RESTRICTIONS ON LOBBYING ACTIVITIES
BY CHARITABLE ORGANIZATIONS
PROPOSED LEGISLATIVE REMEDIES

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The Internal Revenue Code places restrictions on the extent to which tax exempt charitable organizations may act to influence legislative policy development. The Code requires that "no substantial part of the activities" of a charitable organization may consist of "carrying on propaganda, or otherwise attempting, to influence legislation. 1 Although this substantial activity test has been in effect for approximately forty years, 2 neither the courts nor the Internal Revenue Service (IRS) has been able to derive a universally acceptable definition of "substantial." Thus, charitable organizations which engage in influencing legislation are at the mercy of subjective determinations which may threaten their favored tax status. 3

During 1975 a majority of the House Committee on Ways and Means, led by Representative Barber B. Conable (R-N.Y.), and nearly half of the Senate, led by Senator Edmund S. Muskie (D-Me.), introduced identical bills 4 which would moderately expand and define more clearly the extent to which public charities may participate in the legislative process.

This article will explore the present limitations on legislative activities of charitable organizations. It will also discuss the countervailing considerations which favor eliminating the vagueness of existing lobbying restrictions and partially redressing the inequality with business organizations which may claim tax deductions for lobbying expenses. Special emphasis will be placed on legislative proposals which are intended to remove the uncertainty of present law.

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2. Congress enacted this test in the Revenue Act of 1934, ch. 277, Sect. 23(o), 48 Stat. 690. The language of the 1934 "substantial" test is identical to the language contained in the present section 501(c)(3).
3. For the purpose of this article, "charitable organization" or "501(c)(3) organization" will refer to organizations qualifying for tax exemption under section 501(c)(3). The term will not include private foundations which are subject, under section 4945 of the Code, to more severe limitations on their legislative activities. See Int. Rev. Code of 1934, Sect. 4945. It also does not include organizations qualified under Sect. 501(c)(4); infra. note 4.
4. "Favored tax status" refers to a public charity's exemption under section 501(c)(3) of the Code and the ability of its contribution to deduct their charitable contributions under sections 170(c)(2) (income tax deduction), 2055(a) (charitable bequest deductions), and 2522(a) (gift tax deduction). Contributors to many other organizations exempt under section 501, such as civic leagues under section 501(c)(4), are not permitted to deduct their contributions, but the Code does not restrict Sect. 501(c)(4) organizations from engaging substantially in legislative activities. See Int. Rev. Code of 1954, Sect. 501(c)(4).

Historically, the favored tax status is justified on the ground that the charity relieves financial burdens that would otherwise fall on the government. See: Report of the Committee on Ways and Means. H. Rept. No. 1860, 75th Cong., 3d Sess. (1938).
5. H.R. 8021, 94th Cong., 1st Sess. (1975) and S. 2832, 94th Cong., 1st Sess., introduced June 18, 1975, and December 19 (legislative day, December 15), 1975, respectively.
THE "SUBSTANTIAL" TEST

Public charities desiring to participate in the legislative process have few standards to guide them for meeting the "substantial" test. Neither the Internal Revenue Code nor its Regulations define the term "substantial." Instead, the Regulations use the term to define itself, saying that an organization to be exempt may not "devote more than an insubstantial part of its activities" to influencing legislation. In fact, it is the policy of the IRS not to define the term clearly.

The reported cases do not clarify what is meant by "substantial" activity either, although the present provision was first enacted in 1934. Rather, the courts have considered each case in an ad hoc fashion and have used various criteria to test "substantiality." Such criteria have included a percentage test based on the total amount of funds expended on lobbying activities, examinations of the beneficial effects of the organization's legislative activity to the community, the time and effort expended by unpaid volunteers in formulating legislative positions for the organization, and the degree of relationship between the lobbying activities and the objectives and circumstances of the charity.

In Martha Hubbard Davis, the Court used a "very small part" test in holding that the organization in question had not violated the "substantial" provision of section 501(c)(3), stating that the legislative activities constituted a "very small part" of the general activity of the organization. The Court stated further that such activities were "purely incident to its main and controlling purpose and activity" which was entirely charitable and educational. The Court apparently considered several factors in reaching its decision, such as the portion of legislative activity in relation to the organization's general activity, and whether such activities were merely incidental to the organization's primary purpose and activity.

The Sixth Circuit appears to be the only court which has attempted to provide a formula to determine the meaning of "substantial." In Seasongood v. Commissioner, the court held that the devotion of less than 5% of a non-partisan, good-government league's time and effort to legislative activity was not "substantial." In Christian Echoes National Ministry v. United States, the court rejected the percentage test of Seasongood, stating, "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." The court then denied section 501(c)(3) status to the organization in question had not violated the "substantial" provision of section 501(c)(3), stating that the legislative activities constituted a "very small part" of the organization's activities is substantial.

7. See Internal Revenue Service, Exempt Organization Handbook (MT11, 771-56, paragraph 764 April 19, 1972). The handbook states that substantiality is frequently "self-evident" with no simple rule for determining a violation of the "substantial" test. Id.
8. See e.g., Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955), rev'd 22 T.C. 671.
9. See e.g., Dulles v. Johnson, 275 F.2d 362, 367 (2d Cir. 1959), cert. denied, 364 U.S. 834 (1960); Roberts Dairy Co. v. Commissioner, 195 F.2d 948, 950 (8th Cir.), cert. denied, 344 U.S. 865 (1952); St. Louis Union Trust Co. v. United States, 374 F.2d 427, 435-36 (8th Cir. 1967) (dictum).
14. Supra, note 11. The IRS also rejects the Seasongood percentage test. "There is no simple rule as to what amount of activities is substantial . . . The Seasongood Case . . . provides but limited guidance because the court's view as to what sort of activities were to be measured is no longer supported by the weight of precedent . . . In addition, it is not clear how the five percent was arrived at." Internal Revenue Service, Exempt Organization Handbook (MT11) 671-56 paragraph 764(1) April 19, 1972."
and continuous." 15

In League of Women Voters v. United States, 16 the court refused to consider only the number of hours spent on direct lobbying, but included the time and effort spent at the chapter level in formulating and discussing positions to be taken by the League on various proposals. The court, in denying section 501(c)(3) status to the League, stated that the influencing of legislation was the League's "main purpose and reason for being."

In 1974, the Court of Claims in Haswell v. United States 17 followed the holding in Christian Echoes by rejecting the percentage test as the primary means of determining substantiability. In disqualifying the organization as a charity capable of receiving tax deductible contributions under section 170(c)(2), the court balanced the political activities of the organization against its objectives and circumstances and found the organization had engaged in substantial legislative activity. While the court stated that the percentage test was inappropriate because it clouded the balancing test, it applied an expenditure test based on overhead costs and salaries to justify its finding of substantiability. 18 In effect the court simultaneously applied the percentage and balancing tests in finding a violation of the substantial test.

It is readily apparent that the cases offer no clear guidelines as to what constitutes "substantial" activity for purposes of section 501(c)(3). The present state of the law is perhaps best summarized by the Tax Court in Martha Hubbard Davis:

The question is always one of fact to be determined upon the record of purely charitable activities and activities influencing legislation and a comparison of the two. Under such conditions the decisions of the courts in other cases are of little value. 19

THE NEED FOR CORRECTIVE LEGISLATION

The Code's vagueness on permissible lobbying has understandably chilled the desire of charitable organizations to engage in the legislative process. The severe penalty of losing favored tax status for violating the undefined "substantial" test suggests the possibility that the vagueness of the restriction interferes with the first amendment right of free expression 20 and is an improper exercise of legislative sanctions. 21

Those charities who participate in the legislative area risk expensive and time-consuming audits to determine whether they have met undefined standards. The Service has at times attempted to view the term "substantial," not only in undefined quantitative terms, but in undefined qualitative terms as well. A "facts and circumstances" test, apparently called for by the Regulations, takes the bewildered charities out of definable areas, such as specific financial expenditures and allocations of staff time, and into completely uncharted areas, including not only time of volunteers, but importance of the effort, and very possibly other factors. 22

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15. Supra, note 11 at p. 856.
17. Supra, note 11.
22. As Mortimer Caplin, former Commissioner of Internal Revenue, pointed out in his testimony before the Committee on Ways and Means, revenue agents are normally experts on accounting, not ideology, and it is almost impossible to tell what one of them would decide on a given set of facts. Inconsistent enforcement of the law by the Internal
When a charity's exemption is revoked, no matter how tenuous the grounds, it takes a considerable period of time to get the action reversed, whether by administrative or court action. During this period, the charity cannot assure contributors that their contributions will be deductible, and the normal programs of the charity inevitably suffer drastically. In many instances, loss of contributions will result in total and permanent cessation of the organization's charitable activities.

The significant questions of policy and equity which arise from the charge that a chilling effect is created by section 501(c)(3) are compounded by the disparate statutory treatment afforded businesses which engage in lobbying activities. In 1962 Congress enacted section 162(e) granting to business entities the right to deduct as ordinary and necessary expenses amounts paid or incurred in connection with legislative activity of direct interest to the business including, specifically, that portion of the dues paid to any trade association of which the business is a member which is attributable to such legislative activity. These trade associations are frequently classified as tax-exempt, under section 501(c)(6), thus compounding the inequity.

The legislative history of section 162(e) suggests that Congress felt it desirable governmental policy to have available information concerning the impact pending legislation would have on American businesses. The relevant Senate Report expresses this policy:

It is also desirable that the taxpayers who have information bearing on the impact of present laws or proposed legislation on their trade or business not be discouraged in making the information available to the members of Congress or legislators in other levels of Government. The presentation of such information to the legislators is necessary to a proper evaluation on their part of the impact of prior proposed legislation.

The inequity of present law is reflected in the remarks of Senator Muskie made in 1971 in support of S. 1408, a bill permitting charities to engage in direct lobbying activities:

It is fundamental to our constitutional system that they should have equal access along with business groups and others in presenting views to Congress. This is so, not because the views of the public interest groups are necessarily correct, but because in considering the increasingly complex matters which come before it, the Congress should hear and weigh all views to the fullest extent possible.

Revenue Service would naturally follow. Hearings Before the Committee on Ways and Means on H.R. 13720 to Amend the Internal Revenue Code with Respect to Certain Types of Exempt Organizations; 40, 92nd Cong., 2d Sess. (1972); hereinafter cited as Hearings on H.R. 13720.

23. Under present law an organization faced with loss of its 501(c)(3) status cannot obtain immediate judicial review of an adverse determination by the Service. It must go through the normal judicial process. Section 1202 of H.R. 10612, 94th Cong., 1st Sess. (1975), passed by the House of Representatives and pending in the Senate Finance Committee as this article goes to press, undertakes to solve this problem by providing a procedure for a charity to seek declaratory judgment in the Tax Court or United States district court as to its tax-exempt status. While the case is pending, contributions up to $1000 would still be deductible.

24. When the IRS proposed in 1967 that the Sierra Club's favored tax status be revoked because of the Club's political activity, the Club estimated that the proposed revocation cost it $125,000 in contributions. Note The Sierra Club, Political Activity, and Tax Exempt Charitable Status 5 Geo. L.J. 1129 n. 5, 6 (1969).

25. The enactment of Sect. 162(e) superseded Supreme Court holdings that expenditures in furtherance of an attempt to promote or defeat legislation before a legislative body were not deductible, notwithstanding the direct relationship to the taxpayer's trade or business. It had been the Court's purpose to maintain a uniform prohibition against indirect subsidization of the legislative activities of private parties. See Commissioner v. United States. 358 U.S. 498 (1959); Textile Mills. See. Corp. v. Commissioner, 314 U.S. 526 (1941).


LEGISLATIVE PROPOSALS FOR CLARIFYING THE SUBSTANTIAL TEST

Impetus for corrective legislative efforts may be attributed, in part, to a 1969 American Bar Association resolution which called upon Congress to restore the balance in legislative influence between public charities and the business community by permitting such charities to engage in substantial direct legislative activity with respect to matters of direct interest to them. 28 In 1969, an amendment was introduced by Senator John Sherman Cooper (R-Ky.) to redress the imbalance between sections 162(e) and 501(c)(3). 29 The amendment was never called up for final consideration by the Senate Finance Committee.

In 1971, legislation based on the ABA resolution was introduced by Senator Muskie 30 in the Senate and Congressman James W. Symington (D-Mo.) in the House. 31 The bills followed the characteristics of section 162(e), permitting business deductions for lobbying.

Although there was broad support for the Muskie-Symington bill, concern was expressed that the bill "might be interpreted to permit a public charity to devote its predominant activities to legislative efforts." 32 As a result, Senators Muskie and Hugh Scott (R-Pa.) introduced a new bill on January 24, 1972, which was identical to the Muskie-Symington bill except for one additional limitation: The organization must be one that "normally" devotes "substantially more than one-half" of its expenditures in pursuance of its exempt functions other than lobbying. 33

Discussion on the Muskie-Scott bill led to further compromise and considerable refinement which culminated in the introduction on March 9, 1972, of a bill by Congressmen Al Ullman (D-Oreg.) and Herman Schneebeli (R-Pa.). 34 The measure would have permitted charities to devote 20 percent of their expenditures to lobbying activities. No more than one-quarter of this 20 percent could be devoted to grass roots lobbying. Communication of information regarding legislation between an organization and its membership would be included in the direct lobbying expenditure limitation.

The bill further provided that making available the results of non-partisan analysis, study, research, providing technical advice or assistance to a governmental body in response to a written request, or appearances before legislative bodies with respect to decisions that could affect an organization's existence or status were not to be considered "attempts to influence legislation." 35 Every subsequent bill proposing amendment of Section 501 has contained similar exclusions.

28. The ABA resolution is reprinted and discussed in Section of Taxation, Counsel and Committee Recommendations: 21 Tax Lawyer 967-72 (1968). The Commission on Private Philanthropy and Public Needs (known as The Filer Commission) recommended a similar change in lobbying restrictions to permit charities to engage without limit in those activities that are deductible when done by businesses. Report of the Commission on Private Philanthropy and Public Needs, Giving in America: Toward a Stronger Voluntary Sector 181 (1975). The Filer Commission, made up of approximately 30 prominent people and funded through private sources, studied a broad range of issues in the area of private philanthropy for more than two years. The recommendations, designed to expand and reinforce the base of private philanthropy, were presented in late 1975 to the Secretary of the Treasury and the chairmen of the House Ways and Means Committee and the Senate Finance Committee. See also H.R. 9256, 94th Cong., 1st Sess. (1975).
33. S. 3063, 92nd Cong., 2d Sess. (1972). Senator Muskie noted that the "substantially more than one-half" provision of S. 3063 was comparable to the provisions of the Tax Reform Act of 1969 which interpreted "substantially more than one-half" as 65 percent and "normally" as requiring, generally, reference to a four-year period of an organization's experience. 118 Cong. Rec. 843 (1972).
35. These exceptions are modeled after Sect. 4945(e) which pertains to the legislative activities of private foundations. See Int. Rev. Code of 1954 Sect. 4945(e).
The House Committee on Ways and Means held hearings on the Ullman-Schneebeli bill on May 3-5, 1972. Testimony showed strong support for the basic principles of the bill, but questions were raised about specific provisions, particularly by representatives of the Treasury Department. In response to these questions and others raised during further study by all parties, Congressmen Ullman and Schneebeli introduced a new bill on March 1, 1973. On December 19, 1973, Congressman Conable introduced another bill, further reflecting the on-going efforts at communication and compromise. The Ways and Means Committee tentatively adopted the Conable bill with the addition of several provisions. However, the tax reform package drafted for final action by the Committee departed from this bill in several respects. These changes appeared sufficiently far-reaching that it was impossible to arrive at an acceptable draft to include in the final tax reform package approved, under much time pressure, by the Committee. Therefore, Congressman Conable, after consultation with representatives of charitable organizations, asked that the bill be withdrawn.

Congressman Conable and Senator Muskie have once again in the 94th Congress introduced corrective legislation, building on the compromises of the past. As of this writing the bills are being further revised by the staff of the Joint Committee on Internal Revenue Taxation in cooperation with the Treasury Department and the Coalition of Concerned Charities. It is expected that new bills will be introduced in both houses in the near future.

These bills with the anticipated changes adhere to the fundamental principles but undertake to resolve the four major problems raised over the years. First, a percentage expenditure limitation could conceivably make possible the accumulation of immense funds available for lobbying. Second, absent separate restrictions, charities could allocate their allowable limits to "grass roots" lobbying. Third, communications with its members is the lifeblood of any charity, so an exclusion for this is essential. However, if no restriction is placed on such communications, the fear has been expressed that "membership" could be expanded (by a charity seeking to abuse the privilege) to include gigantic mailing lists, which could lead to a type of grass roots lobbying; in addition, even communications with bona fide members should, under certain circumstances, be considered as equivalent to other types of efforts to influence legislation. Fourth, an organization losing its 501(c)(3) status because of lobbying activities could have a large endowment fund, created with tax deductible dollars, that could then be expended without limitation on lobbying activities.

To solve the first problem, the Muskie-Conable bills incorporate the reverse graduation percentage used in prior bills. The numbers, however, differ from those of

36. See statement of Honorable Edwin S. Cohen, Assistant Secretary for Tax Policy, Department of the Treasury, Hearings on H.R. 13720 5-10.
39. Supra, note 5.
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.
42. The term "grass roots" lobbying is used in this article to refer to the influencing of the general public with respect to legislative matters.
43. Statement of Dr. Elvis J. Stahr, Chairman, Coalition of Concerned Charities, Hearings Before the Committee on Ways and Means on the Subject of General Tax Reform, 93rd Cong., 1st Sess., 1483 (1973):
"It seems to me, that in restricting the right of an organization to communicate with and within its own membership, one is striking at the very heart of a public charity by cutting the flow of information between a national staff and its constituent members around the country. This runs the risk of detaching the staff from the very people that provide the resources with which the organization pursues its purposes."
earlier bills. A charity’s lobbying expenditures would be limited as follows: 20 percent of the first $500,000 of a charity’s total expenditures; 15 percent of the next $500,000; 10 percent of the next $500,000; and 5 percent of the excess over $1,500,000. An overall spending limitation of $1,000,000 for lobbying would be applied. 44

The proposed revised bill would penalize a charity exceeding its limitations in the first instances without the severe sanction of loss of exemption by imposing a tax on excess expenditures of 25 percent of all amounts over the limitation. Not until a charity "normally" 45 spent in excess of 150 percent of its limitations would it lose its 501(c)(3) status. To avoid the problem of the transfer of a large endowment fund upon such loss of 501(c)(3) status because of lobbying, the proposed revised bill would provide that the charity could not become a 501(c)(4) organization 46 and could not distribute its assets to another (c)(3) or (c)(4) organization. The grass roots and membership communication concerns are also addressed in the proposed revised bill. Grass roots expenditures would be limited to 25 percent of the permissible limit for all lobbying. The 25 percent tax would be levied if the grass roots ceiling were exceeded even though the overall lobbying ceiling had not been reached. 47 Communications between an organization and its bona fide members ("bona fide" to be defined by Regulations) would be excluded from the definition of "influencing legislation" except when the communication "directly encouraged" the member to influence legislation. A communication urging a member to request others to participate in the lobbying effort would be considered grass roots lobbying. By contrast, the bill already introduced excludes all communications with members from the lobbying limitation and contains no separate limitation on grass roots lobbying. 48

Both the existing and revised bills would eliminate the substantial test only for those organizations electing to come under the bill. Thus, the legislation does not replace the provisions of section 501(c)(3) but merely supplements them for electing organizations. The bill makes it clear that non-electing charities are unaffected by its provisions. One reason given for the election is that compliance with the expenditure-based test would require more frequent and comprehensive audits for some organizations than are required under existing law and that some of the organizations would therefore prefer to remain under the substantial activity test. The election provision also responds to concerns expressed by representatives of some church organizations that the expenditure-based test would violate the First Amendment through "excessive government entanglement." 49

44. For example, a charity with a budget of $750,000 could spend $137,000 for lobbying; one with a budget of $5,000,000 could spend $400,000. All charities with budgets in excess of $17,000,000 would be limited to $1,000,000 for lobbying expenditures.

45. In discussions during the drafting of the bill, "normally" has been referred to as an averaging over a four year period, see supra, note 4.

46. See supra, note 4.

47. If an organization’s lobbying limit were $157,500 it could spend $34,375 on grass roots lobbying. If it spent $40,000 on grass roots, it would be taxed $1,406. Not until it averaged expenditures in excess of $206,250 for all lobbying (150% of its $137,500 over-all limit or $35,625 for grass roots lobbying (150% of its $34,375 limit) would it lose its 501(c)(3) status because of substantial lobbying activities.

48. Both bills are similar in excluding dissemination of nonpartisan studies, provision of technical advice and "self-defense" of one’s tax status. See supra, note 35. The existing bill would also exclude from the definition of "influencing legislation" communications with the executive branch. The proposed bill would exclude such communications except where the "principal purpose" is influencing legislation.

CONCLUSION

The objective of the Conable-Muskie bills is not to permit charitable organizations to engage in full-time lobbying but to offer them clear and reasonable guidelines which would permit a moderate expansion of their legislative activity. Absent such corrective legislation charities will remain subject to case-by-case determinations from the Internal Revenue Service and the courts without adequate guidelines to assist them and legislatures will continue to feel the effects of the tax law’s bias in favor of business lobbying. The corrective legislation does not attempt wholly to eliminate this imbalance, but does provide reasonably definite guidelines so that charities can participate in the legislative process -- a tool often needed to carry out their primary mission effectively.

Rev. Bernadin also has argued that an IRS determination on whether the examined activities of a religious 501(c)(3) organization exceeded lobbying limitations would require the government to attach labels to all activity which it considered “religious” and all activity which it considered “legislative”. Such an interpretation of religious activities would have a potential for restricting religious activities which might be considered political in nature by the IRS. Similar determinations with a potential for entanglement between church and state have been opposed on first amendment grounds. See Statement of William Thompson, Member, General Board, National Council of Churches of Christ, Hearings on H.R. 13720 194, 199. See also Lemon v. Kurtzman, 403 U.S. 602 (1971) (statute authorizing state officials to supplement the salaries of teachers with secular subjects in religious schools constitutional under the first amendment, as the cumulative impact of the entire relationship arising under the statute involves excessive entanglement between government and religion); Presbyterian Church v. Hull Church, 393 U.S. 440 (1969) (civil courts cannot, consistent with the first amendment, determine ecclesiastical questions in resolving property disputes).

The constitutionality of the “substantial” limitation as applied to religious groups was answered in the affirmative by the Tenth Circuit, the only Circuit to reach the question. Christian Echoes supra, note II, at 856-857.