[COMMITTEE PRINT]

# SUMMARY OF ISSUES
# H.R. 13500
# "LOBBYING" BY CHARITIES

---

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

MAY 18, 1976

U.S. GOVERNMENT PRINTING OFFICE

71-426 WASHINGTON : 1976 JCS-23-76

## BACKGROUND

The Internal Revenue Code provides tax-exempt status for a wide variety of organizations. Charitable, religious, educational, etc., organizations are described in section 501(c)(3) as follows:

> (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, *no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation* and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office. (Emphasis added.)

The bill before the Committee on Ways and Means deals only with the effects of the italicized phrases, relating to the influencing of legislation.

That language was added to the tax laws in 1934 by a Senate floor amendment with very little recorded debate.

## ISSUES

### Expenditure Limits in Contrast to Activities Limits

The bar on exempt organizations engaging in "substantial" activity to influence legislation has provoked considerable debate about both the appropriateness of the restriction and its interpretation. Some propose striking out the Code's restrictions on exempt organizations' lobbying activities altogether; others would forbid exempt organizations to do any lobbying at all. The majority of the proposals which have been presented in the last 6 years, however, would replace the "substantial" test in present law with standards that can be more clearly and more objectively determined.

Present law focuses on "activities". There is general agreement that it is difficult to quantify activities in any objective manner. Also, it is argued, any tax abuse which may occur in this area relates to improper expenditures, because no deduction is allowed under present law for the value of volunteer services.

H.R. 13500 follows the general policy adopted by most bills introduced in this area; it relies upon expenditure limits and discards the concept of activity limits.

### Tax as Initial Sanction

The sanction of loss of exempt status is sometimes unduly severe and at other times almost inconsequential. Because of its severity in some cases, administrators and judges are often reluctant to impose the sanction. As a result, activities which are questionable often result in either no sanction or an extreme sanction.

It has been argued that imposition of a tax based on the amount by which an organization violates a standard could lead to a more uniform

administration of the standard and would provide an ability to "fine tune" the sanction. Some maintain that the use of a tax measured by the extent of the violation of the standard would make it easier for affected parties to reach a concensus and agree to a specific formulation of the standard to be imposed. Violation of the standard by some small margin would no longer be as critical to the organization as would be the case if loss of exempt status were the minimum sanction.

H.R. 13500 is unlike its predecessor bills in this regard because it would impose an excise tax measured by the amount by which the organization exceeds the expenditure standards set forth in the bill.

**Permitted Levels of Lobbying; Sanctions**

Under present law, there is no widely accepted rule as to the permitted level of an organization's expenditures for lobbying. In one case (*Seasongood* v. *Commissioner*, 227 F. 2d 907, 912 (C.A. 6, 1955)) the court noted that less than 5 percent of the organization's activities constituted the influencing of legislation and held that the organization had not thereby lost its exempt status. However, the Internal Revenue Service has not used the 5-percent rule as a guideline and other courts do not appear to have relied on this aspect of that opinion.

In 1972, the committee considered permitting organizations to spend up to 20 percent of their charitable expenditures for lobbying. No more than one-quarter of this permitted amount, however, could be spent for "grass roots" lobbying, i.e., attempts to influence the general public with respect to legislation. In response to assertions by the Treasury Department that this would permit upwards of $6 billion per year of lobbying, the committee appeared to favor establishment of sliding scale standards. Under this latter approach, the larger the organization, the smaller the percentage of its expenditures which could be used for lobbying. Some proposals have, in addition, set "caps", or maximum dollar amounts per year, on permitted lobbying expenditures.

It is generally conceded that the use of the sliding scale or the cap would necessitate some rules as to affiliation, so that the expenditure limits could not be avoided simply by the creation of large numbers of small organizations.

H.R. 13500 provides that no sanctions will be incurred by an organization on account of excess lobbying if the organization's lobbying expenditures do not exceed 20 percent of the first $500,000 of "exempt purpose" expenditures, plus 15 percent of the next $500,000 of such expenditures, plus 10 percent of the next $500,000 of such expenditures, plus 5 percent of such expenditures in excess of $1.5 million. H.R. 13500 also imposes an absolute cap, permitting no more than $1 million of lobbying expenditures, no matter how large the organization. No more than one-quarter of the total permissible expenditures determined under this formula for an organization may be spent for grass roots lobbying.

Under H.R. 13500, if an organization exceeds any of these limits, it is subject to an excise tax of 25 percent of the amount by which it exceeds the limit. In addition, if the limits are exceeded by more than 50 percent over a 4-consecutive-year period, then the organization loses its exempt status.

The effect of these rules on organizations of different sizes may be seen in the following table.

UNDER H.R. 13500

| If the charity's exempt purpose expenditures are— | Then the lobbying nontaxable amount is— | Percent | Of which no more than this amount can be spent on grass roots lobbying | Percent |
|---|---|---|---|---|
| $100,000 | $20,000 | 20 | $5,000 | 5 |
| $250,000 | 50,000 | 20 | 12,500 | 5 |
| $500,000 | 100,000 | 20 | 25,000 | 5 |
| $1,000,000 | 175,000 | 17.5 | 43,750 | 4.4 |
| $2,500,000 | 275,000 | 11 | 68,750 | 3.7 |
| $5,000,000 | 400,000 | 8 | 100,000 | 2 |
| $10,000,000 | 650,000 | 6.5 | 162,500 | 1.6 |
| $25,000,000 | 1,000,000 | 4 | 250,000 | 1 |
| $50,000,000 | 1,000,000 | 2 | 250,000 | .5 |
| $100,000,000 | 1,000,000 | 1 | 250,000 | .25 |

## Disclosure

Concern has been expressed that many prospective donors would be reluctant to contribute to the support of an organization with extensive lobbying activities, if they were aware of the extent of those activities. Some may conclude that an organization with lobbying activities should not be supported even though those lobbying activities are within the levels permitted under either present law or the proposals before the Ways and Means Committee.

One way of dealing with this concern might be to require that the amount of the organization's lobbying expenditures be set forth in its information returns and that those parts of the information returns relating to lobbying expenditures be made available to the public. The Internal Revenue Service might be instructed to make this return information available promptly upon request by potential donors or by others. Those States and localities that regulate charitable solicitations might be encouraged to require that this information be presented to potentital donors in the course of charitable solicitations.

It should be noted that other proposals for disclosure of various types of information, generally related to fund-raising costs, are before this committee and other committees. Although such disclosure issues might well receive extensive consideration, the committee may wish to deal with this limited disclosure issue in connection with the exempt organization lobbying bill now before it and to consider broader disclosure issues at another time.

## Affiliation Rules

If a sliding scale or a cap approach is adopted, some method of aggregating the activities of related organizations should be considered, in order to forestall the creation of numerous organizations to avoid the effects of the sliding scale or absolute limit. The affiliation problem in such a case would have some similarity to those which have already been faced in the case of multiple corporation (to increase the benefits of the surtax exemption, etc.)[1] and related private

[1] Sections 1561 through 1564.

foundations (to avoid the requirements of the charitable expenditure [2] and excess business holding rules [3]).

H.R. 13500 provides that two organizations are affiliated if (1) one organization is bound by decisions of the other organization on legislative issues or (2) the governing board of one organization includes enough representatives, etc., of the other organization to cause or prevent action on legislative issues by the first organization.

## Influencing Legislation

Present law does not define the term "influencing legislation" with respect to public charities. The private foundations provisions, enacted in 1969 (sec. 4945(e)) exclude the following categories of activities from the meaning of "influencing legislation":

(1) making available the results of nonpartisan analysis, study, or research,

(2) providing technical advice or assistance in response to a request by a governmental body, and

(3) so-called self-defense direct lobbying.

The Internal Revenue Service has ruled that the first of these categories of activities does not affect the exempt charitable status of an organization (Rev. Rul. 64–195, 1964–2 C.B. 138). The second of these categories has also been specifically ruled by the Internal Revenue Service as not constituting "influencing legislation" in the case of public charities (Rev. Rul. 70–449, 1970–2 C.B. 111).

H.R. 13500 would define "influencing legislation" to include both grass roots lobbying (attempts to affect the opinion of the general public) and direct lobbying (communications with members or employees of legislative bodies or "with any other government official or employee who may participate in the formulation of the legislation"). The bill would exclude the three categories of activities described above which are excluded under the private foundations rules. In addition, the bill would exclude communications between the organization and its bona fide members unless the communications (1) directly encouraged the members to lobby government officials, or (2) directly encourage the members to urge other people to lobby government officials. Finally, the bill would exclude any communication with an administrative branch official or employee unless the "principal purpose" of that communication is to influence legislation.

## Out-of-Pocket Expenditures

If the committee chooses to utilize expenditure limits as the standard, then care should be taken to have the relevant expenditures appear in the books and records of the organization.

For example, a deduction is available under present law for the out-of-pocket expenditures of a person on behalf of a charitable organization.[4] Those expenditures are not now reflected on the organization's

---

[2] Section 4942 (g) (1) (A) (I).

[3] Section 4946 (a) (1) (H).

[4] Regulations § 1.170A–1(h) (6) provide that "no deduction shall be allowed under section 170 for expenditures for lobbying purposes, promotion or defeat of legislation, etc." It is not clear how this provision of the regulations has been applied. It appears that this provision has not been applied to require proration of contributions in accordance with the proportion of the expenditures of an organization for lobbying purposes.

books; in fact, the organization may not even know that the expenditures have been made on its behalf.

H.R. 13500 provides that a person may not deduct out-of-pocket expenditures on behalf of a charitable organization. A question has been raised as to whether this restriction should apply in the case of expenditures on behalf of all charitable organizations or only expenditures on behalf of organizations which have elected the new rules provided by the bill. If this restriction is to apply in the case of expenditures of all charitable organizations, it is argued, then those who do not elect the new rules will be disadvantaged in that their donors will be limited on account of a rationale which does not apply to those nonelecting organizations. On the other hand, it has been noted that, if the deductibility of out-of-pocket lobbying expenses depends upon whether the organization has elected to have the new rules apply, then the donors would have to know whether the organization has effectively elected the new rules in order to know how to fill out their own tax returns. In many cases, this coordination of information between donors and organizations might be difficult.

Another possible approach would be to provide that a donor could not take a deduction for out-of-pocket lobbying expenses unless that donor notified the organization of the expenses. The organization would then be required to keep records of those deducted out-of-pocket expenses and charge those expenses against the organization's maximum permitted lobbying expenses. This required recordkeeping might facilitate the auditing activities of the Internal Revenue Service.

### Loss of Charitable Status

Under present law, an organization which loses its exempt status under section 501(c)(3) generally can nevertheless remain exempt on its own income (although ineligible to receive deductible charitable contributions) as a "social welfare" organization under section 501(c)(4). Concern has been expressed that this continued exemption permits an organization to build up an endowment out of deductible contributions as a section 501(c)(3) charity then use that tax-favored fund to support substantial amounts of lobbying as a section 501(c)(4) social welfare organization. (State law would in the usual case require that funds originally dedicated to charitable purposes are to remain so dedicated, even though the organization may have lost its Internal Revenue Code charitable status.)

In order to stop such a transfer of charitable endowment, H.R. 13500 provides that an organization cannot become a social welfare organization under section 501(c)(4) if it has lost its status as a charity because of excessive lobbying.

### Election of New Rules

In the course of the 1972 hearings on exempt organization lobbying, it was indicated that some organizations may prefer to continue under the rules of present law, notwithstanding the concerns which led many organizations to urge the committee to change present law. In recognition of the fact that the changes proposed by H.R. 13500 would involve some changes in present practices (especially as to keeping of records of expenditures), H.R. 13500 permits organizations to elect the new rules or to remain under present law.

### Churches

In addition, concerns have been expressed by a number of church groups that both existing law and the rules proposed in the bill might violate their constitutional rights under the First Amendment. They have indicated a concern that, if a church were permitted to elect the new rules, then the Internal Revenue Service might be influenced by this legislation even though the church in fact did not elect.

As a result of the concerns expressed by a number of churches, and in specific response to their requests, H.R. 13500 deals with this area in the following manner:

(1) The bill does not permit a church or convention or association of churches (or an "integrated auxiliary" or a member of an affiliated group which includes a church, etc.) to elect to come under these provisions.

(2) H.R. 13500 specifically provides that the new rules under the bill are not to have any effect on the way section 501(c)(3) is to be applied to organizations which do not elect to come under these rules.

(3) H.R. 13500 provides that its enactment is not to be construed as an approval or disapproval of the decision in *Christian Echoes National Ministry, Inc.* v. *United States*, 470 F. 2d 849 (1972), *cert. denied* 414 U.S. 864 (1973).

### Effective Dates

In order to provide time for the Treasury Department to promulgate the necessary regulations interpreting the bill and making elections under its new rules, H.R. 13500 would become effective beginning in 1977.

In order to provide an adequate opportunity for Congress to examine the effect of the new rules on lobbying by exempt organizations, H.R. 13500 provides that the new rules are to remain in effect for 10 years, that is, through 1986.

○