especially when compared to the extent of their distribution with the direct encouragement to action. Another particularly relevant factor is whether the lobbying use of the advocacy communications or research materials is by the organization that prepared the document, a related organization, or an unrelated organization. Where the subsequent lobbying distribution is made by an unrelated organization, clear and convincing evidence (which must include evidence demonstrating cooperation or collusion between the two organizations) will be required to establish that the primary purpose for preparing the communication for use in lobbying.

Yes. Under the “subsequent use” rule, the characterization of expenditures as grass roots lobbying expenditures regulation applies only to expenditures paid less than six months before the first time advocacy communications or research materials are used with a direct encouragement to action with respect to legislation. Reg. 56.4911-2(b)(2)(v)(D). The six month

³⁶ Reg. 56.4911-2(b)(2)(v)(F) provides a special rule for “partisan analysis, study or research,” that is, in the case of advocacy communications or research materials that are not nonpartisan analysis, study or research, the nonlobbying distribution thereof will not be considered “substantial” unless that distribution is at least as extensive as the lobbying distribution thereof.

10. Is there a time limit on the “subsequent use” rule?

rule eliminates the possibility of years of research costs being retroactively characterized as lobbying costs.

ii. Other Exceptions

1. What is the exception for examinations and discussions of broad social problems?

The exception for examinations and discussions of broad social, economic, and similar problems in Reg. 56.4911-2(c)(2) is implicit in the definitions of direct lobbying and grass roots lobbying communications. The regulation provides that such discussions are neither direct lobbying communications nor grass roots

lobbying communications even if the problems are of the type with which government would be expected to deal ultimately. In describing the scope of this exception, the regulation provides that communications regarding a subject that is also the subject of legislation before a legislative body will not be considered lobbying communications so long as the discussion does not address itself to the merits of a specific legislative proposal and does not directly encourage recipients to take action with respect to legislation. Both direct and grass roots lobbying communications must reflect a view on specific legislation so any communication coming within this exception would fail to qualify as either a direct or grass roots lobbying communication. The regulation provides that this exception excludes from grass roots lobbying an organization’s discussions of problems such as environmental pollution or population growth that are being considered by Congress and various State legislatures, but only where the discussions do not directly address the specific legislation being considered and do not directly encourage recipients of the communication to contact a legislator, an employee of a legislative body, or a government official or employee who may participate in the formulation of legislation. Such discussions would also fail to qualify as grass roots lobbying under the three-part test of Reg. 56.4911-2(b)(2)(ii) since they do not reflect a view on the specific legislation.³⁷

³⁷ Prior to the adoption of the final regulations under IRC 4911, the IRC 4945 regulations had included an exception for discussion of broad social problems. This exception was included in the IRC 4911 regulations to provide parity with the IRC 4945 regulations. However, as a substantive matter, the exception seems superfluous.

2. What is the exception for requests for technical advice?

Reg. 56.4911-2(c)(3) provides that a communication will not be considered a direct lobbying communication when it consists of providing technical advice or assistance to a governmental body, a governmental committee, or a subdivision of either in response to a written request by that body, committee, or subdivision, as set forth in Reg. 53.4945-2(d)(2).

Requests made by individual members of a governmental body, committee, or subdivision of either will not qualify under this exception since Reg. 53.4945-2(d)(2)(i) requires that the request for assistance or advice must be made in the name of the requesting governmental body, committee or subdivision. Likewise, the response to such request must be available to every member of the requesting body, committee or subdivision to qualify for the exception. The regulations provide an example of a written response submitted to the person making a request for technical assistance in the name of a congressional committee, making it clear that the response is for the use of all the members of the committee. In that situation, the response will be considered available to every member of the requesting committee if the response is.

Oral or written presentation of technical assistance or advice coming under this exception does not need to qualify as nonpartisan analysis, study or research. The offering of opinions or recommendations will ordinarily qualify under this exception only if such opinions or recommendations are specifically requested by the governmental body, committee or subdivision or are directly related to the materials so requested. Reg. 53.4945-2(d)(2)(ii). The regulations illustrate these rules with the example of a Congressional committee that is studying the feasibility of legislation to provide funds for scholarships to U.S. students attending schools abroad. The committee made a written request to an organization that has engaged in a private scholarship program of this type to describe the manner in which it selects candidates for its program. If the organization's response not only included a description of its own grant-making procedures, but also its views regarding the wisdom of adopting such a program, the technical advice or assistance exception would still apply (because such views are directly related to the subject matter of the request for technical advice or assistance). Similarly, the exception would still apply if the organization was requested, in addition, to give any views it considered relevant and the organization's response included a discussion of alternative scholarship programs and their relative merits. Reg. 53.4945-2(d)(2)(iii), Examples (1), (2), and (3).

3. What is the exception for "self-defense"?

Under the "self-defense" exception of Reg. 56.4911-2(c)(4), a communication is not a direct lobbying communication if the communication is an appearance before, or communication with, any legislative body with respect to a possible action by the body that might affect the existence of the electing public charity, its powers and duties, its tax-exempt status, or the deductibility of contributions to the organization, as set forth in Reg. 53.4945-2(d)(3). Reg. 56.4911-2(c)(4) also contains special rules for membership communications, as well as communications among an affiliated group and a limited affiliated group.

Under this exception, a charity may communicate with an entire legislative body, with committees or subcommittees of a legislative body, with individual legislators, with legislative staff members, or with representatives of the executive branch who are involved with the legislative process, so long as such communication is limited to the prescribed subjects. Similarly, under the self-defense exception, a charity may make expenditures in order to initiate legislation if such legislation concerns only matters which might affect the existence of the charity, its powers and duties, its tax-exempt status, or the deductibility of contributions to such charity.

Therefore, if a bill would cause an organization to lose its exemption from taxation if it engages in certain transactions, expenditures paid or incurred with respect to the organization's submissions on the bill do not constitute taxable expenditures since they are made with respect to a possible decision of Congress which might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation. Reg. 53.4945-2(d)(3)(ii), Example (1). However, the exception would not apply to expenditures incurred by an organization that appeared before an appropriations committee in order to attempt to persuade the committee of the advisability of continuing a contract research program whose discontinuance would affect the organization financially. Expenditures paid or incurred with respect to such appearance are not made with respect to possible decisions of the legislature that might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation, but rather merely affect the scope of the organization's future activities. Reg. 53.4945-2(d)(3)(ii), Example (4).

(6) Special Rules for Mass Media Advertising

1. What are the rules concerning mass media advertising?

Reg. 56.4911-2(b)(5) contains a special rule for certain mass media advertisements. Under this rule, a mass media advertisement that does not qualify as a grass roots lobbying communication under the three-part definition (as discussed above) may nevertheless be considered

a grass roots lobbying communication. This special rule generally applies only to a limited type of paid advertisements that appear in the mass media.

Reg. 56.4911-2(b)(5)(ii) contains a presumption regarding certain paid mass media advertisements about highly publicized legislation. Under this presumption, if an organization's paid advertisement appears in the mass media within two weeks before a vote by a legislative body, or a committee (but not a subcommittee) of such body, on a highly publicized piece of legislation, the paid advertisement will be considered to be a grass roots lobbying communication if the paid advertisement both reflects a view on the general subject of such legislation and either refers to the highly publicized legislation or encourages the public to communicate with legislators on the general subject of such legislation. This presumption can be rebutted by demonstrating that the paid advertisement is a type of mass media communication regularly made by the organization without regard to the timing of legislation (that is, a customary course of business exception) or that the timing of the paid advertisement was unrelated to the upcoming

legislative action.³⁸ A mass media communication that otherwise meets the presumption but is made more than two weeks before a legislative vote will not be considered a grass roots lobbying communication under this rule, even if it is presented only one day more than two weeks. Reg. 56.4911-2(b)(5)(iv), Examples (2) and (4). Furthermore, there must be a legislative vote on the legislation for this rule to apply. If, because of public pressure resulting from an advertising campaign opposing a bill that would meet the presumption, the bill is withdrawn and no vote is ever taken, none of the advertisements will be considered a grass roots lobbying communication under this rule. Reg. 56.4911-2(b)(5)(iv), Example (5).

2. What is "mass media?"

For purpose of this special rule, the term "mass media" means television, radio, billboards and general circulation newspapers and magazines. Newspapers or magazines that are published by an IRC 501(c)(3) organization that

has made an IRC 501(h) election will not be considered general circulation newspapers or magazines unless the total circulation of the newspaper or magazine is greater than 100,000 and fewer than one-half of the recipients are members of the organization (as defined in Reg. 56.4911-5(f)). Reg. 56.4911-2(b)(5)(iii)(A). Where an electing public charity is itself a mass media publisher or broadcaster, all portions of that organization's mass media publications or broadcasts are treated as paid advertisements in the mass media, except those specific portions that are advertisements paid for by another person. Reg. 56.4911-2(b)(5)(iii)(B).

3. What is "highly publicized?"

Reg. 56.4911-2(b)(5)(iii) provides that legislation is "highly publicized" for purpose of this special rule when it receives frequent coverage on television and radio, and in general circulation newspapers, during the two weeks

preceding the vote by the legislative body or committee. In the case of state or local legislation, it is "highly publicized" when it receives frequent coverage in the mass media that serve the State or local jurisdiction in question. Even where legislation receives frequent coverage, it is "highly publicized" only if the pendency of the legislation or the legislation's general terms, purpose, or effect are known to a significant segment of the general public (as opposed to the particular interest groups directly affected) in the area in which the paid mass media advertisement appears.

³⁸ However, even if the organization successfully rebuts the presumption, a mass media communication is a grass roots lobbying communication if the communication would be a grass roots lobbying communication under the general rules of the three-part test.

(7) Earmarking

1. What are the rules relating to transfers by electing charities?

When an electing public charity makes a transfer that is earmarked for grass roots lobbying purposes, the transfer is a grass roots expenditure. Reg. 56.4911-3(c)(1). When an electing public charity makes a transfer that is earmarked for direct lobbying purposes or for direct lobbying and grass roots lobbying purposes, the transfer is treated as a grass roots expenditure in full except to the extent the electing public charity demonstrates that all or part of the amounts transferred were expended for direct lobbying purposes, in which case that part of the amounts transferred is a direct lobbying expenditure by the electing public charity.³⁹ Reg. 56.4911-3(c)(2).

A transfer for less than fair market value by an electing public charity to any organization (other than those described in IRC 501(c)) that makes lobbying expenditures is not an exempt purpose expenditure unless the public charity makes the benefit generally available at less than fair market value in the course of an activity that is substantially related to accomplishing the exempt purpose of the charity.⁴⁰ Reg. 56.4911-3(c)(3). Transfers for fair market value, whether to related or unrelated organizations, are not covered by this rule.

The amount by which the cost or fair market value (whichever is greater) of the transfer exceeds the value given to the electing public charity in return for the transfer is the amount subject to this rule. Reg. 56.4911-3(c)(3)(i)(E). This amount is treated as a grass roots expenditure to the extent of the transferee's grass roots expenditures. If the transferred amount exceeds the transferee's grass roots expenditures, the excess is treated as a direct lobbying expenditure to the extent of the transferee's direct lobbying expenditures. If the transfer exceeds both grass roots and direct lobbying expenditures by the transferee, the excess is not treated as a lobbying expenditure. Reg. 56.4911-3(c)(3)(ii). Reg. 56.4911-3(c)(3)(iii) illustrates this provision by the following example:

Organization C, an electing public charity, shares employee E with N, a noncharity that makes lobbying expenditures. N's grass roots expenditures are \$5,000 and its direct lobbying expenditures are \$25,000. Each organization pays one-half of the \$100,000 in direct and overhead costs associated with E. E devotes one-quarter of his time to C and three-quarters of his time to N. In substance, this arrangement is a transfer (for less than fair market value) from C to N in the amount of \$25,000 (one-quarter of the \$100,000 of direct and overhead costs associated with E's work).

³⁹ These rules do not apply to transfers that are not exempt purpose expenditures because they are described in Reg. 56.4911-4(e).

⁴⁰ This rule also does not apply to controlled grants or to transfers that are not exempt purpose expenditures because they are described in Reg. 56.4911-4(e).

Accordingly, C is treated as having made a \$5,000 grass roots expenditure (the lesser of N's grass roots expenditures (\$5,000) or the amount of the transfer (\$25,000)). C is also treated as having made a \$20,000 direct lobbying expenditure (the lesser of N's direct lobbying expenditures (\$25,000) or the remaining amount of the transfer (\$20,000)).

2. When is a transfer earmarked for a specific purpose?

To be treated as a lobbying expenditure in accordance with Reg. 56.4911-3(c)(1) or Reg. 56.4911-3(c)(2), a transfer must be "earmarked" for direct or grass roots lobbying purposes pursuant to Reg. 56.4911-4(f)(4). This regulation provides that a transfer, including a

grant or payment of dues, is "earmarked" for direct or grass roots lobbying purposes to the extent the transfer meets either one of the following requirements:

- (A) The transferor directs the transferee to add the amount transferred to a fund established to accomplish the direct or grass roots lobbying purpose, or
- (B) The amount transferred or, if less, the amount agreed upon to the expended to accomplish the purpose, if there exists an agreement, oral or written, whereby the transferor may cause the transferee to expend amounts to accomplish the direct or grass roots lobbying purpose or whereby the transferee agrees to expend an amount to accomplish the direct or grass roots lobbying purpose.

(8) Allocation Rules

1. What are the principles of the allocation rules?

Reg. 56.4911-3 contains allocation rules for determining what portion of the costs of a lobbying communication is a direct lobbying expenditure, what portion is a grass roots lobbying expenditure, and what portion is not a lobbying expenditure. The general principle

involved is that all costs of preparing a direct or grass roots lobbying communication are included as expenditures for direct or grass roots lobbying ("lobbying expenditures"), including both direct and indirect costs. Therefore, lobbying expenditures include amounts paid or incurred as current or deferred compensation for an employee's services as well as the allocable portion of administrative, overhead, and other general expenditures attributable to the direct or grass roots lobbying communication. For example, as a general rule, all expenditures for researching, drafting, reviewing, copying, publishing and mailing a direct or grass roots lobbying communication, as well as an allocable share of overhead expenses, are included as expenditures for direct or grass roots lobbying. Reg. 56.4911-3(a)(1).

2. How are expenditures for nonmember communications allocated?

When an electing public charity makes a lobbying communication that is not sent only or primarily to members and that also has a bona fide nonlobbying purpose, the allocable lobbying expenditures must include all costs that are attributable to those parts of the communication on the same specific subject as the lobbying

message. Reg. 56.4911-3(a)(2)(i). All costs attributable to those parts of the communication that are not on the same specific subject as the lobbying message are not included as lobbying expenditures for allocation purposes. Whether or not a portion of a communication is on the same specific subject as the lobbying message will depend on the surrounding facts and circumstances.⁴¹

3. When are portions of a communication "on the same specific subject?"

A portion of a communication will be "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 that is the subject of the lobbying message. Moreover, discussion of the background or consequences of the specific

legislation, or discussion of the background or consequences of an activity or specific issue affected by the specific legislation, is also considered to be on the same specific subject as the lobbying communication. Reg. 56.4911-3(a)(2)(i).

Reg. 56.4911-3(b), Examples (8) and (9), illustrate the "same specific subject" rule. In the examples, a nonmembership organization prepared and mailed a four page document. The first two pages, titled "The Need for Child Care," support the need for additional child care programs, and include statistics on the number of children living in homes where both parents work or in homes with a single parent. The two pages also make note of the inadequacy of the number of day care providers to meet the needs of these parents. The third page, titled "H.R. 1," indicates the organization's support of H.R. 1, a bill pending in the U.S. House of Representatives. The document states that H.R. 1 will provide for \$10,000,000 in additional subsidies to child care providers, primarily for those providers caring for lower income children. The third page also notes that H.R. 1 includes new federal standards regulating the quality of child care providers. The document ends with T's request that recipients contact their Congressional representative in support of H.R. 1. The fourth page does not refer to the general need for child care or the specific need for additional child care providers. Instead, the fourth page advocates that a particular federal agency commence, under its existing statutory authority, licensing of day care providers in order to promote safe and effective child care. The examples

⁴¹ With the exception of the definition of grass roots lobbying, the provision of the 1986 proposed regulations that created the biggest stir was the proposed rule that all expenditures for a fundraising communication would be treated as grass roots lobbying if any part of the communication also consists of grass roots lobbying. 51 FR 40211, 40222-3 (Nov. 5, 1986). The 1988 proposed regulations revised this allocation rule by providing two different rules: a "same specific subject" rule for nonmember communications and a reasonable allocation rule for membership communications. The 1990 regulations also adopted these rules.

conclude that the first three pages of the document are on the same specific subject; therefore, all expenditures of preparing and distributing those three pages are grass roots lobbying expenditures. However, the cost of the fourth page is not a lobbying expenditure since it is not on the same specific subject.

4. How are expenditures for member communications allocated?

Reg. 56.4911-3(a)(2)(ii) provides that in the case of lobbying expenditures for a communication that also has a bona fide nonlobbying purpose and that is sent only or primarily to members, an electing public charity must make a reasonable allocation between the amount expended for the lobbying purpose and

the amount expended for the nonlobbying purpose. For the purpose of applying this rule, if more than half of the recipients of a lobbying communication are members of the organization within the meaning of Reg. 4911-5, then the communication is considered to be sent only or primarily to members. (See the discussion below for the rules regarding communications with members.) The regulation further provides that an electing public charity that includes as a lobbying expenditure only the amount expended for the specific sentence or sentences that encourage the recipient to take action with respect to legislation has not made a reasonable allocation. Reg. 56.4911-3(b), Examples (10) and (11), illustrate these principles. A member organization that prepared and mailed a document primarily to members that discusses the need for child care, refers to and reflects a view on specific legislation concerning child care, and states that readers should contact the legislature regarding the specific legislation. The organization determines that the document has a bona fide nonlobbying purpose, educating its members about the need for child care. In Example (10), the organization allocates one-half of the preparation and distribution costs to lobbying, which the regulation concludes is reasonable. However, in Example (11), the regulations conclude that an allocation of only one percent of the costs to lobbying based upon the fact that only two lines out of 200 state that the recipient should contact the legislature was not reasonable.

5. How are mixed lobbying expenditures allocated?

Generally, a communication (to which the membership rules of Reg. 56.4911-5 does not apply) that is both a direct lobbying communication and a grass roots lobbying communication will be treated as a grass roots lobbying communication. However, to the extent

the electing public charity demonstrates that the communication was made primarily for direct lobbying purposes, the organization may make a reasonable allocation between the direct and the grass roots lobbying purposes served by the communication. Reg. 56.4911-3(a)(3).⁴²

⁴² Under the proposed 1986 regulations, the organization had to demonstrate that the expenditure was incurred solely for direct lobbying purposes. 51 FR 40211, 40223 (Nov. 5, 1986).

(9) Special Rules for Membership Communications

1. What are the rules concerning membership communications?

Reg. 56.4911-5 provides that expenditures for certain communications between an organization and its members (“membership communications”) are treated more leniently for purposes of IRC 4911 than are similar communications to nonmembers. Pursuant to the

regulation, certain membership communication expenditures are not lobbying expenditures even though those expenditures would be lobbying expenditures if the communication were to nonmembers. In other cases, expenditures that would be grass roots expenditures if the communication were to nonmembers are direct lobbying expenditures when made to members.

2. Who is a “member”?

Under Reg. 56.4911-5(f)(1), a person is a member of an electing public charity if the person (either an individual or organization) pays dues or makes a contribution of more than a nominal amount, makes a contribution of more than a

nominal amount of time, or is one of a limited number of “honorary” or “life” members who have more than a nominal connection with the electing public charity and who have been chosen for a valid reason (such as length of service to the organization or involvement in activities forming the basis of the electing public charity’s exemption) unrelated to the electing public charity’s dissemination of information to its members.

A person may be treated as a member of an electing public charity even though that person does not qualify as a member under the tests set forth in Reg. 56.4911-5(f)(1) if the electing public charity demonstrates to the satisfaction of the Service that there is a good reason for its membership requirements not meeting the above requirements and that its membership requirements do not operate to permit an abuse of these rules. This rule has been applied, for example, in PLR 93-32-042 (May 19, 1993), in which members of separately incorporated state and local organizations were treated as members of a national organization based upon coordinated activities and payment of a share of dues to the national organization.

3. When are expenditures for member communications not lobbying expenditures?

Pursuant to Reg. 56.4911-5(b), expenditures for a communication that refers to, and reflects a view on, specific legislation will not be considered lobbying expenditures if the communication satisfies the following four requirements:

- (A) The communication is directed only to members of the organization;
- (B) The specific legislation the communication refers to, and reflects a view on, is of direct interest to the organization and its members;

- (C) The communication does not directly encourage the member to engage in direct lobbying (whether individually or through the organization); and
- (D) The communication does not directly encourage the member to engage in grass roots lobbying (whether individually or through the organization).

4. What happens when a member communication encourages direct lobbying?

A communication that otherwise meets the requirements set forth in Reg. 56.4911-5(b) but does not come within that rule because it directly encourages the members to engage in direct lobbying will be treated as a direct lobbying communication. IRC 4911(d)(3)(A); Reg. 56.4911-5(c). Reg. 56.4911-5(f)(6)(i)(A)

provides that a member communication directly encourages a recipient to engage in direct lobbying, whether individually or through the organization, if the communication does any of the following:

- (A) The communication states the recipient should contact an individual described in Reg. 56.4911-2(b)(1)(i);
- (B) The communication states the address, telephone number, or similar information of a legislator or an employee of a legislative body; or
- (C) The communication provides a petition, tear-off postcard or similar material for the recipient to communicate his or her views to an individual described in Reg. 56.4911-2(b)(1)(i).

5. What happens when member communications encourage grass roots lobbying?

A communication that meets the requirements of Reg. 56.4911-5(b) that it be directed only to members and refer to and reflect a view on specific legislation of direct interest and concern to the organization and its members, but does not qualify under that rule because it directly encourages the members to urge persons

other than members to engage in direct or grass roots lobbying is treated as grass roots lobbying. IRC 4911(d)(3)(B); Reg. 56.4911-5(d). Reg. 56.4911-5(f)(6)(ii) provides that a communication directly encourages recipients to engage individually or collectively (whether through the organization or otherwise) in grass roots lobbying if the communication does any of the following:

- (A) The communication states the member should encourage nonmembers to contact an individual described in Reg. 56.4911-2(b)(1)(i);
- (B) The communication states the recipient should provide to nonmembers the address, telephone number, or similar information of a legislator or an employee of a legislative body; or

- (C) The communication provides (or requests the recipient provide to nonmembers) a petition, tear-off postcard or similar material for the recipient (or nonmember) to use to ask nonmembers to communicate views to an individual described in Reg. 56.4911-2(b)(1)(i). For example, a petition that has an entire page of preprinted signature blocks is considered to be provided to the member to ask nonmembers to communicate views. Similarly, where a communication is distributed to a single member and provides several tear-off postcards addressed to a legislator, the postcards are presumed to be provided for the member to use to ask nonmembers to communicate with the legislator.

6. Is there a "self-defense" exception for members?

Yes, in some instances a communication by an electing public charity on behalf of its members will come within the "self-defense" exception. Reg. 56.4911-2(c)(4)(iii) provides that the exception applies to an electing public charity when more than 75 percent of its members are

other organizations that are described in IRC 501(c)(3). Appearances before, or communications with, any legislative body with respect to a possible action by the body which might affect the existence of one or more of the IRC 501(c)(3) member organizations, their powers, duties, or tax-exempt status, or the deductibility (under IRC 170) of contributions to one or more of the IRC 501(c)(3) member organizations are covered by this exception. However, the exception applies only if the principal purpose of the appearance or communication is to defend the IRC 501(c)(3) member organizations. It does not apply if the principle purpose is to defend any member organizations that are not described in IRC 501(c)(3).

In addition, Reg. 56.4911-5(f)(6)(i)(B) provides an exception for communications with members. A communication that directly encourages a member to engage in direct lobbying activities that would not be attempts to influence legislation because of the "self-defense" exception if engaged in directly by the organization is treated as a communication that does **not** directly encourage a member to engage in direct lobbying.

7. What happens when written communications are not directed solely to members?

While not treated quite as leniently as communications directed **only to** members of an organization, written communications that are designed **primarily for** the members but are not directed only to members also qualify for special treatment. Under Reg. 56.4911-5(e), expenditures for such written communications that refer to, and

reflect a view on, specific legislation of direct interest to the organization and its members, are treated as expenditures for direct or grass roots lobbying depending upon the type of lobbying encouraged. For purposes of Reg. 56.4911-5(e), a communication is designed primarily for members of an organization if more than half of the recipients of the communication are members of the organization.

8. What are the allocation rules for such communications that encourage direct lobbying but not grass roots lobbying?

Reg. 56.4911-5(e)(2) provides allocation rules for a written communication distributed primarily to members (as described above) that directly encourages recipients (individually or through the organization) to engage in direct lobbying but does not directly encourage them to engage in grass roots lobbying. In those cases, the cost of preparing and distributing the

communication is allocated between direct lobbying and grass roots lobbying expenditures. The regulation cross references the rules concerning computation of advertising income contained in Reg. 1.512(a)-1(f)(6) and indicates that the portion of the cost to be allocated includes all costs of preparing all the material with respect to which readers are urged to engage in direct lobbying plus the mechanical and distribution costs attributable to the lineage devoted to this material.

The amount to be allocated as determined above is then multiplied by the sum of the "nonmember subscribers percentage" and the "all other distribution percentage," both as defined in Reg. 56.4911-5(f)(7), to determine the amount allocable as a grass roots lobbying expenditure for the communication.⁴³ (Solely for purposes of this particular allocation, the nonmember subscribers percentage is treated as zero unless it is greater than 15 percent of total distribution.) The grass roots lobbying expenditure is subtracted from the amount to be allocated to determine the direct lobbying expenditure.

9. What are the allocation rules for such communications that encourage grass roots lobbying?

If a written communication is directed primarily for, but not only to, the members of the organization, as described above, and it directly encourages recipients to engage in grass roots lobbying (either individually or through the organization or otherwise), the expenditures for the communication are treated as a grass roots lobbying expenditure. The communication is

treated as a grass roots lobbying communication even if it also encourages readers to engage in direct lobbying. As with the amount to be allocated between direct lobbying expenditures and grass roots lobbying expenditures as discussed above, grass roots lobbying expenditures includes all the costs of preparing all the material with respect to which readers are urged to engage in grass roots lobbying plus the mechanical and distribution costs attributable to the lineage devoted to this material. See Reg. 1.512(a)-1(f)(6).

⁴³ With respect to the term "subscriber," Reg. 56.4911-5(f)(5) provides that a subscriber to a written communication is a person that either (1) is a member of the publishing organization and the membership dues expressly include the right to receive the written communication, or (2) has affirmatively expressed a desire to receive the written communication and has paid more than a nominal amount for the communication.

(10) Affiliated Groups

i. Affiliation Rules

1. What are the affiliation rules?

IRC 4911(f)(1) through IRC 4911(f)(3) contain a limited anti-abuse rule for affiliated organizations. In general, the rule prevents avoiding the sliding-scale percentage limitation on lobbying expenditures (as well as avoiding the \$1,000,000 cap on lobbying expenditures) through creation of numerous organizations.⁴⁴ With one exception, this is accomplished by treating the members of an affiliated group as a single organization for purposes of measuring both lobbying expenditures and permitted lobbying expenditures.⁴⁵

Therefore, if the expenditures of the group as a whole do not exceed the permitted limits, then each of the electing member organizations is treated as not exceeding the permitted limits. Conversely, if the expenditures of the group as a whole exceed the permitted limits, then each of the electing members is treated as having exceeded the limits and would pay tax on its proportionate share of the group's excess lobbying expenditures. Note, however, that only those members of the affiliated group that have made the IRC 501(h) election are subject to the tax, nonelecting members remain subject to the "no substantial part" test. Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, 1976-3 C.B. Vol. 2 at 423.

As will be discussed more fully below, membership in an affiliated group includes only IRC 501(c)(3) organizations that are eligible to make the IRC 501(h) election. Organizations described in other subparagraphs of IRC 501(c)(3) are not eligible for membership in an affiliated group even if they are affiliated within the meaning of IRC 4911(f)(2) with an eligible organization.

2. When are two organizations considered to be affiliated?

For purposes of the regulations under IRC 4911, two organizations are affiliated if one organization is able to control action on legislative issues by the other organization because of interlocking governing boards or because of provisions in the governing

⁴⁴ For example, a large organization, by dividing in two, would increase its overall cap from \$1 million to \$2 million. Because of declining percentages at higher levels, creating a second organization allows additional permitted lobbying expenditures for organizations whose exempt purpose expenditures exceed \$500,000. An organization with \$1 million of exempt purpose expenditures is permitted to have \$175,000 of total lobbying expenditures without incurring tax, but two organizations with \$500,000 of exempt purpose expenditures each would be permitted to have \$100,000 of total lobbying expenditures, for a total amount of \$200,000.

⁴⁵ The single exception to the general rule relates to members of a "limited affiliated group of organizations" (organizations that are affiliated solely by reason of governing instrument provisions that extend control solely with respect to national legislation). IRC 4911(f)(4) and Reg. 56.4911-10.

instruments of the controlled organization (subject to the limitation described in Reg. 56.4911-7(a)(2)).⁴⁶ The organizations are affiliated due to the ability of the controlling organization to control action on legislative issues by the controlled organization, not because such control is exercised. Reg. 56.4911-7(a)(1).

3. What is “action on legislative issues?”

Reg. 56.4911-7(a)(3) provides that the term “action on legislative issues” includes taking a position in the organization’s name on legislation, authorizing any person to take a position on legislation in the organization’s name, and authorizing lobbying expenditures. “Action

on legislative issues” does not include actions taken merely to correct unauthorized actions taken in the organization’s name.

4. What are “interlocking governing boards?”

Reg. 56.4911-7(b)(1) provides that, in general, two organizations have interlocking governing boards if one organization (the controlling organization) has a sufficient number of representatives on the governing board of the second organization (the controlled organization)

so that by aggregating their votes, the representatives of the controlling organization can cause or prevent action on legislative issues by the controlled organization. If two organizations have interlocking governing boards, the organizations are affiliated without regard to how or whether the representatives of the controlling organization vote on any particular matter.

Generally, Reg. 56.4911-7(b)(2) provides that the number of representatives of the controlling organization who are members of the controlled organization’s governing board will be presumed sufficient to cause or prevent action on legislative issues by the controlled organization if it either (1) constitutes a majority of incumbents on the governing board, or (2) constitutes a quorum, or is sufficient to prevent a quorum, for acting on legislative issues. However, if under the governing documents of the controlled organization, it can be determined that a lesser number of votes than the number described in Reg. 56.4911-7(b)(2) is necessary or sufficient to cause or to prevent action on legislative issues, a number of representatives of the controlling organization who are members of the controlled organization’s governing board that equals or exceeds that number will be considered sufficient to cause or prevent action on legislative issues. Reg. 56.4911-7(b)(3). Nevertheless, if the number of representatives of one organization is less than 15 percent of the incumbents on the governing board of a second organization, the two organizations are not affiliated by reason of interlocking governing boards. Reg. 56.4911-7(b)(4).

⁴⁶ The exception provided in Reg. 56.4911-7(a)(2) states that two organizations, neither of which is described in IRC 501(c)(3), are affiliated only if there exists at least one organization described in IRC 501(c)(3) that is affiliated with both organizations.

Furthermore, there is no affiliation through interlocking boards where the board consists of representatives of unrelated organizations, none of which satisfies the control tests. Therefore, where five unrelated organizations each appoint two members to the board of an organization, it is not affiliated with any of the five organizations due to interlocking governing boards. Reg. 56.4911-7(f), Example (2). This rule has been applied in situations involving national organizations that have boards consisting of delegates from separately incorporated state or regional associations. See PLR 91-45-039 (Aug. 14, 1991) and PLR 93-32-042 (May 19, 1993).

5. When are board members considered representatives of another organization?

There are three circumstances under which members of the governing board of the controlled organization are considered representatives of the controlling organization. The first occurs if the controlling organization has specifically designated that person to be a board member of the controlled organization. A board member of the controlled organization is specifically designated by the controlling organization if the board member is selected by virtue of the right of the controlling organization, under the governing instruments of the controlled organization, either to designate a person to be a member of the controlled organization's governing board, or to select a person for a position that entitles the holder of that position to be a member of the controlled organization's governing board. Reg. 56.4911-7(b)(5)(ii).⁴⁷ The second occurs when a member of the governing board of one organization serves on the governing board of a second organization. In this instance, the person is a representative of the second organization. Reg. 56.4911-7(b)(5)(iv). The third occurs when the board member is an officer or paid executive staff member of the other organization. In that situation, the person is a representative of the other organization. Although titles are significant in determining whether a person is a member of the executive staff of an organization, any employee of an organization who possesses authority commonly exercised by an executive is considered an executive staff member for these purposes. Reg. 56.4911-7(b)(5)(v).

6. What are the rules relating to governing instruments?

Reg. 56.4911-7(c) provides that the controlling organization is affiliated with the controlled organization due to the governing instruments of the controlled organization if those instruments limit the independent action of the controlled organization on legislative issues by requiring it to be bound by decisions of the controlling organization on such issues. Organizations also are affiliated if the controlled organization's governing instrument allows the controlling organization to veto positions on legislation that the controlled organization might take, even if the veto power is never exercised. Reg. 56.4911-7(f), Example (3).

⁴⁷ A board member of one organization who is specifically designated by a second organization, a majority of the governing board of which is made up of representatives of a third organization, is a representative of the third organization as well as being a representative of the second organization pursuant to the rules of Reg. 56.4911-7(b)(5)(ii). Reg. 56.4911-7(b)(5)(iii).

7. May board actions establish affiliation other than through amendments to the governing instrument?

To be affiliated under IRC 4911, two organizations must have interlocking boards or one organization must be bound by the other organization on legislative issues by provisions in its governing instruments. Assuming the organization does not have an interlocking board with another organization, actions by the organization's board of directors that do not

constitute amendments to its governing instrument will not establish affiliation under IRC 4911. This is discussed in Reg. 56.4911-7(f), Example (4), the governing board of an organization resolves to adopt positions taken on legislative issues by another organization. The two organizations are eligible organizations and do not have interlocking governing boards. The governing instruments of the first organization do not mention the other organization and do not indicate that the first organization is to be bound by the decisions on legislation of any organization. The two organizations are not affiliated under IRC 4911.

8. How are organizations that file a group return treated?

A determination that organizations are not affiliated for purposes of IRC 4911 does not indicate that those organizations are not affiliated for purposes of filing a group return. In PLR 91-45-039, (Aug. 14, 1991) the Service concluded that "affiliated" has a broader meaning

as used in Reg. 1.6033-2(d) than it does under IRC 4911. Therefore, the mere fact that organizations file a group return does not indicate that the organizations are affiliated under IRC 4911. Furthermore, a group return may be filed even if some of the organizations have made the IRC 501(h) election. However, pursuant to Reg. 56.4911-6, which sets out the record keeping requirements for electing organizations, the group return will include separate statements regarding each organization that has made the election. Furthermore, for purposes of determining the liability for tax under IRC 4911(a), a separate schedule on the group return must be completed for each organization (other than any that are part of an affiliated group under IRC 4911(f)) that has made the IRC 501(h) election. Each schedule must show the lobbying expenditures, the lobbying nontaxable amount, the grass roots expenditures, and the grass roots nontaxable amount for each electing organization. Computation of the IRC 4911 tax must be made for each such organization on Form 4720, *Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code*. The computation must be based only upon the amounts applicable to the individual organization; it may not be based upon the composite figures for the group. A separate Form 4720 must be filed for each electing organization with IRC 4911(a) tax liability.

9. May organizations be indirectly affiliated?

Yes, organizations may be indirectly affiliated either because they are controlled by the same controlling organization or because the controlling organization affiliated with one organization is a controlled organization affiliated with the other organization. When a controlling

organization is affiliated with each of two or more controlled organizations, then the controlled

organizations are affiliated with each other. Reg. 56.4911-7(d)(1). Therefore, if two or more organizations are controlled directly by the same controlling organization, they are affiliated with each other even if the method of control is different. Under the "chain rule" of Reg. 56.4911-7(d)(2), if one organization is a controlling organization described in this section with respect to a second organization and that second organization is a controlling organization with respect to a third organization, then the first organization is affiliated with the third. Again, the method of control does not need to be the same at each level of the chain for the organizations to be affiliated. See Reg. 56.4911-7(f), Example (6), for an illustration of these rules.

10. What happens if a controlling organization is not described in IRC 501(c)(3)?

The same affiliation rules would apply if the controlling organization is not described in IRC 501(c)(3) since organizations may be indirectly affiliated, as noted above. This situation is discussed in Reg. 56.4911-7(f), Example (7). In the example, an organization that is described in IRC 501(c)(4) is affiliated, as

the controlling organization, with two organizations that are described in IRC 501(c)(3) and are eligible to elect under IRC 501(h). The two IRC 501(c)(3) organizations are affiliated and will be an affiliated group if either makes an election under IRC 501(h). Even though the IRC 501(c)(4) organization is affiliated with the two IRC 501(c)(3) organizations, it is not a member of that affiliated group of organizations because it is not an eligible organization within the meaning of Reg. 1.501(h)-2(b)(1). The rules regarding an affiliated group of organizations are discussed immediately below.

ii. The Affiliated Group

1. What is an "affiliated group of organizations?"

For purposes of the anti-abuse rules of IRC 4911, Reg. 56.4911-7(e)(1) provides that an "affiliated group of organizations" consists of a group of organizations that meet each of the following conditions:

- (A) Each of the organizations is affiliated with every other member for at least thirty days of the taxable year of the affiliated group (determined without regard to the election provided for in Reg. 56.4911-7(e)(5));
- (B) Each of the organizations is eligible to elect the expenditure test; and
- (C) At least one of the organizations is an electing member organization.

Each organization in a group of organizations that satisfies the above requirements is a member of the affiliated group of organizations for the taxable year of the affiliated group.

2. May an organization be a member of more than one affiliated group?

Yes, an organization may have multiple affiliated group memberships. That is, for any taxable year of the organization, it may be a member of two or more affiliated groups of organizations. Reg. 56.4911-7(e)(2).

3. What is an "electing member organization?"

An "electing member organization" is an organization to which the expenditure test election applies on at least one day of the taxable year of the affiliated group of which it is a member. For these purposes, the election is not considered to apply to the organization on any day before the

date on which it files the Form 5768 making the IRC 501(h) election, notwithstanding Reg. 1.501(h)-2(a). Reg. 56.4911-7(e)(4).

4. What is the taxable year of an affiliated group?

There are three different rules that can apply here. The first rule is that if all members of an affiliated group have the same taxable year, that is the taxable year of the affiliated group. The second rule applies when the members of an affiliated group do not all have the same taxable

year. In that case, the taxable year of the affiliated group is the calendar year. Reg. 56.4911-7(e)(3). A third rule applies when all the members elect to be covered by the provisions of Reg. 56.4911-7(e)(5). Under Reg. 56.4911-7(e)(5), each member organization treats its own taxable year as the taxable year of the affiliated group. The election may be made by an electing member organization by attaching to its annual return a statement from itself and every other member of the affiliated group that contains: the organization's name, address, and employer identification number; and its signed consent to the election. The election must be made no later than the due date of the first annual return of any electing member for its taxable year for which the member is liable for tax under IRC 4911(a), determined under Reg. 56.4911-8(d). The election may not be made or revoked after the due date of the return except upon such terms and conditions as the Commissioner may prescribe.

5. Is there an exception for "self-defense"?

Yes, Reg. 56.4911-2(c)(4)(ii) provides that the "self-defense" exception applies to a communication by a member of an affiliated group of organizations (within the meaning of Reg. 56.4911-7(e)) that is an appearance before, or communication with, a legislative body with

respect to a possible action by the body that might affect the existence of any other member of the affiliated group, its powers and duties, its tax-exempt status, or the deductibility of contributions to it. Therefore, such communications will not be considered lobbying communications.

6. Is there a special membership communication rule?

Yes, for purposes of the member communication rules of Reg. 56.4911-5, a person who is a member of an organization that is a member of an affiliated group is treated as a member of each organization in the affiliated group. Reg. 56.4911-5(f)(3).

iii. Excess Lobbying Expenditures

1. How is an affiliated group treated for purposes of the IRC 4911 tax?

Under IRC 4911(f), an affiliated group of organizations is treated as one organization for purposes of the IRC 4911(a) tax. Thus, the affiliated group's direct lobbying expenditures, grass roots lobbying expenditures, and exempt purpose expenditures are equal to the sum of such expenditures paid or incurred during the taxable year by each member of the affiliated group. Similarly, the lobbying and grass roots nontaxable amounts for the affiliated group are determined under the rules of IRC 4911(c)(2) and IRC 4911(c)(4) based on the sum of the group's exempt purpose expenditures. The group's lobbying and grass roots ceiling amounts are then calculated under the IRC 501(h) regulations. Reg. 56.4911-8(b).

2. When is the IRC 4911 tax imposed on an affiliated group?

The tax under IRC 4911(a) is imposed on an affiliated group if the group has excess lobbying expenditures. Reg. 56.4911-8(c) provides that the affiliated group's excess lobbying expenditures for any taxable year are the greater of the following amounts:

- (A) The amount by which the group's lobbying expenditures exceed the group's lobbying nontaxable amount; or
- (B) The amount by which the group's grass roots expenditures exceed the group's grass roots nontaxable amount.

3. What is the tax liability of an electing member?

Reg. 56.4911-8(d) provides three rules for allocating the IRC 4911(a) tax between the electing member organizations of an affiliated group. Each electing member organization is liable for all or a portion of the tax, but no member of the affiliated group that has not made an IRC 501(h) election is liable for any portion of the tax with respect to the affiliated group, even if they made direct or grass roots lobbying expenditures.

The first rule applies when the affiliated group's excess lobbying expenditures equal the amount determined under Reg. 56.4911-8(c)(1) and at least one electing member has made

lobbying expenditures. Each electing member organization is liable for a portion of the tax equal to the amount of the tax multiplied by a fraction, the numerator of which is the electing member organization's lobbying expenditures paid or incurred during the taxable year of the affiliated group, and the denominator of which is the sum of the lobbying expenditures of all electing member organizations in the group paid or incurred during the taxable year of the affiliated group. Reg. 56.4911-8(d)(2)

The second rule applies when the affiliated group's excess lobbying expenditures equal the amount determined under Reg. 56.4911-8(c)(2) and at least one electing member has made grass roots expenditures. The same rule is applied as described above, except that "grass roots expenditures" is substituted for "lobbying expenditures." Reg. 56.4911-8(d)(3).

The third rule applies when the affiliated group has excess lobbying expenditures, but no electing organization has made either lobbying or grass roots expenditures. Each electing member organization is liable for a portion of the tax equal to the amount of tax multiplied by a fraction, the numerator of which is the electing member organization's exempt purpose expenditures and the denominator of which is the exempt purpose expenditures of all the electing member organizations in the affiliated group. Reg. 56.4911-8(d)(4).

4. When is an organization liable for the tax?

Pursuant to Reg. 56.4911-8(d)(5), an electing member organization liable for the IRC 4911 tax of an affiliated group is liable for the tax as if the tax were imposed for its taxable year with which or in which the taxable year of the affiliated group ends.

5. What if an organization is a member of two groups having excess lobbying expenditures?

When an organization is a member of two or more affiliated groups and is liable for the IRC 4911 tax during a taxable year for the excess lobbying expenditures of more than one group, then the organization is liable only for the greater tax. Reg. 56.4911-8(d)(6).

6. What happens when a member organization ceases to be a member of a group?

An electing member organization that ceases to be a member of an affiliated group of organizations that had a taxable year different from its own, must thereafter determine its liability under Reg. 56.4911-1 for the IRC 4911 tax as if its taxable year were the taxable year of the affiliated group of which it was formerly a

member. An organization to which this rule applies that is liable for the IRC 4911 tax is liable as if the tax were imposed for its taxable year in which ends the taxable year of the affiliated group of which it was formerly a member. The Commissioner may, at the Commissioner's discretion, permit an organization to disregard this rule and to determine any liability under IRC 4911(a) based upon its own taxable year. Reg. 56.4911-8(e).

iv. Application of IRC 501(h)

1. When might affiliated group members lose exempt status?

As with the calculation of IRC 4911 tax, affiliated groups are treated as one entity for purposes of determining whether members are denied exemption as organizations described in IRC 501(c)(3) pursuant to IRC 501(h). If, for a taxable year of an affiliated group, it is determined that the sum of the affiliated group's lobbying or grass roots expenditures for the group's base years exceeds 150 percent of the sum of the group's nontaxable amounts for the base years, then each member that was an electing member organization at any time in the taxable year shall be denied tax exemption beginning with its first taxable year beginning after the end of the taxable year of the affiliated group. Thereafter, exemption shall be denied unless the organization reapplies and is recognized as exempt as an organization described in IRC 501(c)(3). For purposes of this section, the term "base years" generally means the taxable year of the affiliated group for which a determination is made and the group's three preceding taxable years. Base years, however, do not include any year preceding the first year in which at least one member of the group was treated as described in IRC 501(c)(3). Reg. 56.4911-9(b).

2. What happens to a nonelecting member of an affiliated group?

An organization that is a member of an affiliated group of organizations but that is not an electing member organization remains subject to the "substantial part test" described in IRC 501(c)(3) with respect to its activities involving attempts to influence legislation. Reg. 56.4911-9(c).

3. What are the filing requirements?

The filing requirements for affiliated groups are set forth in Reg. 56.4911-9(c) and apply to each member of the group for the taxable year of the member in which ends the taxable year of the affiliated group. Each member of the group must provide to every other member, before the first day of the second month following the close of the affiliated group's taxable year, its name, identification number, and the information required under the reporting rules of Reg. 1.6033-2(a)(2)(ii)(k) for its expenditures during the group's taxable year and for prior taxable years of the group that are base years. For groups that elect under Reg. 56.4911-7(e)(5) to have each member file information with respect to the group based on its taxable year, each member shall provide the above information, treating each taxable year of any member of the group as a taxable year for the group. In addition to the information required by the reporting rules of Reg. 1.6033-2(a)(2)(ii)(k), each member of the group must provide on its annual information return the group's taxable year and, if the election under Reg. 56.4911-7(e)(5) is made, the name, identification number, and taxable year identifying the return with which its consent to the election was filed. Furthermore, in addition to the

information required above, each electing member organization must provide the following on its annual return:

- (A) The name and identification number of each member of the group, and
- (B) The calculation of the group's excess lobbying expenditures if the organization is liable for all or any portion of the IRC 4911 tax.

4. How are these rules applied?

Reg. 56.4911-9(e) provides an example illustrating the application of IRC 501(h) to an affiliated group of organizations, M, N, and O. M and O filed IRC 501(h) elections in 1979 and have not revoked them. N did not make an

IRC 501(h) election. M's taxable year ends November 30, N's taxable year ends January 31, and O's taxable year ends June 30. Since the organizations have different taxable years, the calendar year is the taxable year of the group. The following tables summarize the group's expenditures for the calendar years indicated. (None of the lobbying expenditures were for grass roots lobbying.)

Table I. Group's Expenditures

Year	Exempt purpose expenditures (EPE)	Calculation	Lobbying nontaxable amount (LNTA)	Lobbying expenditures (LE)
1979	\$400,000	(20% of \$400,000 =)	\$80,000	\$100,000
1980	300,000	(20% of \$300,000 =)	60,000	100,000
1981	600,000	(20% of \$500,000 + 15% of \$100,000 =)	115,000	120,000
1982	500,000	(20% of \$500,000 =)	100,000	220,000
Total	1,800,000		355,000	540,000

Table II. Expenditures of M and O

Year	Exempt purpose expenditures		Lobbying nontaxable amount		Lobbying expenditures		M plus O
	M	O	M	O	M	O	
1979	125,000	100,000	25,000	20,000	60,000	20,000	80,000
1980	100,000	50,000	20,000	10,000	40,000	40,000	80,000
1981	250,000	100,000	50,000	20,000	60,000	40,000	100,000
1982	200,000	100,000	40,000	20,000	160,000	40,000	200,000

The affiliated group had excess lobbying expenditures in each of the years shown and M and O are liable for the IRC 4911 tax. The tax is allocated between M and O based on the ratio of their lobbying expenditures for the year to the total lobbying expenditures the two of them incurred. N is not liable for any tax under IRC 4911. For 1979, the tax due is \$5,000 (25% of \$20,000). M is liable for \$3,750 and O is liable for \$1,250. For 1980, the tax is \$10,000 and each owe \$5,000. For 1981, M is liable for \$750 and O is liable for \$500. For 1982, M is liable

for \$24,000 and O is liable for \$6,000. In 1982, the sum of group's lobbying expenditures for the base years (1979 through 1982) exceeded 150 percent of the sum of the group's lobbying nontaxable amounts for those years (\$532,500). Therefore, M and O are denied exemption as IRC 501(c)(3) organizations for their taxable years beginning in 1983 (beginning December 1, 1983 for M and July 1, 1983 for O). Whether N's lobbying expenditures disqualify it for tax exemption at any time after January 1, 1979, is determined under the substantial part test of IRC 501(c)(3).

v. Limited Affiliated Groups

1. What is a limited affiliated group of organizations?

IRC 4911(f)(4) provides for an exception to the general rules applicable to affiliated groups for certain limited affiliated groups of organizations. Reg. 56.4911-10(b) provides that a limited affiliated group of organizations consists of two or more organizations that meet each of

the following requirements:

- (A) Each organization is a member of an affiliated group of organizations;
- (B) No two members of the affiliated group are affiliated by reason of interlocking governing boards;⁴⁸ and
- (C) No member of the affiliated group is, under its governing instrument, bound by decisions of one or more of the other such members on legislative issues other than national legislative issues.

Each organization in an affiliated group of organizations that satisfies all three of these requirements is a member of the limited affiliated group. However, if any of these requirements are not met, the organizations will not be a limited affiliated group. Even if some organizations within the group would meet all three requirements, those organizations would not constitute a limited affiliated group if any organization within the group did not meet all three requirements. Reg. 56.4911-10(h), Example (6), illustrates this rule.

2. What is a "national legislative issue?"

Reg. 56.4911-10(g) provides that the term "national legislative issue" means legislation, limited to action by the Congress of the United States or by the public in any national procedure. If an issue is both national and local, it is characterized as a national legislative issue if the

contemplated legislation is Congressional legislation.

⁴⁸ See Reg. 56.4911-10(h), Example (5).

Reg. 56.4911-10(h), Examples (1) and (2) illustrate “national legislative issues.” In Example (1), a state has an income tax law that uses definitions contained in the Code as it may be amended from time to time. Legislation to change a definition in the Code is pending in Congress. This is a national legislative issue even though Congressional action may affect state law. However, in Example (2), an organization takes a position favoring approval by Congress of a proposed amendment to the United States Constitution. This is a national legislative issue. After approval by Congress and submission to the states for ratification, the proposed amendment ceases to be a national legislative issue.

3. What is “controlling member organization” and “controlled member organization?”

Reg. 56.4911-10(c) provides that a member of a limited affiliated group is a “controlling member organization” if it controls one or more of the other members of the group. A member is a “controlled member organization” if it is controlled by one or more of the other members of the group. Whether an organization

controls a second organization shall be determined by whether the second organization is bound, under its governing instruments, by actions taken by the first organization on national legislative issues.

4. How are expenditures determined for “controlling” and “controlled” members?

Expenditures for a controlling member organization that has made an election under IRC 501(h) are determined in accordance with the rules set forth in Reg. 56.4911-10(d), even if the organization is also a controlled member organization. In determining a controlling member organization’s expenditures, no

expenditure shall be counted twice. The direct lobbying expenditures of a controlling member organization that has made the IRC 501(h) election include the direct lobbying expenditures paid or incurred with respect to national legislative issues during the taxable year by each organization that is a member of the limited affiliated group and is controlled by the controlling member organization. Similarly, the grass roots lobbying expenditures of the controlling member organization include the grass roots lobbying expenditures of the controlled member organizations. However, the controlling member organization’s exempt purpose expenditures do not include the exempt purpose expenditures (other than lobbying expenditures with respect to national legislative issues) of any organization that is a controlled member organization with respect to it.

A controlled member organization that has made an IRC 501(h) election but does not control any organization in the limited affiliated group determines its lobbying expenditures based on its own expenditures without regarding the expenditures of any other member of the limited affiliated group. Reg. 56.4911-10(e).

Reg. 56.4911-10(h), Example (3), illustrates these rules regarding determination of expenditures. The example concerns three organizations that constitute a limited affiliated group, all of whom have made the IRC 501(h) election. One of the controlled organizations engages

in direct lobbying on a national legislative issue. This cost is included in the direct lobbying and the exempt purpose expenditures of both the controlling and that controlled organization, but will not be included in the lobbying or exempt purpose expenditures of the other controlled organization. The controlling organization also engages in direct lobbying on the same issue, but the cost of hiring the lobbyist is includible only in the controlling organization's lobbying expenditures. Any lobbying expenditures incurred by either controlled organization on any issue that is not a national legislative issue will not be included in the controlling organization's lobbying or exempt purpose expenditures.

5. What information must be reported by a controlling member organization?

In addition to the information required by Reg. 1.6033-2(a)(2)(ii)(k), each controlling member organization that has made an election under IRC 501(h) must provide on its annual return the name and identification number of each member of the limited affiliated group. Reg. 56.4911-10(f)(1). Furthermore, each

controlling member organization that has made the IRC 501(h) election must notify each member that it controls of its taxable year in order for the controlled organization to prepare the report required by Reg. 56.4911-10(f)(3).⁴⁹ Such notification must be made before the beginning of the second month after the close of each taxable year of the controlling member for which the election is in effect. Reg. 56.4911-10(f)(2).

6. Is there a "self-defense" exception?

Yes, Reg. 56.4911-2(c)(4)(iv) provides that the "self-defense" exception applies to a communication by an electing public charity that is a member of a limited affiliated group if it is an appearance before, or communication with, the Congress of the United States with respect to a

possible action by the Congress that might affect the existence of any member of the limited affiliated group, its powers and duties, tax-exempt status, or the deductibility of contributions to it.

7. Is there a membership communication rule?

Yes, Reg. 56.4911-5(f)(4) provides that a member of an organization that is a member of a limited affiliated group are treated as members of each organization in the limited affiliated group, but only with respect to national legislative issues.

⁴⁹ Reg. 56.4911-10(f)(3) requires every controlled member organization (whether or not the expenditure test election is in effect with respect to it) to provide to each member of the limited affiliated group that controls it, before the first day of the second month following the close of the taxable year of each such controlling organization, its name, identification number, and both the lobbying expenditures and grass roots expenditures on national legislative issues incurred by the controlled member organization.

4. Lobbying Activities of IRC 501(c)(3) Private Foundations

A. Legislative and Regulatory History

In the Tax Reform Act of 1969, Congress created the distinction between private foundations and public charities and imposed a number of excise taxes on certain activities of private foundations. One of these provisions is an excise tax on the taxable expenditures of private foundations and on foundation managers who agree to the making of the taxable expenditure. IRC 4945. A taxable expenditure includes any amount paid or incurred by a private foundation to carry on propaganda, or otherwise to attempt, to influence legislation, as well as certain political campaign expenditures and grants to individuals and organizations. IRC 4945(d). Taxes on these types of private foundation expenditures did not seem likely when the House Committee on Ways and Means began its hearings on private foundation activities since the Chairman's press release, which outlined the hearings' agenda, made no mention of this kind of activity. Tax Reform 1969: Hearings Before the House Comm. on Ways and Means, 91st Cong., 1st Sess. 3-11 (1969) (press release of Chairman Wilbur D. Mills). However, testimony given almost at the outset of the hearings raised the specter of private foundation involvement in the political process generally (although nothing specific was alleged about the lobbying activities of private foundations), as well as raising concerns about various grants made to individuals by private foundations. For example, the President of the Ford Foundation became embroiled in a lengthy and often acrimonious discussion with various Committee members over both the Foundation's granting "Travel & Study Awards" to members of Senator Robert Kennedy's staff following his assassination and its involvement in political campaign activities including an extremely controversial school decentralization experiment in Brooklyn that included an election and the Foundation's financing of voter registration drives in Cleveland before the election of Mayor Carl B. Stokes.⁵⁰ *Id.* at 354-431 (statement and testimony of Mr. McGeorge Bundy). To a considerable extent, those incidents seem to have impelled enactment of IRC 4945(d).

The Staff of the Joint Committee on Internal Revenue Taxation, in its General Explanation of the Tax Reform Act of 1969, 48 (1969), explained the reasons for enactment of IRC 4945, and for the inclusion of lobbying activity as a taxable expenditure, as follows:

The Congress concluded that more effective limitations must be placed on the extent to which tax-deductible and tax-exempt funds can be dispensed by private persons and that these limitations must involve more effective sanctions. Accordingly, the Congress determined that a tax should be imposed upon expenditures by private foundations for activities that should not be carried on by exempt organizations (such as lobbying, electioneering and "grass roots" campaigning). The Congress also believes that granting

⁵⁰ Although no activities that would be characterized as lobbying for IRC 501(c)(3) purposes were discussed during Mr. Bundy's testimony, there was some concern expressed regarding influencing members of Congress through payment of their travel and other expenses, such as when the Ford Foundation made a grant to sponsor a Japanese-American Assembly in Japan attended by several members of Congress.

foundations should take substantial responsibility for the proper use of funds that they give away.

In general, the Congress' decisions reflect the concept that private foundations are stewards of public trusts and their assets are no longer in the same status as assets of individuals who may dispose of their own money in any lawful way they see fit.

Regulations implementing the provisions of IRC 4945(d)(1) were proposed in 1971 (36 FR 5357 (Mar. 20, 1971)) and adopted the next year. T.D. 7215, 37 FR 23161 (Oct. 31, 1972). The regulations were amended by T.D. 8308, 55 FR 35579 (Aug. 31, 1990).

However, even though private foundations are subject to tax on their lobbying expenditures, they remain subject to the "no substantial part" test for determining whether they retain their exempt status. Staff of the Joint Committee on Internal Revenue Taxation, General Explanation of the Tax Reform Act of 1969, 49 n. 21 (1969).

B. Specific Issues

1. What is the tax on lobbying by private foundations?

Pursuant to IRC 4945(d)(1), any amount paid or incurred by a private foundation to carry on propaganda, or otherwise to attempt, to influence legislation is a taxable expenditure. IRC 4945 imposes on the private foundation an initial tax equal to 10 percent of the taxable

expenditure and an additional 100 percent tax on taxable expenditures that are not corrected within the taxable period. In addition, an initial tax equal to 2½ percent of the taxable expenditure is imposed on foundation managers who knowingly agreed to the making of the taxable expenditure. Any foundation managers who refuse to agree to all or part of the correction are subject to a tax equal to 50 percent of the taxable expenditure.

2. What is "attempt to influence legislation" under IRC 4945?

Generally, the rules for determining what is an attempt to influence legislation for purposes of IRC 4945 are the same rules as for electing public charities, as are the exceptions. Where there are different, or additional, rules for private foundations, these are noted below.

3. Is there a membership communication rule?

No, Reg. 56.4911-5, which provides rules for electing public charities' communications with their members, does not apply to private foundations. Consequently, whether a private foundation's communications with its members (assuming it has any) are lobbying

communications is determined solely under the general rules enunciated under Reg. 56.4911-2. However, where a private foundation makes a grant to an electing public charity, the membership

rules apply to the electing public charity's communications with its own members. Therefore, in the limited context of determining whether a private foundation's grant to an electing public charity is a taxable expenditure, the membership rules apply. For example, a grant is not a taxable expenditure when it is specifically earmarked for a communication from an electing public charity to its members that is not considered lobbying because of the membership rules. Reg. 53.4945-2(a)(2).

4. What are the rules relating to jointly funded projects?

Reg. 53.4945-2(a)(2) provides that a private foundation will not be treated as having made a taxable expenditure merely because it makes a grant conditional upon the recipient obtaining a matching support appropriation from a governmental body. Furthermore, a private

foundation will not be treated as making taxable expenditures for carrying on discussions with officials of governmental bodies that meet the following requirements:

- (A) The subject of the discussions is a program that is or may be jointly funded by the foundation and the government;
- (B) The discussions are undertaken for the purpose of exchanging data and information on the program's subject matter; and
- (C) The discussions are not undertaken in order to make any direct attempt to persuade governmental officials to take particular positions on specific legislative issues other than the program.

5. Is lobbying by the recipient of a program-related investment attributed to the foundation?

Private foundations often make "program-related investments" (investments described in IRC 4944(c) and Reg. 53.4944-3). Reg. 53.4945-2(a)(4) provides that any amount paid or incurred by program-related investment recipients in connection with an appearance before, or communication with, any legislative

body with respect to legislation or proposed legislation of direct interest to the recipient shall not be attributed to the investing foundation, if the following conditions are met:

- (A) The foundation does not earmark its funds to be used for any activities that constitute attempting to influence legislation; and
- (B) A business expense deduction under IRC 162 is allowable to the recipient for such amount.⁵¹

⁵¹ Note, however, that IRC 162(e), as amended by OBRA 1993, now disallows most business expense deductions for amounts paid or incurred in connection with influencing legislation.

6. What is the rule for general support grants?

A general support grant by a private foundation to a “public charity” (organizations described in IRC 509(a)(1), IRC 509(a)(2), or IRC 509(a)(3)) is not a taxable expenditure if the grant is not earmarked to be used in an attempt to influence legislation, regardless of whether the

public charity has made the IRC 501(h) election. Reg. 53.4945-2(a)(6)(i). One example of where this rule applies is when a public charity that has received a general support grant informs the grantor foundation that, as an insubstantial portion of its activities, it attempts to influence the State legislature with regard to changes in the mental health laws. The use of the grant is not earmarked for the legislative activities of the public charity. The grant is not a taxable expenditure even if it is subsequently used by the public charity in its legislative activities. Reg. 53.4945-2(a)(7)(ii), Example (1).

7. What is the rule for specific project grants?

A grant by a private foundation to fund a specific project of a public charity is not a taxable expenditure, even if the public charity engages in lobbying activities as part of the project, to the extent that each of the following requirements are met:

- (A) The grant is not earmarked to be used in an attempt to influence legislation; and
- (B) The sum of all grants made by the private foundation for the same project for the same year, does not exceed the amount budgeted, for the year of the grant, by the grantee organization for activities of the project that are not attempts to influence legislation.

For example, a private foundation makes a specific project grant of \$150,000 to a public charity. In requesting the grant, the public charity stated that the total budgeted cost of the project is \$200,000, of which \$20,000 is allocated to attempts to influence legislation related to the project. The private foundation relied on the budget figures provided and had no reason to doubt their accuracy or reliability. The private foundation does not earmark any of the funds from the grant to be used for attempts to influence legislation, so the grant is not a taxable expenditure under IRC 4945(d)(1) because the amount of the grant does not exceed the amount allocated to specific project activities that are not attempts to influence legislation. Reg. 53.4945-2(a)(7)(ii), Example (3). Even if the grant letter to the public charity provides that the private foundation has the right to renegotiate the terms of the grant if there is a substantial deviation from those terms, this additional fact would not make the grant a taxable expenditure. Reg. 53.4945-2(a)(7)(ii), Example (4). However, if the specific project grant is \$200,000, rather than \$150,000, part of the grant would be a taxable expenditure under IRC 4945(d)(1) because the amount of the grant exceeds by \$20,000 the amount the public charity allocated to specific project activities that are not attempts to influence legislation. Therefore, the private foundation has made a taxable expenditure of \$20,000. Reg. 53.4945-2(a)(7)(ii), Example (5).

8. What is the rule for multi-year specific project grants?

If the grant is for more than one year, the rule applies to each year of the grant with the amount of the grant measured by the amount actually disbursed by the private foundation in each year or divided equally between years, at the option of the private foundation. The same method of measuring the annual amount must be

used in all years of a grant. As with the rule for general support grants, this rule applies regardless of whether the public charity has made the IRC 501(h) election. Reg. 53.4945-2(a)(6)(ii).⁵²

Reg. 53.4945-2(a)(7)(ii), Example (11), discusses a private foundation makes a specific project grant of \$300,000 to a public charity for a three-year specific project studying child care problems. The private charity provides budget material indicating that the specific project will expend \$200,000 in each of three years, with lobbying expenditures of \$10,000 in the first year, \$20,000 in the second year and \$100,000 in the third year. The private foundation pays \$200,000 in the first year, \$50,000 in the second year and \$50,000 in the third year. The amount actually disbursed by the private foundation in the first year exceeds the nonlobbying expenditures of the public charity in that year. However, because the amount of the grant in each of the three years, when divided equally among the three years is not more than the nonlobbying expenditures of the public charity on the specific project for any of the three years, none of the grant is treated as a taxable expenditure.

A less happy scenario is set forth in Reg. 53.4945-2(a)(7)(ii), Example (13), where a private foundation makes a \$120,000 specific project grant to a public charity for a three-year project. The private foundation intends to pay the grant in three equal annual installments. The public charity provides budget material indicating that the specific project will expend \$100,000 each year, of which the project's lobbying expenditures will be \$50,000 each year. After the private foundation pays the first annual installment, but before it pays the second installment, reliable information comes to its attention that the public charity has spent \$90,000 of the project's \$100,000 first-year budget on lobbying expenditures, causing the private foundation to doubt the accuracy and reliability of the budget materials. The private foundation nevertheless pays the second-year installment. In the project's second year, the public charity once again spends \$90,000 on lobbying expenditures. Because the private foundation doubts or reasonably should doubt the accuracy or reliability of the budget materials when it makes the second-year grant payment, it may not rely upon the budget documents at that time. Accordingly, although none of the first installment is a taxable expenditure, only \$10,000 of the second-year grant

⁵² Reg. 53.4945-2(a)(6)(iii) provides that for purposes of determining the amount budgeted by a prospective grantee for specific project activities that are not attempts to influence legislation, a private foundation may rely on budget documents or other sufficient evidence supplied by the grantee organization (such as a signed statement by an authorized officer, director or trustee of such grantee organization) showing the proposed budget of the specific project, unless the private foundation doubts or, in light of all the facts and circumstances, reasonably should doubt the accuracy or reliability of the documents.

payment is not a taxable expenditure. The remaining \$30,000 of the second installment is a taxable expenditure.

9. What happens if the grantee public charity loses its exempt status due to lobbying?

Reg. 53.4945-2(a)(7)(i) provides that a grant to a public charity that subsequently ceases to be described in IRC 501(c)(3) due to its attempts to influence legislation will not be considered a taxable expenditure provided the following conditions are met:

- (A) The grant meets the requirements of the rules relating to general support grants and specific project grants;
- (B) The grantee had received a ruling or determination letter, or an advance ruling or determination letter, that it a public charity;
- (C) Notice of a change in the grantee's status has not been made to the public, and the private foundation has not acquired knowledge that the Service has given notice to the grantee of a change in status; and
- (D) The grantee is not controlled by the private foundation.⁵³

5. Lobbying and Tax-Exempt Organizations Not Described in IRC 501(c)(3)

1. What restrictions are imposed on the amount of lobbying by IRC 501(c) organizations?

Unlike IRC 501(c)(3) organizations, other organizations described in IRC 501(c) may engage in an unlimited amount of lobbying, provided that such lobbying is related to the organization's exempt purpose. The Service enunciated this principle in Rev. Rul. 61-177, 1961-2 C.B. 117, which holds that a corporation

that was organized and operated primarily for the purpose of promoting a common business interest is exempt under IRC 501(c)(6) even though its sole activity is influencing legislation germane to such common business interest. Rev. Rul. 61-177 notes that there is no requirement, by statute or regulations, that a business league or chamber of commerce must refrain from lobbying activities to qualify for exemption.

The rule set forth in Rev. Rul 61-177 applies to organizations described in the other subparagraphs of IRC 501(c). Outside of IRC 501(c)(3), there is no explicit statutory restriction on lobbying in IRC 501(c). As far as the regulations are concerned, the only mention of lobbying is positive. Reg. 1.501(c)(4)-1(a)(2)(ii) provides that a social welfare organization may

⁵³ A grantee organization is controlled by a private foundation for this purpose if the private foundation and its disqualified persons (as defined in IRC 4946(a)(1)), by aggregating their votes or positions of authority, can cause or prevent action on legislative issues by the grantee. Reg. 53.4945-2(a)(7)(i)(D).

qualify under IRC 501(c)(4) even though its activities are described in the “action organization” regulations, provided that it otherwise meets the IRC 501(c)(4) qualification requirements. See also, Rev. Rul. 67-6, 1967-1 C.B. 135; Rev. Rul. 67-293, 1967-2 C.B. 185; Rev. Rul. 68-656, 1968-2 C.B. 216; Rev. Rul. 71-530, 1970-2 C.B. 237; Rev. Rul. 76-81, 1976-1 C.B. 156; and G.C.M. 31864 (Aug. 21, 1961). In determining whether lobbying is allowable under the other subparagraphs of IRC 501(c), Slee lives.

2. Why must lobbying be related to the organization’s exempt purposes?

The exempt status of an organization under IRC 501(c) depends upon whether its activities are consistent with the exempt purposes described in the subparagraph of IRC 501(c) under which it qualifies. The requirements imposed under the various subparagraphs of IRC 501(c) differ extensively. For example, an

organization may continue to qualify for exemption under IRC 501(c)(4) so long as it is **primarily** engaged in promoting in some way the common good and general welfare of the people in the community. Reg. 1.501(c)(4)-2(i). Therefore, an IRC 501(c)(4) organization could engage in a substantial amount of lobbying on other matters without affecting its exempt status. At the other extreme are IRC 501(c)(2) title holding companies, which, under the terms of the statute, are limited to “the **exclusive** purpose of holding title to property, collecting income therefrom, and turning over the proceeds” to another exempt organization. Any lobbying by an IRC 501(c)(2) organization, therefore, would defeat its exempt status, unless, perhaps, the purpose of the lobbying was to preserve the exempt status of such title holders. (An unlikely possibility, since the IRC 501(c)(2) exemption has remained undisturbed since its enactment in 1916.)

3. May an IRC 501(c)(3) organization have a related IRC 501(c)(4) lobbying organization?

Yes, this is a rather common occurrence. So long as the organizations are kept separate (with appropriate record keeping and fair market reimbursement for facilities and services), the activities of an IRC 501(c)(4) organization will not jeopardize the related IRC 501(c)(3) organization’s exempt status. The ability of an IRC 501(c)(3) organization to establish a related

IRC 501(c)(4) lobbying organization was an important factor in the concurring opinion of Regan v. Taxation with Representation of Washington, 461 U.S. 540 (1983), in which the Supreme Court upheld the prohibition on substantial lobbying by IRC 501(c)(3) organizations. Taxation with Representation of Washington was the successor to two other organizations, an IRC 501(c)(3) organization and a related IRC 501(c)(4) organization, that applied for recognition of exemption from federal income tax as an organization described in IRC 501(c)(3). It was denied because it proposed to engage in substantial lobbying activity, although it would have qualified as an IRC 501(c)(4) organization.

This structure does raise issues regarding whether the resources of the IRC 501(c)(3) organization are used to subsidize lobbying activities of the IRC 501(c)(4) organization, particularly in situations where the two organizations share staff, facilities or other expenses or in which the two organizations conduct joint activities requiring an allocation of income and

expenses. Any allocation of income or expenses between the two organizations must be carefully reviewed to ensure that the allocation method is appropriate and that an arms' length standard is utilized. The determination of whether the method used is appropriate is based upon all the facts and circumstances.

4. May an organization that loses IRC 501(c)(3) status due to lobbying qualify as an IRC 501(c)(4) organization?

IRC 504(a) precludes an organization that has lost its IRC 501(c)(3) status due to attempts to influence legislation from qualifying as an IRC 501(c)(4) organization. In addition, an organization prohibited from qualifying as an IRC 501(c)(4) organization by IRC 504 may not be treated as any IRC 501(c) organization, except for IRC 501(c)(3). Reg. 1.504-1. Therefore, the

only route that an organization revoked for excessive lobbying may take to return to exempt status is to reapply for recognition of exempt status under IRC 501(c)(3). The one exception to this rule is for churches and church-related organizations that are ineligible to make an IRC 501(h) election because they are described in IRC 501(h)(5) and Reg. 1.501(h)-2(b)(3). IRC 504(c); Reg. 1.504-1.

5. May an IRC 501(c)(3) organization that anticipates loss of its status convert to an IRC 501(c)(4) organization?

IRC 504(b) authorized the Secretary of the Treasury to prescribe regulations to prevent avoidance of this rule, including avoidance by transferring all or part of the assets of an IRC 501(c)(3) organization to an organization that is controlled by the same persons who control the IRC 501(c)(3) organization. These regulations are set forth in Reg. 1.504-2. In determining

whether an organization has attempted to avoid IRC 504 by transferring any of its assets, the term "transfer" includes any use by, or for the benefit of, the recipient, except transfers made for adequate and full consideration. Generally, a transfer that involves the following five elements will cause loss of exemption to the recipient:

- (A) The transfer is from an IRC 501(c)(3) organization that is determined to be an "action" organization or is denied exemption by IRC 501(h);
- (B) At the time of the transfer or at any time during the recipient's next ten taxable years, the recipient is controlled (directly or indirectly) by the same persons who control the transferor;⁵⁴

⁵⁴ For these purposes, the transferor will be presumed to control any organization with which it is affiliated within the meaning of Reg. 56.4911-7(a) (or would be if both organizations were described in IRC 501(c)(3)), and the recipient will be treated as controlled (directly or indirectly) by the same persons who control the transferor if the recipient would be treated as controlled under the private foundation qualifying distribution rules (Reg. 53.4942(a)-3(a)(3)) if the transferor were a private foundation. Reg. 1.504-2(f).

- (C) The transfer is made (1) after the date that is 24 months before the earliest of the effective date of the determination IRC 501(h) that the transferor is not exempt, the effective date of the Commissioner’s determination that the transferor is an “action” organization, or the date on which the Commissioner proposes to treat it as no longer described in IRC 501(c)(3), and (2) before the transferor again is recognized as an organization described in IRC 501(c)(3);
- (D) The recipient is exempt from tax under IRC 501(a) but is neither an organization described in IRC 501(c)(3), nor a qualified pension plan described in IRC 401(a) to which the transferor contributes as an employer; and
- (E) The amount of the transfer exceeds the lesser of 30 percent of the net fair market value of the transferor’s assets or 50 percent of the net fair market value of the recipient’s assets, computed immediately before the transfer.⁵⁵

Furthermore, even if the transferor and recipient are not commonly controlled, or the amount of the transfer is less than the amount set forth in the fifth element above, or the recipient is eligible to elect the expenditure test, the Commissioner may determine, based on all the facts and circumstances, that the transfer was made to avoid IRC 504(a). In that case, the recipient will cease to be exempt under IRC 501(a). One fact the Commissioner may consider is whether the recipient engages, or has engaged, in attempts to influence legislation. The Commissioner may also consider any factors enumerated in the special exception described below. Reg. 1.504-2(c).

6. Is there any exception to this transfer rule?

The Commissioner may determine, based on all the facts and circumstances, that a transfer that does meet the five elements set forth above was not made to avoid IRC 504 and the recipient will not be denied exemption. Reg. 1.504-2(e). In making this determination, the Commissioner

may consider all relevant factors including the following:

- (A) Whether enforceable and effective conditions on the transfer preclude use of any of the transferred assets for any purpose that, if it were a substantial part of an organization’s activities, would be inconsistent with exemption as an organization described in IRC 501(c)(3);

⁵⁵ For these purposes, the amount of a transfer is the sum of the amounts transferred to any number of recipients in any number of transfers, all of which are described in the previous four elements, and the time of the transfer is the time of the first transfer so taken into account. Reg. 1.504-2(b)(6)(i). Furthermore, the amount of a transfer to a recipient is the sum of the amounts transferred to the recipient in any number of transfers, all of which are described in the previous four elements, and the time of the transfer is the time of the first transfer so taken into account. Reg. 1.504-2(b)(6)(ii).

- (B) In the absence of conditions described above, whether the transferred assets are used exclusively for purposes that are consistent with the transferor's exemption as an organization described in IRC 501(c)(3);
- (C) Whether the assets transferred would be described in the private foundation minimum investment return rules (Reg. 53.4942(a)-2(c)(3)) before and after the transfer if both the transferor and recipient were private foundations;
- (D) Whether the transfer would satisfy the private foundation termination rules requiring unencumbered transfers (Reg. 1.507-2(a)(7) and Reg. 1.507-2(a)(8)) if the transferor were a private foundation;
- (E) Whether all of the transferred assets have been expended during a period when the recipient was not controlled (directly or indirectly) by the same persons who controlled the transferor; and
- (F) Whether all of the transferred assets were transferred, before the close of the recipient's taxable year following the taxable year in which the transferred assets were received, to one or more public charities described in IRC 507(b)(1)(A) none of which are controlled by the same persons who control either the original transferor or recipient.

7. What is the tax status of a ballot measure committee?

Expenditures to support or oppose initiatives, referenda, etc., generally are considered to be lobbying expenditures rather than political campaign activity. Consequently, a ballot measure committee cannot qualify as an IRC 501(c)(3) organization because it is an

"action" organization. Furthermore, it cannot qualify as a "political organization" under IRC 527 since a political organization's "exempt function" involves, in general, influencing or attempting to influence the selection, nomination, election or appointment of an individual to a federal, state, or local public office or office in a political organization. IRC 527(e)(2). Reg. 1.527-2(c)(1) uses the term the "selection process" to encapsulate what is contemplated by "exempt function." Generally, expenditures to support or oppose a referendum or initiative measure are not for an exempt function activity, since this activity generally does not further the purpose of influencing or attempting to influence the selection process.⁵⁶ However, a ballot measure committee may qualify for exempt status under other subparagraphs of IRC 501(c), such as IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6).

⁵⁶ In addition to the statutory language ("individual") and the regulatory language (the "selection process"), the legislative history treats ballot measure expenditures as outside the purview of exempt function activity. See S. Rep. No. 93-1357, 93d Cong., 2d Sess. 27 (1974) reprinted in 1975-1 C.B. 517, 532, (stating, in discussing the primary activities test, that "a qualified organization could support the enactment or defeat of a ballot proposition, as well as support or oppose a candidate, if the latter activity was not its primary activity").

6. Lobbying and IRC 162(e)

A. Legislative and Regulatory History

(1) The Pre-Statutory Era

Like the restriction on lobbying by charities, the disallowance of a business expense deduction for lobbying first appeared as a Treasury regulation. T.D. 2137, 17 Treas. Dec. 48, 57-58 (1915). The validity of the regulation was first addressed by the Supreme Court in Textile Mills Security Corp. v. Commissioner, 314 U.S. 326 (1941). Textile Mills involved an attempt to deduct expenses made on behalf of German textile interests to pass special legislation that would enable the interests to recover property seized during World War I. The Court, without any dissent, concluded that the regulation did not contravene any Congressional policy and therefore upheld the denial of the deduction.⁵⁷

The Supreme Court revisited the validity of the regulation almost two decades later, in the companion cases of Cammarano v. United States, 358 U.S. 498 (1959), and F. Strauss & Son, Inc. v. Commissioner, 358 U.S. 498 (1959). Both cases involved extensive grass roots lobbying campaigns by liquor distributors against prohibition or state control of liquor distribution proposals which would have destroyed the distributors' businesses. Again, the Court upheld the validity of the regulation, principally on the basis that the regulation had "acquired the force of law" because Congress had repeatedly reenacted the business expense deduction without rejecting the regulation. Cammarano, at 508-509.

(2) Allowance of the Lobbying Deduction

In 1962, Congress finally addressed the issue. Over the objection of the Treasury Department, it enacted IRC 162(e) as part of the Trade Expansion Act of 1962.⁵⁸ IRC 162(e)(1) specifically provided a deduction for direct lobbying expenses (including travel expenses, costs of preparing testimony, and a portion of dues) paid in carrying on a trade or business if such expenses are (1) in direct connection with appearances or communications involving legislation or proposed legislation of direct interest to the taxpayer, or (2) in direct connection with information communicated between the taxpayer and an organization of which it is a member as to legislation or proposed legislation of direct interest to the taxpayer and the organization. However, IRC 162(e)(2) provided that no deduction is allowed for any amount paid or incurred (by contribution, gift, or otherwise) for participation or intervention in any political campaign or

⁵⁷ It is difficult to imagine that there was any public dissent either, since the decision was handed down on December 8, 1941, the day after the attack on Pearl Harbor.

⁵⁸ Invoking the Slee principle, Secretary of the Treasury C. Douglas Dillon, in testimony before the Senate Finance Committee, set forth the Treasury position as follows:

We are not against lobbying. We think lobbying is fine, the more of it the better, because the representatives of the people know what the country wants. We are only saying that the Government should not pay for it. Hearings on H.R. 10650 Before the Senate Comm. on Finance, 87th Cong., 2d Sess. 4,387 (1962).

in connection with any attempt to influence the general public with respect to legislative matters, elections, or referenda.

In explaining the reasons for the provisions, the House and Senate Reports stressed the difficulties of separating lobbying costs from other business costs. Even more important, the Reports stated, was the policy consideration that emanated from the "anomalous" proposition that permitted the deduction of expenses incurred from appearance with respect to executive or judicial matters, but not legislative ones.⁵⁹ H.R. Rep. No. 1447, 87th Cong., 2d Sess. 17 (1962), reprinted in 1962-3 C.B. 405, 421; Sen. Rep. No. 1881, 87th Cong., 2d Sess. 22 (1962), reprinted in 1962-3 C.B. 707, 728.

(3) Disallowance of the Lobbying Deduction

In February 1993, the Treasury Department submitted a proposal to deny all business deductions for lobbying expenses. Page 45 of the Summary of the Administration's Revenue Proposals states, in pertinent part, as follows:

Reasons for Change

*The deduction for lobbying expenses inappropriately benefits corporations and special interest groups for intervening in the legislative process.*⁶⁰

Proposal

Businesses would no longer be allowed to deduct their lobbying expenses. Lobbying expenditures for this purpose would be defined similarly to the definition of expenditures to influence legislation in section 4911(d) and would include attempts to influence legislation through communications with the executive branch as well as the legislative branch of government. The current restrictions on deductions for expenses of grassroots lobbying and participation in political campaigns would remain. These rules would prevent charities from engaging in more than an insubstantial amount of lobbying. No deduction would be allowed for the part of membership dues that are used for lobbying, but as under current law, trade associations and similar organizations would not lose their exempt status for lobbying. Trade associations and similar organizations would be required to report to their members the portion of their dues used for lobbying activities.

⁵⁹ As we have seen, however, this "anomaly" persists for IRC 501(c)(3) organizations.

⁶⁰ This position was spelled out, at much greater length, in the 1962 legislative history of IRC 162(e). See Supplemental and Minority Views of Senators Paul Douglas and Albert Gore, 1962-3 C.B. 1092, 1116-1120.

On May 4, 1993, House Ways and Means Chairman Rostenkowski introduced the Administrations's bill, H.R. 1960. The Committee Report on the bill that emerged from the House, H.R. 2264, stated a different reason for change: "The committee has determined that, in the context of deficit reduction legislation, it is appropriate to limit the business deduction for lobbying expense." H.R. Rep. No. 103-111, 103d Cong., 1st Sess. 659 (1993) reprinted in 1993-3 C.B. 235.

What finally resulted was § 13222 of OBRA 1993. It amended IRC 162(e) by replacing the existing language with a new IRC 162(e) applicable to amounts paid or incurred after December 31, 1993.⁶¹ The new IRC 162(e) disallows the deductibility of direct legislative lobbying expenses at the Federal and state (but not the local) level. It also disallows deductions for contacts with certain federal officials. Grass roots lobbying and political campaign expenditures continue to be nondeductible. In addition, IRC 162(e)(3) includes pass-through provisions affecting dues paid to exempt organizations, so organizations can not indirectly do what is disallowed directly.

The regulations under IRC 162 have, since their adoption in 1965, provided for the disallowance of dues paid to an organization to the extent the organization is engaged in an activity prohibited under IRC 162(e). Reg. 1.162-20(c)(3). However, no mechanism existed at the association level to ensure notification to members of the disallowance. Therefore, § 13222 of OBRA 1993 also amended IRC 6033, adding a new subsection to provide a system based on the disallowance of dues that builds in an incentive (or penalty) to ensure that associations notify their members. The trigger is contained in IRC 6033(e), which imposes reporting and notice requirements on tax-exempt organizations incurring expenditures to which IRC 162(e) applies. IRC 162(e)(3) denies a deduction for the dues (or other similar amounts) paid to certain tax-exempt organizations to the extent that the organization, at the time the dues are assessed or paid, notifies the dues payer that the dues are allocable to nondeductible lobbying and political expenditures of the type described in IRC 162(e)(1).⁶²

An exempt organization subject to IRC 6033(e) has several options. It may provide a notice to its members when they pay dues that contains a reasonable estimate of the amount allocable to lobbying expenditures. If it does not give notification, it must pay a proxy tax at the highest rate imposed by IRC 11 (currently 35 percent) on its lobbying expenditures (up to the amount of dues and other similar payments received by the organization) during the taxable year. In addition, if the organization does provide notices to its members but underestimates the actual amount of lobbying expenditures, it is subject to the proxy tax on the excess lobbying expenditures paid during the applicable year that were not included in the notices. However, this tax may be waived if the organization agrees to include the excess lobbying expenditures in the following year's notices.

⁶¹ A constitutional challenge to the provisions of § 13222 of OBRA 1993 was dismissed on jurisdictional grounds. American Society of Association Executives v. Bentsen, 848 F. Supp. 245 (D.D.C. 1994).

⁶² Payments that are similar to dues include voluntary payments or special assessments used to conduct lobbying.

This mechanism allows a membership organization to elect not to provide its members with a disallowance notice in which case the organization will be required to pay the tax. If an organization elects the proxy tax option, no portion of any dues or other payments made by members of the organization will be deemed nondeductible as a result of the organization's lobbying activities.

(4) History of Regulations and Administrative Pronouncements

Reg. 1.162-20, dealing with expenditures attributable to grass roots lobbying, political campaigns, and certain advertising, was published in 1965 (T.D. 6819, 30 FR 5581 (Apr. 20, 1965)) and amended nearly four years later (T.D. 6996, 34 FR 835 (Jan. 18, 1969)). In general, the regulation provides that if expenditures for lobbying purposes do not meet the requirements of IRC 162(e)(1), such expenditures are not deductible as ordinary and necessary business expenditures. Reg. 1.162-20(c)(1).⁶³

As a result of the OBRA 1993 legislation, the Service published final regulations providing allocation rules and rules concerning the definition of influencing legislation in 1995. T.D 8602, 60 FR 37568 (July 21, 1995). These new regulations also provide that to the extent the existing provisions of Reg. 1.162-20 are inconsistent with the new IRC 162, they are superseded. Reg. 1.162-20(c)(5). At the same time, the Service published Rev. Proc. 95-35, 1995-2 C.B. 391, to provide procedures for organizations to determine whether they were excepted from the reporting and notice requirements of IRC 6033(e) in accordance with IRC 6033(e)(3).

B. Specific Issues

(1) Organizations Excepted from the Reporting and Notice Requirements

1. What organizations are excepted from IRC 6033(e)?

IRC 6033(e)(1)(B)(i) provides that the IRC 6033(e) notice requirements do not apply to IRC 501(c)(3) organizations. In addition, IRC 6033(e)(3) provides an exception for organizations that establish to the satisfaction of the Secretary that substantially all of the dues or similar amounts received by the organization are not deducted by its members as business expenses. Most IRC 501(c) organizations do not receive dues that are deducted by their members as business expenses under IRC 162. Therefore, the Service provides in Rev. Proc. 95-35, § 4.01, that, pursuant to IRC 6033(e)(3), the requirements of IRC 6033(e) shall not apply to organizations recognized by the Service as exempt from taxation under IRC 501(a), other than (1) IRC 501(c)(4) social welfare organizations that are not veterans organizations, (2) agricultural and horticultural organizations described in IRC 501(c)(5), and (3) IRC 501(c)(6) organizations. Organizations otherwise subject to IRC 6033(e) whose lobbying expenditures consist solely of

⁶³ Proposed amendments to Reg. 1.162-20 were published in 1980 but have not been finalized. FR 78167 (Nov. 25, 1980).

in-house expenditures that do not exceed \$2000 in a taxable year are also excepted from these requirements. IRC 6033(e)(1)(B)(ii).

2. Which IRC 501(c)(4) and IRC 501(c)(5) organizations does Rev. Proc. 95-35 except?

IRC 501(c)(4) veterans' organizations and IRC 501(c)(5) labor organizations are excepted by the Service from the IRC 6033(e) requirements in Rev. Proc. 95-35, § 4.01. Other IRC 501(c)(4) social welfare organizations and IRC 501(c)(5) agricultural and horticultural organizations that meet a safe harbor set forth in Rev. Proc. 95-35, § 4.02, also will be excepted from IRC 6033(e). The safe harbor provides that these organizations are not subject to IRC 6033(e) if more than 90 percent of their annual dues are received from (1) members paying annual dues of \$50 or less,⁶⁴ (2) IRC 501(c)(3) organizations, (3) state or local governments, (4) entities whose income is exempt from tax under IRC 115, or (5) organizations excepted by § 4.01 of Rev. Proc. 95-35 as noted above. Organizations that do not meet the safe harbor may establish that they satisfy the requirements of IRC 6033(e)(3) by maintaining records establishing that at least 90 percent of the annual dues received by the organization are not deductible by its members (without regard to IRC 162(e)) and notifying the Service on its Form 990, *Return of Organization Exempt from Income Tax*, that it is described in IRC 6033(e)(3).⁶⁵ Rev. Proc. 95-35, § 5.06.

3. What organizations described in IRC 501(c)(6) are excepted by Rev. Proc. 95-35?

Generally, IRC 501(c)(6) organizations are subject to the IRC 6033(e) requirements. However, Rev. Proc. 95-35, § 4.03, provides an exception for IRC 501(c)(6) organizations if over 90 percent of their annual dues are received from (1) IRC 501(c)(3) organizations, (2) state or local governments, (3) entities whose income is exempt from tax under IRC 115, or (4) organizations excepted by § 4.01 of Rev. Proc. 95-35 4.01, as noted above. IRC 501(c)(6) organizations that do not meet this test may also establish that they satisfy the requirements of IRC 6033(e)(3) by maintaining records establishing that at least 90 percent of the annual dues received by the organization are not deductible by its members (without regard to IRC 162(e)) in the same manner as IRC 501(c)(4) and IRC 501(c)(5) organizations and notifying the Service on its Form 990 that it is described in IRC 6033(e)(3).⁶⁶ Rev. Proc. 95-35, § 5.06.

⁶⁴ The \$50 amount will be increased for years after 1995 by a cost-of-living adjustment under IRC 1(f)(3), rounded to the next highest dollar. Rev. Proc. 95-35, § 5.05.

⁶⁵ The organization may also request a private letter ruling to this effect in accordance with the procedures set forth in Rev. Proc. 96-4, 1996-1 I.R.B. 94. If an organization receives a favorable private letter ruling, the Service will not contest its entitlement to exemption under IRC 6033(e)(3) for a subsequent year so long as the character of its membership is substantially similar to its membership at the time of the ruling.

⁶⁶ IRC 501(c)(6) organizations may also request a private letter ruling as discussed above.

4. What are “annual dues” and “similar amounts?”

The term “annual dues” means the amount an organization requires a person to pay to be recognized by the organization as a member for an annual period. “Similar amounts” includes, but is not limited to, voluntary payments made by persons, assessments made by the organization to

cover basic operating costs, and special assessments imposed by the organization to conduct lobbying activities. Rev. Proc. 95-35, § 5.01. “Member” is used in its broadest sense and is not limited to persons with voting rights in the organization. Rev. Proc. 95-35, § 5.02. If payment for a “membership” is intended to provide more than one person with recognition by the organization as a member for an annual period, annual dues is the full amount of payment request for that category of membership.

5. How does Rev. Proc. 95-35 treat affiliated organizations?

Rev. Proc. 95-35 provides a special aggregation rule that treats affiliated organizations (*e.g.*, a national trade association that has state and local chapters) as a single organization for purposes of IRC 6033(e). The rule provides that if more than one organization described in

IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6) share a name, charter, historic affiliation, or similar characteristics, and coordinate their activities, organizations in the affiliate structure are treated as a single organization. In applying the tests set forth in the safe harbor, only dues paid by the “ultimate members,” whether paid to one level, which then remits the amounts to other levels in the structure, or paid separately to each level. Amounts paid by one organizational level to another are not considered, even if they are characterized as “dues.” If the organization as a whole meets the requirements of IRC 6033(e)(3), (*e.g.*, more than 90 percent of the dues are received from persons paying \$50 or less) all organizations in the affiliated structure meet the requirements.⁶⁷ Rev. Proc. 95-35, § 5.03.

Rev. Proc. 95-35, § 5.04, provides an example applying the affiliation rule. A group of national, state, and local IRC 501(c)(4) organizations share a common name and work jointly to promote their purpose. Individuals or families pay annual dues of \$40 to the local organizations, entitling them to membership in the national and state organizations. The local organizations remit a portion of the dues to the state and national organizations. These remittances by the local organizations exceed \$50. The total amount received by all local organizations is \$950x. In addition, corporations pay dues of \$500 to and become members of the national organization. The total amount received from these members is \$50x. Since the \$950x exceeds 90 percent of the \$1000x received from all members, all of the national, state, and local organizations meet the requirements of IRC 6033(e)(3). The transfers from the local organization are not considered in this determination.

⁶⁷ If organizations within the affiliated structure are on different taxable years, the organizations may base their calculations of annual dues received on any single reasonable taxable year.

(2) Definitional Issues Regarding Lobbying

1. What is the meaning of "influencing legislation?"

IRC 162(e)(4)(A) defines "influencing legislation" as "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 legislation."

This definition is essentially identical (as it relates to direct, as opposed to grass roots, lobbying) to IRC 4911, as discussed above in Part 3.

Reg. 1.162-29(b)(1) provides that "influencing legislation" involves the following activities:

- (A) Any attempt to influence any legislation through a lobbying communication; and
- (B) All activities, such as research, preparation, planning and coordination, including deciding whether to make a lobbying communication, engaged in for a purpose of making or supporting a lobbying communication.

Reg. 1.162-29(b)(2) provides that an "attempt to influence any legislation through a lobbying communication" is the act of making the lobbying communication, regardless of whether the attempt is successful.

2. What is a "lobbying communication?"

Pursuant to Reg. 1.162-29(b)(3), a "lobbying communication" is a communication (other than any communication compelled by subpoena, or otherwise compelled by federal or state law)⁶⁸ with any member or employee of a legislative body or any other government official

or employee who may participate in the formulation of the legislation that does either of the following:

- (A) The communication refers to specific legislation and reflects a view on that legislation; or
- (B) The communication clarifies, amplifies, modifies, or provides support for views reflected in a prior lobbying communication.

⁶⁸ The "subpoena exception" follows the Conference Report (H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 607 (1993), reprinted in 1993-3 C.B. 485), which states that "any communication compelled by subpoena, or otherwise compelled by Federal or State law, does not constitute an 'attempt to influence' legislation or an official's action and, therefore, is not subject to the general disallowance rule."

The phrase “reflects a view” is of critical importance. After it appeared in the proposed regulations, several commentators suggested it should be defined to mean an explicit statement of support or opposition to the legislation. Some commentators also suggested that presenting a balanced analysis of the merits and defects of specific legislation should not constitute reflecting a view on legislation. However, neither recommendation was adopted in the final regulations. T.D. 8602, 60 FR 37568 (July 21, 1995).

Therefore, an organization can reflect a view on legislation without specifically stating it supports or opposes that legislation. Reg. 1.162-29(b)(7), Example 8, illustrates this with regard to an organization that writes a letter to a United States Senator discussing how a certain pesticide has benefited citrus fruit growers and disputing problems linked to its use. The letter discusses a bill pending in Congress and states in part:

This bill would prohibit the use of pesticide O. If citrus growers are unable to use this pesticide, their crop yields will be severely reduced, leading to higher prices for consumers and lower profits, even bankruptcy, for growers.

Despite the fact that the organization does not explicitly state that it opposes the bill, its views on the bill are reflected in the statement. Thus, the communication is a lobbying communication, and the organization is attempting to influence legislation.

3. Do the exceptions under IRC 4911(d)(2) apply for purposes of IRC 162(e)?

No. A significant difference between the two statutes is that while IRC 4911(d) contains specific exceptions to the term “influencing legislation,” IRC 162(e) does not. An example of this difference is the “self defense” exception under IRC 4911(d)(2)(C). IRC 162(e) contains no counterpart, and the legislative history strongly

suggests that no exception is to be inferred. Statements in footnote 49 of the Conference Report (H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 597 (1993), reprinted in 1993-3 C.B. 475), H.R. Rep. No. 1447 (87th Cong., 2d Sess. 16-18 (1962), reprinted in 1962-3 C.B. 405, 420-422) and S. Rep. No. 1881 (87th Cong., 2d Sess. 21-24 (1962), reprinted in 1962-3 C.B. 707, 727-730) indicate that the holding of Cammarano v. United States, 358 U.S. 498 (1959) (upholding the validity of regulations denying a deduction for lobbying even when the expenses related to proposed legislation that affected the survival of the taxpayer’s business) remains good law unless specifically contradicted by statute. Similarly, IRC 162(e) draws no distinction between influencing legislation and educating legislators, unlike the IRC 4911(d)(2) exceptions for making available the results of nonpartisan analysis, study, or research and for providing technical advice or assistance to a governmental body. See also, H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 607 (1993), reprinted in 1993-3 C.B. 485, where the Conference Report notes that exceptions contained in previous versions of the bill were not included in conference agreement. Therefore, IRC 162(e) disallows a deduction for some activities that would not be considered “direct lobbying” under IRC 4911. Accordingly, Reg. 1.162-29(a) specifically provides that the rules enunciated in the regulation have no bearing on IRC 4911 or IRC 4945.

4. What is "legislation?"

IRC 162(e) disallows the deduction for amounts spent or incurred to influence "legislation" considered by a "legislative body." IRC 162(e)(4)(B) provides that, for this purpose, "legislation" has the same meaning as under

IRC 4911(e)(2) (discussed in Part 2). Consequently, Reg. 1.162-29(b)(4) provides that "legislation" includes any action on Acts, bills, resolutions and similar items by a "legislative body." "Legislation" includes a proposed treaty required to be submitted by the President to the Senate for and consent from the time the President's representative begins to negotiate a position with the prospective parties to the treaty.

5. What is "specific legislation?"

Under Reg. 1.162-29(b)(5), the term "specific legislation" is not limited to acts, bills, etc., that have been formally introduced before a legislative body. Therefore, specific legislative proposals are included as "specific legislation"

even if never introduced. Accordingly, reference to a bill enacted in another state constitutes reference to "specific legislation" despite the fact that a similar bill has not been proposed in the state in question. Reg. 1.162-29(b)(7), Example 7. However, merely identifying a problem and indicating that a legislative body should do something about the problem without specifying what the legislative body should do will not constitute a specific legislative proposal. For example, an organization provides to legislators a paper that it has prepared stating that the lack of new capital is hurting the economy. If the organization merely indicates that increased savings and local investment will assist the economy and includes a cover letter stating, "You must take action to improve the availability of new capital," the organization has not referred to a specific legislative proposal. Reg. 1.162-29(b)(7), Example 5. However, if the organization indicates that lowering the capital gains rate would increase the availability of new capital and includes a cover letter stating, "I urge you to support a reduction in the capital gains tax rate," then it has referred to a specific legislative proposal. Reg. 1.162-29(b)(7), Example 6.

6. What are "legislative bodies?"

The term "legislative bodies" is defined in Reg. 1.162-29(b)(6). The term includes Congress, state legislatures, and other similar governing bodies. However, local councils and similar governing bodies are not "legislative bodies" for

purposes of IRC 162(e). Executive, judicial, and administrative bodies are also not included. Administrative bodies includes school boards, housing authorities, sewer and water districts, zoning boards, and other similar federal, state, or local special purpose bodies, whether elective or appointive.

Thus, communications with the administrative agency charged with writing regulations implementing a statute regarding recommendations concerning those regulations are not considered lobbying communications because the regulations are not legislation considered by a "legislative body." Reg. 1.162-29(b)(7), Example 3. Furthermore, testifying at a congressional oversight hearing concerning proposed regulations to implement a particular statutory enactment will not constitute a lobbying communication since the issue is the administrative action and not

specific legislation considered by a “legislative body,” even though the hearings are before a “legislative body.” Reg. 1.162-29(b)(7), Example 2.

7. What is the exception for local councils and similar bodies?

As noted above, IRC 162(e)(2) provides an exception to the general disallowance rule for certain lobbying expenditures related to local councils and similar governing bodies. IRC 162(e)(2) provides that two types of lobbying expenses are deductible. One is the ordinary and necessary expenses (including travel and preparation of testimony) in connection with appearances before, making statements to, or sending communications to the committees or individual members of a local council. The other is the expenses of communication with an organization of which the taxpayer is a member about local legislation or proposed legislation of direct interest to the taxpayer or the organization. The portion of the dues that are paid to an organization that are attributable to either of these activities is also not subject to the disallowance rule. However, grass roots lobbying on local government legislative actions is not covered by the exception. The legislative history indicates that the term “local councils or similar governing bodies” includes any legislative body of a political subdivision of a state, such as a county or city council. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 605 (1993), reprinted in 1993-3 C.B. 483. For purposes of the IRC 162 lobbying rules, Indian tribal governments are treated as “local councils or similar governing bodies.” IRC 162(e)(7).

8. What is a “covered executive branch official?”

IRC 162(e)(1)(D) disallows a deduction for expenditures for any “direct communication with a covered executive branch official in an attempt to influence the official actions or positions of [the] official.” Pursuant to IRC 162(e)(6), a “covered executive branch employee” includes the President, the Vice President, any person serving in level I of the Executive Schedule (e.g., a Cabinet Officer) or any other person designated by the President as having Cabinet-level status and their immediate deputies, the two most senior-level officers of each agency within the Executive Office of the President, and any other official or employee of the White House Office of the Executive Office of the President. The legislative history indicates that all written or oral communication with covered executive branch officials are included. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 605 n. 57 (1993), reprinted in 1993-3 C.B. 483. A communication with the covered executive branch official will be considered with that official if the official is intended as the primary recipient.

9. What is the exception for de minimis in-house lobbying?

IRC 162(e)(5)(B)(ii) excepts from the general disallowance rule organizations that are involved in a minimal amount of in-house lobbying. When an organization’s total amount of in-house lobbying expenses does not exceed \$2,000 (computed without taking into account general overhead costs otherwise allocable to lobbying), this exception applies. For purposes of this rule, in-house expenses include labor and material costs.

Payments made to a third-party lobbyist and dues payments allocable to lobbying are subject to the disallowance rules, regardless of whether or not the organization's in-house expenses are exempted. In addition, the *de minimis* in-house rule does not apply to expenses incurred for political activity, grass roots lobbying or foreign lobbying which continue to be disallowed under current law rules.

(3). Lobbying Purpose

1. When is an activity engaged in for the purpose of making a lobbying communication?

As noted above, Reg. 1.162-29(b)(1) provides that an "attempt to influence legislation" includes not only a lobbying communication but also all research and other preparatory activities engaged in for a purpose of making or supporting a lobbying communication. Reg. 1.162-29(c) sets forth a purpose test, which considers the original

intent for engaging in a particular activity in order determine whether a lobbying activity, in whole or in part, has occurred. The general rule, set forth in Reg. 1.162-29(c)(1), provides that the purpose or purposes for engaging in an activity are determined on the basis of all the facts and circumstances, including (but not limited to) the following factors:

- (A) Whether the activity and the lobbying communication are proximate in time;
- (B) Whether the activity and the lobbying communication relate to similar subject matter;
- (C) Whether the activity is performed at the request of, under the direction of, or on behalf of a person making the lobbying communication;
- (D) Whether the results of the activity are also used for a nonlobbying purpose; and
- (E) Whether, at the time the organization engages in the activity, there is specific legislation to which the activity relates.⁶⁹

⁶⁹ The proposed regulations provided two presumptions concerning the purpose for engaging in an activity that is related to a lobbying communication. Specifically, Prop. Reg. 1.162-29(c)(3) provided that if an activity relating to a lobbying communication is engaged in for a non-lobbying purpose prior to the first taxable year preceding the taxable year in which the communication was made, the activity is presumed to be engaged in solely for that non-lobbying purpose. The Commissioner could rebut this presumption in part by establishing that the activity was also engaged in for a purpose other than the non-lobbying purpose. Conversely, Prop. Reg. 1.162-(c)(4) provided that if an activity relating to a lobbying communication is engaged in during the same taxable year as the communication is made or the immediately preceding taxable year, and is not within the preceding presumption, the activity is presumed to be engaged in for the sole purpose of making or supporting a lobbying communication. An organization could rebut the presumption by establishing that the activity was engaged in for a non-lobbying purpose. 59 FR 24992, 24996 (May 13, 1994).

The regulations provide several examples of how the facts and circumstances test is applied. One example involves an organization that conducts a study and provides information to an administrative agency regarding the impact of proposed regulations on its business at a time when no specific legislative proposal on a similar topic is pending. The next year, in response to proposed legislation on the same subject, the organization sends a letter opposing the legislation to a legislator along with a copy of the study. Although the communication with the legislator is a lobbying communication, the organization conducted the study and submitted comments to the administrative agency at a time when no similar legislative proposal was pending. Therefore, it engaged in the study for a nonlobbying purpose. Reg. 1.162-29(c)(4), Example 1. Similarly, an organization that has entered into a contract with a government agency conducts tests regarding the project, submits the test results to the government agency and revises the project specifications in compliance with the contract. It subsequently prepares a summary of the test results and revised specifications which it submits to legislators to encourage them to support appropriations for the contract. The summary was prepared specifically for, and close in time to, the lobbying communication and so was for a lobbying purpose. However, the tests were conducted and the specifications revised pursuant to contract requirements and, thus, were solely for a nonlobbying purpose. Reg. 1.162-29(c)(4), Example 4. On the other hand, an organization that conducts a study at the request of its legislative affairs staff concerning the impact of proposed legislation on its business does so solely for a lobbying purpose, despite the fact that the organization subsequently used the study for labor negotiations with its employees. Reg. 1.162-29(c)(4), Example 2.

2. What if an activity is engaged in for multiple purposes?

Pursuant to Reg. 1.162-29(c)(2), if an organization engages in an activity both for a lobbying purpose and for some nonlobbying purpose, it must treat the activity as engaged in partially for the lobbying purpose and partially for the nonlobbying purpose. This division of the

activity must result in a reasonable allocation of costs between nondeductible lobbying costs and other costs. (The allocation rules set forth in Reg. 1.162-28 are discussed below.) Reg. 1.162-29(c)(4), Example (5), illustrates this with regard to a person who travels to the state capital to attend a two-day conference. While there, he spends a third day meeting with state legislators to explain why his corporation opposes a pending bill unrelated to the subject of the conference. Although his trip is partially for a nonlobbying purpose, it also has a lobbying purpose since he refers to and reflects a view on the pending bill. Thus, his corporation must reasonably allocate his traveling expenses between these two purposes.

Reg. 1.162-29(c)(3) provides that certain activities are not engaged in for the purpose of making or supporting lobbying communications. These activities consist of those activities undertaken to comply with the requirements of any law (for example, satisfying state or federal securities law filing requirements), reading any publications available to the general public or

Commentators contended that these presumptions undermined and complicated the purpose test. The final regulations eliminate the presumptions, replacing them with the list of facts and circumstances set forth in Reg. 1.162-29(c)(1). T.D. 8602, 60 FR 37568 (July 21, 1995).

3. May certain activities be treated as having no purpose to influence legislation?

viewing or listening to other mass media communications, and merely attending a widely attended speech. In addition, if, prior to evidencing a purpose to influence particular legislation (or similar legislation), an organization determines the existence or procedural status of that legislation, determines the time, place, and

subject of any hearing to be held by a legislative body with respect to that legislation, or prepares or reviews routine, brief summaries of the provisions of that legislation, the organization is treated as engaging in that activity with no purpose of making or supporting a lobbying communication.

This provision is illustrated by Reg. 1.162-29(c)(4), Example 6, which discusses an organization whose legislative affairs staff prepares a summary of legislation that would affect the organization's business at the time it is proposed and continues to confirm the procedural status of the bill periodically. Two months after the bill was introduced, the organization assigns one of its employees to prepare a position letter on the bill to be delivered to legislators. The preparation of the original summary and the procedural status checks on the bill for the first two months are not considered to be for a lobbying purpose. However, once the organization made the determination to make a lobbying communication, the procedural status checks on the bill after that time were for a lobbying purpose.

4. What if activities support lobbying communications by another organization?

Reg. 1.162-29(d) provides that when an organization engages in activities for a purpose of supporting a lobbying communication to be made by another person, the organization's activities are treated as influencing legislation. For example, if an organization or its employee (as a volunteer or otherwise) engages in an activity to assist a trade

association in preparing its lobbying communication, the organization's activities are influencing legislation even though the lobbying communication is made by the trade association. However, the personal activities an organization's employee outside the scope of employment will not be attributed to the organization.

5. What happens if a lobbying communication is not made?

In some instances, organizations engage in activity to support lobbying communications that they never make. Under Reg. 1.162-29(e), if the organization determines before the filing date of its return that it does not expect, under any reasonably foreseeable circumstances, to make a

lobbying communication, the activity is treated as if it had not been engaged in for a lobbying purpose and the organization need not treat any amount allocated to that activity for that year as

an amount to which IRC 162(e)(1)(A) applies.⁷⁰ On the other hand, if the organization reaches the conclusion at any time after the filing date, then any amount previously disallowed with respect to that activity is treated as an amount that is paid at that time that is not subject to IRC 162(e)(1)(A). Thus, the organization is effectively treated as if it incurred the costs relating to the activity in the later year in connection with a nonlobbying activity. Exempt organizations to which IRC 6033(e) applies may treat such amounts as reducing (but not below zero) their lobbying costs. The organization may carry forward any amount not used to reduce lobbying costs to subsequent years.

6. Is there an anti-avoidance rule?

Yes, Reg. 1.162-29(f) provides that if an organization, alone or with others, structures its activities with a principal purpose of achieving results that are unreasonable in light of the purposes of IRC 162(e) and IRC 6033(e), the Commissioner can recast the organization's

activities for federal tax purposes to achieve tax results that are consistent with the intent of these provisions and the pertinent facts and circumstances.

(4). Cost Allocations

1. How must costs be allocated?

As noted above, when an organization engages in an activity that has both a lobbying and a nonlobbying purpose, it must allocate the cost of the activity between the two using a reasonable method. Reg. 1.162-29(c)(2) and

Reg. 1.162-28(b)(1). Reg. 1.162-28 describes costs that must be allocated to lobbying activities and methods that may be used to allocate those costs. Reg. 1.162-28 does not apply, however, to organizations that are engaged in the trade or business of conducting lobbying activities on behalf of another person.⁷¹ Furthermore, the regulation is not intended to be applied for purposes of IRC 4911 and 4945 and the regulations thereunder. The organization must maintain records in accordance with IRC 6001 and its regulations.

2. What is a reasonable method of allocation?

Reg. 1.162-28(b) permits organizations to use any reasonable method to allocate costs between lobbying and nonlobbying activities. A method is considered reasonable if it is applied consistently, allocates a proper amount of costs to lobbying activities (including labor and

administrative costs), and is consistent with the special rules regarding labor hours outlined in

⁷⁰ The filing date for this purpose is the earlier of the time the organization files its timely return for the year or the due date of the timely return.

⁷¹ IRC 162(e)(5)(A) provides that organizations that are engaged in the trade or business of conducting lobbying activities on behalf of another person are not subject to the general disallowance rules. However, the rules do apply to payments by such other person to the organization for conducting the lobbying activities.

Reg. 1.162-28(2)(g). Reg. 1.162-28 describes three different allocation methods that are considered reasonable: a ratio method, a gross-up method, and an allocation method that applies IRC 263A principles. Whether any other allocation method is reasonable depends on the facts and circumstances of a particular case. The three specified methods, alone or in combination, do not establish a baseline allocation against which to compare other methods. Therefore, another cost allocation method is not unreasonable simply because it allocates a lower amount of costs to lobbying activities than any of the three specified methods.⁷² However, Reg. 1.162-29(c)(2) provides that an organization’s treatment of multiple purpose activities will not result in a reasonable allocation if it allocated to influencing legislation (1) only the incremental amount of costs that would not have been incurred but for the lobbying purpose or (2) an amount based on the number of purposes for engaging in that activity without regard to the relative importance of those activities.

3. What costs are allocable to lobbying activities?

Reg. 1.162-28(c) provides that the costs properly allocable to lobbying activities include labor costs and general and administrative costs. Labor costs include costs attributable to full-time, part-time, and contract employees. This includes all elements of compensation, including overtime

pay, vacation pay, holiday pay, sick leave pay, payroll taxes, pension costs, employee benefits, and payments to a supplemental unemployment benefit plan. General and administrative costs include depreciation, rent, utilities, insurance, maintenance costs, security costs, and other administrative department costs (for example, payroll, personnel, and accounting.)

4. What is the "ratio method?"

Under the ratio method set forth in Reg. 1.162-28(d), an organization multiplies its total costs of operations (excluding third-party costs) by a fraction. The numerator of the fraction is the organization’s lobbying labor hours

and the denominator is the organization’s total labor hours. The formula is expressed as follows:

$$\frac{\text{Lobbying labor hours}}{\text{Total labor hours}} \times \text{Total costs of operations}$$

The product of this calculation is added to the organization’s third-party lobbying costs, as defined in Reg. 1.162-28(d)(5).⁷³ Third-party lobbying costs are amounts paid or incurred in whole or in part for lobbying activities conducted by third parties and amounts paid or incurred for travel (including meals or lodging while away from home) and entertainment relating in whole or in part to lobbying activities.) Thus, third-party costs include amounts paid to lobbying organizations and dues or other similar amounts allocable to lobbying paid to exempt organizations.

⁷² Because some commentators interpreted the proposed regulations as treating only the three specified methods as reasonable, the final regulations clarify that organizations may use any reasonable method.

⁷³ Payments to independent contractors for lobbying purposes would not fall under labor costs. They would, however, be included in third-party lobbying costs.

Lobbying Issues

Reg. 1.162-28(d)(2) provides that an organization may use any reasonable method to determine the number of labor hours spent on lobbying activities and may use the de minimis rule of Reg. 1.162-28(g)(1).⁷⁴ It further provides that an organization may treat as zero the hours spent by personnel engaged in secretarial, clerical, support, and other administrative activities as opposed to activities involving significant judgment with respect to lobbying activities.⁷⁵ Reg. 1.162-28(d)(3) defines total labor hours as the total number of hours of labor that an organization's personnel spend on the organization's trade or business during the year and provides that an organization may make reasonable assumptions concerning total hours spent by personnel on its trade or business. However, Reg. 1.162-28(d)(3) also provides that if the organization treats as zero the lobbying labor hours spent by personnel engaged in secretarial, maintenance, and other similar activities, it must also treat as zero the total labor hours of all personnel engaged in those activities.

Reg. 1.162-28(d)(6) illustrates the operation of the ratio method. In the example, three employees of an organization engage in both lobbying and nonlobbying activities. One spends 300 hours, another spends 1,700 hours, and the third spends 1,000 hours on lobbying activities, for a total of 3,000 hours for the year. The organization reasonably estimates that each of its three employees spends 2,000 hours a year working for the organization. The organization's total costs of operations are \$300,000 and it has no third-party costs. Under the ratio method, the organization allocates \$150,000 to its lobbying activities for the year, calculated as follows:

$$\begin{array}{rcccc} \frac{\text{Lobbying labor hours}}{\text{Total labor hours}} & \times & \text{Total costs of operations} & + & \text{Allocable third-party costs} & = & \text{Costs allocable to lobbying activities} \\ \hline [\frac{(300 + 1,700 + 1,000)}{6,000}] & \times & \$300,000 & + & [0] & = & \$150,000 \end{array}$$

⁷⁴ Reg. 1.162-28(g)(1) provides that an organization may treat time spent by an individual on lobbying activities as zero if less than five percent of the person's time is spent on lobbying activities. Reasonable methods may be used to determine if that time is less than five percent. However, pursuant to Reg. 1.162-28(g)(2), any time spent by an employee on "direct contact lobbying" (including the hours spent by that employee in connection with direct contact lobbying, such as allocable travel time relating to direct contact lobbying) may not be excluded under the rule of Reg. 1.162-28(g)(1). "Direct contact lobbying" is defined as a meeting, telephone conversation, letter, or other similar means of communication with a federal or state legislator or covered federal executive branch official that otherwise qualifies as a lobbying activity. Reg. 1.162-28(g)(2) specifically provides that a person who engages in research, preparation, and other background activities related to direct contact lobbying but who does not make direct contact with a legislator or covered executive branch official is not engaged in direct contact lobbying.

⁷⁵ Therefore, as Reg. 1.162-28(d)(2) explicitly provides, the hours spent on lobbying activities by para-professionals and analysts may not be treated as zero.

5. What is the "gross-up method?"

Under the general gross-up method, which is described in Reg. 1.162-28(e)(1), an organization multiplies its basic labor costs for lobbying labor hours by 175 percent. Pursuant to Reg. 1.162-28(e)(3), basic labor costs are limited to wages or other similar costs, such as

guaranteed payments for services. Costs attributable to pensions, profit-sharing, employee benefits, supplemental unemployment compensation plans, or similar items, are not included in basic labor costs. Third-party lobbying costs are then added to the result of the calculation to arrive at total lobbying costs.

Reg. 1.162-28(e)(2) provides an alternative gross-up method. Under this alternative, an organization may treat as zero the lobbying labor hours of personnel who engage in secretarial, clerical, support, or other administrative activities that do not involve significant judgment with respect to lobbying. However, if an organization uses this alternative method, it must multiply costs for lobbying labor hours by 225 percent.

Reg. 1.162-28(b)(2) provides that an organization (other than one subject to IRC 6033(e)) that does not pay or incur reasonable labor costs for persons engaged in lobbying activities may not use the gross-up method. Such organizations would include a partnership or sole proprietorship in which the lobbying activities are performed by the owners who do not receive a salary or guaranteed payment for services. This provision is significantly different from its predecessor in the proposed regulations. Under the proposed regulations, **any** organization that did not pay reasonable labor costs for people engaged in lobbying activities could use neither the ratio or gross up method. 58 FR 68330, 68332 (Dec. 27, 1993) Tax-exempt organizations contended that they would be prevented from using either or these methods if they used volunteers in their lobbying activities (since no labor costs were incurred). Under the final regulations, tax-exempt organizations can use either the ratio or gross-up methods even if their lobbying activities are conducted by volunteers. Because volunteers are not organizations' personnel, time spent by volunteers is excluded from the organization's lobbying labor hours and total labor hours (although the hours may be included in their own employer's lobbying labor hours or total labor hours).

Reg. 1.162-28(e)(4) illustrates the operation of the gross-up method to the same facts discussed above with regard to the ratio method. In this instance, the organization determines that its basic labor costs are \$20 per hour for the first employee, \$30 per hour for the second employee and \$25 per hour for the third employee. Thus, its basic lobbying labor costs are \$82,000 (((\$20 x 300) + (\$30 x 1,700) + (\$25 x 1,000))). Under the gross-up method, the organization allocates \$143,500 to its lobbying activities for the year, calculated as follows:

$$\begin{array}{rcccccc}
 175\% & \times & \text{Basic lobbying} & & \text{Allocable} & & \text{Costs allocable} \\
 & & \text{labor costs of} & + & \text{third-party} & = & \text{to lobbying} \\
 & & \text{all personnel} & & \text{costs} & & \text{activities} \\
 & & [175\% \times \$82,000] & + & [0] & = & \$143,500
 \end{array}$$

Many organizations engaged in lobbying activities are subject to the uniform capitalization rules of IRC 263A, therefore, the regulations permit organizations to use the principles of that section and the regulations thereunder to determine costs properly allocable to lobbying activities.

6. What is the “IRC 263A method?”

Specifically, under IRC 263A, lobbying is considered a service department or function. Therefore, an organization may use its IRC 263A methodology to determine the amount of costs allocable to its lobbying department or function for purposes of complying with the regulations.

Organizations not subject to IRC 263A may also use the principles of that section and the regulations thereunder to determine the amount of costs allocable to lobbying activities.

(5) Exempt Organization Requirements

1. How are exempt organizations taxed under IRC 6033(e)?

As discussed above, organizations may not avoid the disallowance of the deduction for lobbying by deducting dues paid to tax-exempt organizations that engage in lobbying. Thus, to prevent this avoidance, IRC 6033(e) provides that organizations subject to its provisions are required

to provide a notice to its members indicating the nondeductible portion of dues paid due to lobbying activities. If the exempt organization does not provide the notice or if its actual lobbying expenditures exceed the amount disclosed in the notice, the organization will be subject to a proxy tax on the amount that should have been included in the notice but was not. The proxy tax is equal to this amount multiplied by the highest corporate rate imposed by IRC 11. IRC 6033(e)(2). Thus, the organization has the option of providing a notice to its members of the amount of dues that is not deductible due to lobbying or paying the proxy tax.

2. What notices must be provided to members?

An organization subject to IRC 6033(e) is required to provide notice to each person paying dues of the portion of dues that the organization reasonably estimates will be allocable to the organization’s lobbying expenditures during the year and, thus, is not deductible by the member.

This estimate must be provided at the time of assessment or payment of the dues and must be reasonably calculated to provide the organization’s members with adequate notice of the nondeductible amount. IRC 6033(e)(1)(A)(ii). The legislative history indicates that the notice should be provided in a conspicuous and easily recognizable format, referring to IRC 6113 and the regulations thereunder for guidance regarding the appropriate format of the disclosure statement.⁷⁶

IRC 501(c)(4), IRC 501(c)(5), and IRC 501(c)(6) organizations are required to disclose information regarding their lobbying activities on Form 990, *Return of Organization Exempt from Income Tax*. If an organization is excepted from the IRC 6033(e) requirements either because substantially all of its dues were not deductible by its members or because its lobbying

⁷⁶ For guidance regarding IRC 6113, see Notice 88-120, 1988-2 C.B. 454. However, unlike IRC 6113, there is no penalty associated with failure to provide the disclosure notice in this format.

3. What information must be disclosed on the Form 990?

expenditures consisted solely of in-house expenditures that did not exceed \$2,000, it must disclose this information on the Form 990. If the organization does not meet either of these exceptions, it must disclose the information necessary to determine if it is subject to the proxy

tax. This information consists of the total dues received from members, the amount of its IRC 162(e) lobbying expenditures, and the amount it disclosed to its members as the nondeductible portion of dues. IRC 6033(e)(1)(A)(i).

4. What amount is disclosed on the Form 990 as IRC 162(e) lobbying expenditures?

The amount disclosed begins with the organization's lobbying expenses determined in accordance with IRC 162(e). Thus, direct lobbying of local councils or similar governing bodies with respect to legislation of direct interest to the organization or its members and in-house direct lobbying expenses if the total of such

expenditures is \$2,000 or less (excluding allocable overhead expenses) should be excluded from the amount disclosed. IRC 162(e)(2) and IRC 162(e)(5)(B). Amounts carried over from prior years, either because the lobbying expenditures exceeded the dues received in those years or because the organization received a waiver of the proxy tax imposed on that amount must be included. IRC 6033(e)(1)(C) and IRC 6033(e)(2)(B). The current year's lobbying expenditures should be reduced, but not below zero, by costs allocated in a prior year to lobbying activities that were cancelled after a return reporting these costs was filed in accordance with Reg. 1.162-29(e)(2).

5. What amount is disclosed for nondeductible dues notices?

If the organization notified its members in accordance with IRC 6033(e)(1)(A)(ii) of its estimate of the portion of dues that would not be deductible under IRC 162(e), it must disclose on Form 990 the total amount of dues that its members were notified were nondeductible. For

example, if the organization timely notified its members that 25 percent of their dues would be nondeductible and the members paid a total of \$100,000 of dues allocable to the year, the amount reported on Form 990 would be \$25,000.

6. What if lobbying expenditures exceed the estimated amount?

If the actual lobbying expenditures of an organization subject to IRC 6033(e) exceed the amount that it notified its members was not deductible (either because the expenses were higher than anticipated or the dues receipts were lower), the organization is liable for a proxy tax

on the excess amount. IRC 6033(e)(2)(A). The organization may seek a waiver of the proxy tax.⁷⁷

7. How does an organization request a waiver?

A waiver of the proxy tax is requested on Form 990. The organization checks a box agreeing to add the amount it entered as its taxable amount of lobbying expenditures to its dues estimate for the following year and enter the amount on the next year's Form 990. An

organization may use this waiver procedure only if it sent dues notices at the time of assessment or payment of dues that reasonably estimated the dues allocable to nondeductible lobbying expenditures.

8. How is the IRC 6033(e) proxy tax determined?

As noted above, an organization subject to IRC 6033(e) must report on the Form 990 the total dues it received from members, the amount of its IRC 162(e) lobbying expenditures for the year, and the amount it disclosed to its members as the nondeductible portion of dues. The

amount subject to the IRC 6033(e)(2) proxy tax is its IRC 162 expenditures less the amount disclosed to the members as nondeductible. However, if this amount is more than the amount by which the total dues received exceeds the amount disclosed to the members as nondeductible, then the tax is imposed on the lesser amount and the excess is carried over to the next year. For example, an organization reports on the Form 990 that its IRC 162(e) expenditures for the taxable year were \$600x and the aggregate amount of nondeductible dues notices is \$100x. If the total amount of dues received was \$800x, then the taxable amount would be \$500x (\$600x - \$100x). However, if the total amount of dues received was \$400x, the taxable amount would be limited to \$300x (\$400x - \$100x) and the excess \$200x (\$500x - \$300x) would be carried over and included in the next year's IRC 162 expenditures.

The taxable amount is multiplied by the highest rate specified in IRC 11 to determine the IRC 6033(e) proxy tax. If the organization elects to pay the tax, it is reported on Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*. When an organization elects to pay the proxy tax rather than to provide its members with an estimate of dues allocable to IRC 162(e) expenditures, all of the members' dues remain eligible for deduction to the extent otherwise deductible. The organization may also request a waiver of this tax if it made a reasonable estimate and agrees to adjust its notice of IRC 162(e) expenditures to members in the following year. Thus, in the second example above, if the organization requested a waiver, both the excess amount and the taxable amount would be carried over and included in the next year's IRC 162 expenditures.

⁷⁷ It is also possible that an organization could overstate the portion of the dues that are not deductible in the notice of disallowance. It could do so by overestimating the amount of the disallowed expenses or underestimating dues income. The Conference Report indicates that guidance should be issued to cover this eventuality. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 608 n. 66 (1993), reprinted in 1993-3 C.B. 486. The matter is under study.

9. Must estimated tax on the proxy tax be paid?

No, organizations that are subject to IRC 6033(e) are not required to pay estimated tax on the IRC 6033(e) proxy tax, even if they do not provide notices to their members. The instructions for Form 990-T indicate that the proxy tax is not to be included when calculating

estimated tax liability.

10. What if lobbying expenditures are under-reported?

Under-reported lobbying expenditures are subject to the IRC 6033(e) proxy tax for the year at issue only to the extent that the same expenditures (if actually reported) would have resulted in a proxy tax liability for that year. A waiver of the proxy tax for the taxable year only

applies to reported expenditures. Under-reporting lobbying expenditures may also subject the organization to a \$10 per day penalty under IRC 6652 for filing an incomplete or inaccurate return.

(6) Miscellaneous Rules

1. May payments to charities that lobby be deducted?

As stated above, IRC 501(c)(3) organizations are not subject to the IRC 6033(e) disclosure requirements. However, § 13222 of OBRA 1993 also added IRC 170(f)(9) which provides that contributors to charities that engage in lobbying activities cannot take an IRC 170 or

IRC 162 deduction for the contribution if (a) the charities' lobbying activities are on matters of direct financial interest to the contributors' trade or business and (b) a principal purpose of the contribution is to avoid the general disallowance rule that would apply if the contributor conducted such lobbying activities directly.

2. What is the "anti-cascading" rule?

IRC 162(e)(5)(A) provides that in the case of an organization engaged in the trade or business of lobbying activities or an employee who receives reimbursements for lobbying expenses, the disallowance rule does not apply to expenditures of the organization or person in

conducting such activities directly on behalf of a client or employer. Instead, the payments made by the client or employer to the lobbyist or employee are nondeductible as lobbying expenditures. The purpose of this rule is to insure that, when multiple parties are involved, the general disallowance rule results in the denial of the deduction at only one level. The rule only applies where the parties have a direct, one-on-one relationship and does not have any relevance to payments to membership organizations that further the interests of all members, rather than one particular member. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 610 (1993), reprinted in 1993-3 C.B. 488.

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