

LOBBYING BY PUBLIC CHARITIES: 1976 LEGISLATIVE DEVELOPMENTS

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Editor's Note: In its May, 1976, issue, the Journal of Legislation published an article by James A. Moore, Barbara J. Washburn and Eugene Goldman, *Restrictions on Lobbying Activities by Charitable Organizations: Proposed Legislative Remedies*. The suggestions encompassed in the Moore/Washburn/Goldman article were enacted into law as part of the Tax Reform Act of 1976. This note responds to requests from numerous charitable organizations for an explanation of the changes enacted in 1976. In it, the author reviews the problems which led to the enactment of this change in the tax code, the legislative efforts which culminated in this change, and the effects of this change on the nation's charities.

For forty years, charitable organizations were severely restricted by the Internal Revenue Code in the extent to which they could engage in legislative activities.¹ The 1934 and 1954 codes provided that "no substantial part of the activities" of such organizations could be devoted to efforts "to influence legislation."²

The "substantial" test, in practice, was never defined in a "universally acceptable" manner,³ resulting in confusion to the nation's charities and restrictions on their efforts to convey views to Congress and to their members about needed or pending legislation.

Section 1307 of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, provides, for the first time, a specific definition of the extent to which charitable organizations may engage in legislative activities. Section 1307 embodies the objectives sought by the Coalition of Concerned Charities,⁴ its main goal having been the clarification of the Internal Revenue Code requirement that "no substantial part of the activities" of a charitable organization may consist of "carrying on propagand, or otherwise attempting to influence legislation."⁵

Prior the enactment of section 1307, the language of section 501 (c) (3)

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1. See: Revenue Act of 1934, ch. 277 Sec. 23(o), 48 Stat. 690, and I.R.C. of 1954, as amended, Sec. 501.

2. *Supra*, note 1.

3. J. Moore, B. Washburn, E. Goldman, *Restrictions on Lobbying Activities by Charitable Organizations: Proposed Legislative Remedies*, 3 Notre Dame J. Legis. 17 (1976).

4. *Supra*, note 3, at 22, n. 40 "The Coalition of Concerned Charities is a group of over 80 501(c) (3) organizations from the health, education, environment, and social service fields formed in 1973 to work for passage of legislation clarifying and expanding the rights of 501(c) (3) organizations to lobby."

5. I.R.C. Sec. 501(c) (3).

of the Internal Revenue Code of 1954, as amended, gave rise to vagueness with respect to the extent to which a charitable organization might attempt to influence legislation. Both the courts and the Internal Revenue Service heretofore had failed to agree on a concise interpretation of the "no substantial part" test.⁶ Instead, the courts considered each case on an ad hoc basis.

This aura of uncertainty, due to the lack of relatively specific guidelines, inhibited participation of charitable organizations in legislative operations. Charitable organizations were effectively forced to restrict severely their lobbying activities in order hopefully to remain within the "no substantial part" test, a test with uncertain standards. If the organizations did not meet this test, they would lose their tax-exempt status.

How and when were these charitable organizations to know that their lobbying activities had become too extensive? This concern was most effectively expressed by Senator Edmund S. Muskie (D-Me.) in his introduction of S. 1408, a bill that would revise the tax code to allow tax-exempt charities to engage in communications with legislative bodies, committees, and members thereof:

Tax-exempt status is available to these organizations, only so long as no substantial part of their activities constitutes attempts to influence legislation. This limitation has had a severe impact on the ability of charitable and public groups to participate meaningfully in the formulation of public policy. A determination that such an organization has engaged "substantially" in attempting to affect legislation will result in a denial of tax-exempt status and a consequential denial of deductions for contributions which the organization receives. This is the equivalent of death for many of them. Even a review of their tax-exempt status can dry up desperately needed funds. It makes no sense to decide that these organizations operate in the public interest and grant them tax-exempt status and then silence them when they attempt to speak to those who must decide public policy.⁷

Various legislative suggestions were discussed, and bills introduced, in an attempt to define more specifically than the present law the degree of legislative activity in which public charities may engage.⁸ These attempts also sought to dismiss the inequity between section 162(e) of the Internal Revenue Code, allowing business entities deductions for lobbying, and section 501(c) (3), which permitted charities to lobby only so long as "no substantial part of their activities" constituted attempts to influence legislation.

Representative Barber B. Conable, Jr. (R-N.Y.) has been an effective catalyst in attempts for corrective legislation in this area. For more than four years he

6. See, e.g., *Seasongood v. Commissioner*, 227 F.2d 907 (6th Cir. 1955), *rev'g*. 22 T.C. 671, which held that where less than 5% of the time and effort of a good government association was devoted to activities which the Tax Court found to be political, such political activities were not substantial within the meaning of the Internal Revenue Code. However, *Christian Echoes National Ministry v. United States*, 470 F.2d 849, 855 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973) rejected the *Seasongood* percentage test, stating that "the political activities of an organization must be balanced in the context of the objectives and circumstances of the organization to determine whether a substantial part of its activities was to influence or attempt to influence legislation. . . . (t)hat a percentage test to determine whether the activities were substantial obscures the complexity of balancing the organization's activities in relation to its objectives and circumstances."

7. 92d Cong., 1st Sess. (1971), 117 Cong. Rec. 8517 (1971).

8. See, e.g., S. 1408, 92d Cong., 1st Sess. (1971); H.R. 8920, 92d Cong., 1st Sess. (1971); S. 3063, 92d Cong., 2 Sess. (1972); H.R. 13720, 92d Cong., 2d Sess. (1972); H.R. 5095, 93rd Cong., 1st Sess. (1973); H.R. 12037, 93rd Cong., 1st Sess. (1973).

seriously engaged in various efforts legislatively to define what is "lobbying" for a charity, and to determine how much is "substantial." He realized that numerous charities would be affected by this legislation, and that many charities sought varying items to be included.⁹

Ultimately, the forces in support of this new legislation, spearheaded by Representative Conable, found a lifeline in the form of H.R. 13500, which included a set of requirements to be used in determining when an electing tax-exempt charitable organization has engaged in lobbying activities of a scope sufficient to cause the loss of tax exemption and the right to receive tax deductible contributions:

Altho it has been more than 40 years since this language (501 (c) (3) of the Internal Revenue Code) was first enacted, neither court decisions nor treasury regulations over that period have given sufficient detailed meaning to the language of the statute to enable most exempt organizations to know which activities on their parts are permissible and which impermissible. It is widely believed that the standards of present law are so vague as to lead to unreasonable uncertainty and uneven enforcement. This bill is aimed at establishing relatively specific spending limits in place of the uncertain standards of present law, while at the same time establishing a more reasonable relationship between the sanctions and the violations of the standards.¹⁰

Section 1307 of the Tax Reform Act of 1976 basically incorporates the provisions of H.R. 13500.¹¹ Section 1307 closely parallels suggestions offered by James A. Moore in his detailed analysis of previous Muskie-Conable proposals.¹² Section 1307 permits public charitable tax-exempt organizations to elect¹³ to substitute the present "no substantial part" requirement with a specified limit as to the percentage of the organization's total expenditures which may be devoted to influencing legislation (the "lobbying non-taxable amount").¹⁴

9. Washington Report by Representative Barber B. Conable (October 23, 1975):

Enter Common Cause, a non-profit organization frankly set up for lobbying in the public interest and thus not claiming the tax exemption. Common Cause is pushing a general lobbying bill, requiring full disclosure by all lobbyists and much more lobbying regulation than in the past. They have found they can't get support for their lobbying bill from the charitable movement unless my bill passes, because the charities don't want to make full disclosure of their lobbying status until the law tells them what "substantial" means.

10. H.R. 13500, 94th Cong., 2d Sess. (1976).

11. Staff of the Joint Committee on Internal Revenue Taxation, 94th Cong., 2d Sess., *Conference Comparison on H.R. 10612, Tax Reform Act of 1976* (1976). Section 1307 is the equivalent of H.R. 13500 except to the extent that the rules disallowing deductions for out-of-pocket expenditures made to influence legislation do not apply to expenditures by organizations not eligible to elect the new expenditure tests.

12. *Supra*, note 3.

13. The Internal Revenue Service's Office of Public Affairs, in connection with its exempt organization officials, stated that as of the publication of this note, exact procedures for exercising this election have not been promulgated. They theorize that a separate schedule will have to be attached to the information return (form 990) for the election to become effective.

26 U.S.C. Sec. 501(c) (3) (1954), as amended by TRA of 1976, Pub. L. No. 94-455, Sec. 1307, 90 Stat. 1520. Churches, conventions, or associations of churches, integrated auxiliaries thereof, and a member of an affiliated group of organizations [within the meaning of 26 U.S.C. Sec. 4911 (1954), as amended by Tax Reform Act of 1976, Sec. 1307] may not make such an election.

14. 26 U.S.C. Sec. 4911(d) (1954), as amended by TRA of 1976, Pub. L. No. 94-455, Sec. 1307, 90 Stat. 1520. Influencing legislation is defined as any attempt to influence any legislation through an attempt to affect the opinion of the general public or any segment thereof ("grass roots lobbying") and any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any other government official or employee who may participate in the formulation of the legislation ("direct lobbying"). "Legislation" entails 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.

This election would permit expenditures for influencing legislation for a year to the extent of 20% of the first \$500,000 of the organization's exempt purpose expenditures,¹⁵ plus 15% of the next \$500,000, 10% of the third \$500,000, and 5% of any additional expenditures. An overall spending limit of \$1,000,000 would be applied. If it were not for this "reverse graduation" principle, due to the enormous budgets of large charities, expenditures of a substantial percentage of such budgets would result in deluging Congress and other governmental bodies with lobbyists operating with tax-free dollars. This reverse percentage concept aids in the elimination of the major worry of the legislators and a concern noted by Mr. Moore, that of a percentage limitation conceivably making possible the accumulation of immense funds available for lobbying.¹⁶ Within these limits, a separate limitation is placed on grass roots lobbying. This grass roots non-taxable amount is one-fourth of the lobbying non-taxable amount.¹⁷ These two limitations may be elected separately and the election may be made on a year to year basis. Where the election is not made, old law will continue to govern.¹⁸ As Mr. Moore suggested, one reason for allowing an election is that compliance with the expenditure-based test would require more frequent and comprehensive audits for some organizations than are required under the existing law and that some of the organizations would therefore prefer to remain under the substantial activity test.¹⁹

This new provision excludes four categories of activities from the concept "influencing legislation." These exclusions are: (1) making available the result of non-partisan analysis, study, or research;²⁰ (2) providing technical advice or assistance in response to a request by a government body; (3) appearances before or communications to a legislative body with respect to a possible decision of that body which might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deduction of contributions to the organization; and

15. H.R. 1210, 94th Cong., 2d Sess. (1976). (H.R. 94-1210 interprets H. R. 13500, *supra*, note 10.) "Exempt purpose expenditures" entails the total of the amount paid or incurred by the organization for exempt religious, charitable, educational, etc., purposes. A comparison of the amount of lobbying expenditures by an organization with its exempt purpose expenditures must be made to determine whether an electing organization is subject to the excise tax.

16. Theories behind, and effects of, Muskie-Conable legislative attempts were offered by Pepper, Hamilton & Scheetz in a report prepared for the Commission on Private Philanthropy and Public Needs, *Legislative Activities of Organizations Other Than Foundations*, September 18, 1974. These theories and effects are analyzed in light of section 1307 of the Tax Reform Act of 1976 in this note. One such effect which the authors discussed is that of the employment of the "reverse graduation" principle, i.e., the greater the budget, the smaller the percentage allowed to be spent on direct lobbying, combined with an overall flat dollar ceiling for each charitable organization.

17. *Supra*, note 15.

18. Hopkins, *Most Tax Exempt Organizations Affected by Far Reaching Provisions of the Tax Reform Act*, 45 J. Tax. 6 (1976). The election shall be effective for all taxable years of the organization which end after the date the election is made, and begin before the date the election is revoked by such organization. Thus, an organization may, at any time prior to the end of the taxable year, elect the new standards for that taxable year. Once the election has been exercised, it cannot be revoked for a taxable year after that year has begun.

A charitable organization may choose not to make the election due to filing requirements. These filing requirements demand that a charity making the election must disclose on its information return (form 990) the amount of its lobbying expenditures (total and grass roots) and the amount it could have spent for these purposes without being subject to the 25% penalty tax which is imposed on any expenditures over the established limits. An organization which so elects and which is a member of an affiliated group must furnish this information with respect to both itself and the entire affiliated group.

19. *Supra*, note 3, at 23.

20. The phrase "non-partisan analysis, study, or research" may lead to extensive litigation if it is not carefully interpreted by the Internal Revenue Service.

(4) communications between the organization and its bona fide members²¹ unless the communications directly encourage the members to urge non-members to influence legislation.²² This fourth exclusion insures that communications with members, obviously a crucial matter for the charities, will be carefully restricted to bona fide members to prevent backdoor grass roots lobbying.²³ As Mr. Moore stressed, if no restriction is placed on such communications, the fear is that "membership" could be expanded (by a charity attempting to abuse the privilege) to include immense mailing lists.²⁴

Prior to the section 1307 enactment, a violation of the "no substantial part" test resulted in loss of the favored status. This was a major concern of Representative Conable, for this resulted in no intermediate penalty or sanction.²⁵ Now, an electing organization, if it exceeds either its general limitation or the grass roots limitation in a taxable year, is subject to an excise tax of 25% of its excess lobbying expenditures. It is only once the electing organization's lobbying expenditures "normally"²⁶ exceed 150% of the limitation that loss of tax-exempt status will occur. These sanctions are imposed automatically.²⁷ If, during the taxable year, the organization's expenditures exceed both the non-taxable lobbying amount and the non-taxable grass roots amount, then the 25% tax is to be imposed on whichever one of the excesses is the greater. This excise tax is not deductible.²⁸

Another major restriction under section 1307 relates to the status of the organization after loss of its charitable status. If an organization has lost its classification as a charity under 501(c) (3) due to excessive lobbying, it cannot then become a social welfare organization under 504(c)(4) of the Internal Revenue Code.²⁹ This restriction against applying 504(c)(4) was provided in order to curtail another concern raised by Mr. Moore:³⁰ the situation wherein an organization losing its 502(c)(3) status becomes a 504(c)(4) organization, thus exercising unrestricted use of the endowment created by tax deductible dollars.

An affiliated organization provision was also included in the new legislation. This provision was implemented in order to prevent the use of the decreasing percentage test used to compute the lobbying and grass roots non-taxable amounts by a group of organizations. Section 4911(f) of the Internal Revenue Code, as amended by the Tax Reform Act of 1976, provides a method of aggregating the expenditures of related organizations to prevent the formation of a group of organizations for the purpose of circumventing the effects of the reverse graduation principle and to prevent attempts to avoid the \$1,000,000 ceiling on lobbying

21. *Supra*, note 15. To be a bona fide member, a person must have more than a nominal connection with the organization. The person should have affirmatively expressed a desire to be a member.

22. *Supra*, note 14.

23. *Supra*, note 16, at 33.

24. *Supra*, note 3, at 22.

25. *Supra*, note 10.

26. *Supra*, note 15. "Normal" means on the average over a four-year period.

27. *Supra*, note 15. Imposition of these sanctions (or, in the case of loss of exemption, the effective date of the sanction) is not subject to the discretion of the Internal Revenue Service.

28. *Supra*, note 15.

29. *Supra*, note 15. This provision denying an organization which loses its charitable status the opportunity to become a 504(c) (4) tax-exempt social welfare organization applies only if the loss of status is due to excessive lobbying. Such an organization could ultimately reestablish its status as a charitable organization.

30. *Supra*, note 3, at 22.

expenditures.³¹ Where two or more 501(c) (3) organizations are members of an affiliated group and at least one of the members has elected coverage under the new standards, the calculations of lobbying and exempt purpose expenditures must be made as though such affiliated organization is one group.³² If these expenditures exceed the permitted limits, each of the electing member organizations must pay a proportionate share of the penalty excise tax, with the non-electing members treated under the old provisions.³³

Thus, section 1307 of the Tax Reform Act of 1976 provides the long sought reasonable standards for determining the extent to which charitable organizations may engage in lobbying activities.

As Representative Conable points out,

H. R. 13500, which became part of PL 94-455, the Tax Reform Act of 1976, was an important step in providing some symmetry in lobbying regulation by facilitating the lobbying of charities. Because of this change in the law, elected public officials can now benefit in greater degree from the experience and views of tax-exempt charitable organizations.

The uncertainty of what was "substantial" legislative activity caused continuing problems for the charitable groups and prompted some to avoid completely any participation in formulation of public policy. In contrast, the tax laws granted a great many classes of noncharitable organizations broad latitude to deduct the costs of efforts to influence legislation.

American non-profit organizations are diverse, sophisticated, involved and motivated; their views are needed in Washington and the state capitals. Such charities as the American Cancer Society, the National Audubon Society and the Wilderness Society, to name a few, have great experience and knowledge in the development of public policy in education, health, environment and many other areas; because of PL 94-455 they should now be able to participate in the process to a reasonable degree.³⁴

A significant and effective factor underlying the enactment of these standards was the continuing effort of the Coalition of Concerned Charities, headed by Elvis J. Stahr, president of the National Audubon Society, Inc. In addition to the Coalition's efforts, positive support for the Muskie-Conable bills was generated by the Commission on Private Philanthropy and Public Needs (The Filer Commission).³⁵ James A. Moore, a senior partner in Pepper, Hamilton & Schetz, Washington, D.C., served as counsel to the Coalition and effectively coordinated the efforts by the nation's charities to define the standards for permissible legislative activities. According to Dr. Stahr, "Mr. Moore masterminded for four years the effort to obtain clarification of the restrictions on the legislative activity of chari-

31. *Supra*, note 16, at 32.

32. 26 U.S.C. Sec. 49(f)(1)(A) (1954), as amended by Tax Reform Act of 1976, Pub. L. No. 94-455, Sec. 1307, 90 Stat. 1520.

33. *Supra*, note 18.

34. Statement by Rep. Barber B. Conable, Jr., to the *Journal of Legislation*, March 28, 1977, on file in the *Journal of Legislation*.

35. See: *Report of the Commission on Private Philanthropy and Public Needs, Giving in America: Toward a Stronger Voluntary Sector* 181 (1975).

table organizations. The effort culminated in success through the inclusion in the Tax Reform Act of 1976 of a section (#1307) embodying the objectives sought by the Coalition of Concerned Charities," of which Dr. Stahr is chairman.³⁶

The Coalition of Concerned Charities recognized that Representative Conable "carried the brunt of the effort on the Hill."³⁷

The continuing concern by Senator Muskie and Representative Conable for legislation to define these standards and for the programs of the nation's charities, combined with the charitable organizations' efforts led by Dr. Stahr, resulted in Congressional action in 1976 which will be of tangible benefit to the nation's charities and to the nation which they serve.

36. Letter from Elvis J. Stahr, president, National Audubon Society, Inc., and chairman, Coalition of Concerned Charities, to Fredric M. Carlin, executive editor, *Journal of Legislation*, December 13, 1976.

37. Letter from Elvis J. Stahr, *supra*, note 36.