Business Feature / By Judah I. Kupfer, Esq.

Restrictions on Lobbying by Exempt Organizations: How Much Advocacy Is Too Much?

Introduction

As the leader of a nonprofit organization and a concerned member of society, Joseph takes it upon himself to stay in tune with the issues of the day and the latest legislation that may affect his organization as well as his broader community. When there is a bill introduced in the city council, state legislature or in Congress that may be of concern, he speaks to his elected officials, urging them not to pass the particular bill into law. Joseph also pushes his members to contact their legislators and convey to them their concerns. Whether or not he knows it, each of Joseph's actions constitutes lobbying activity on behalf of his organization.

Advocacy is an integral part of democracy and a hallmark of the American system. It is expected that people will and should stand up for what they believe in and advocate regarding issues of importance to them. However, when such advocacy is conducted by exempt organizations, federal law imposes certain restrictions to the amount of advocacy the organization may carry on. It is important for an organization to understand those limits so that it may confidently advocate without running afoul of these rules and risk loss of federal tax exemption.

Current law permits exempt organizations to engage in some lobbying activity but prohibits "substantial" lobbying. To determine what is substantial, organizations are subject to a "balancing test" that considers various factors and activities of the organization. Alternatively, most organizations have the option of electing out of the balancing test and instead choosing to be subject to a dollar limit to the amount the organization may spend on lobbying activities. Each of these sets of rules is summarized below. As this article is intended to merely alert the reader to the issues involved, it is important for organizations to seek legal advice for their particular circumstances and to learn the additional detail that was omitted from this article.

What is the restriction?

Under §501(c)(3), exempt organizations are restricted from engaging in substantial lobbying. In the words of the Tax Code: "no substantial part of [a §501(c)(3)'s] activities is carrying on propaganda, or otherwise attempting to influence legislation." It is important to note that the restriction permitting no engagement whatsoever in political campaign activity is completely distinct and separate and one should not confuse the two.

What kinds of contact constitute lobbying?

There are two types of lobbying: *direct lobbying* and *grassroots lobbying*. Direct lobbying is accomplished when an exempt organization directly contacts legislators or their staffs to propose, support or oppose legislation. This is the type that people would ordinarily assume to be lobbying. The second type of lobbying, grassroots lobbying, is accomplished when an organization urges the public to contact the legislators or their staffs. Thus, conversations with members or the general public may be lobbying as well. To violate the rule against substantial lobbying, an organization would need to conduct activities aimed towards influencing legislation and those activities must be substantial. Let's take a closer look at each of these elements.

What is "influencing legislation"?

We must first define what is included in "influencing legislation," so that we may later seek to determine whether it is substantial. Influencing legislation requires an understanding of the term "legislation." Legislation, for these purposes, is any action by Congress, a state legislature, local governing bodies (such as a city council or township) in an initiative, constitutional amendment or similar action. When the general public votes in a referendum, advocating to the public is also considered lobbying. However, actions by administrative agencies or the Executive Branch are not included. In a similar vein, an attempt to influence the confirmation of appointed judges is lobbying, but influencing the outcome of an election of judges would not be lobbying (but may be considered political campaign activity, a separate restriction on exempt organizations).

Organizations often speak to their members regarding issues of common interest. Such discussions would not constitute grassroots lobbying unless the organization in some form urged its members (and/or the general public) to contact their legislators to support, propose or oppose legislation. By the same token, organizations often conduct studies and research and share it with their legislators. Sharing such studies is not lobbying so long as the studies are conducted in a nonpartisan manner and the purpose was not to support or oppose a position. Organizations may also advocate social change or take a position on broad public issues without it being considered lobbying.

What is "substantial"?

The default rule for all §501(c)(3) organizations is a "balancing test" – to be safe, all lobbying conducted by an organization must be insubstantial relative to whatever else the organization does. Factors that are considered include: the percentage of the organization's budget or employee time spent on lobbying, the continuous or intermittent nature of the lobbying involvement, the nature of the organization and its aims, the controversial nature of the organization's position and its visibility. Essentially all of the organization's activities are considered and weighed against the lobbying activity in terms of time, cost, exposure and the nature of the activity. In any instance where various factors are balanced, the outcome would be less than clear; thus, an organization would be well advised to stay far enough away from the line so as not to risk crossing it. To add certainty and predictability, §501(h) is an option that allows organizations to elect an alternate test for "substantiality," which will be discussed below.

What if the organization fails the "balancing test"?

Should the organization fail the balancing test and be deemed to have engaged in substantial lobbying, the Internal Revenue Service will revoke the organization's federal tax exemption. In addition, most organizations (other than a private foundation, a shul that qualifies as a "church" for tax purposes, and those that make a §501(h) election) will also be subject to an excise tax in the amount of 5% of all lobbying expenditures (i.e., 5% of the amount it spent on lobbying activity) in the year in which the organization loses its exemption. An additional 5% is imposed on managers of the organization that knew of the conduct and willfully allowed it to go on, unless such managers had "reasonable cause," such as if they had relied on the well reasoned opinion of an attorney confirming that the conduct was permissible.

§501(h) Election

Whereas the balancing test looks to all facts and circumstances to determine whether the lobbying was substantial, the organization that makes the §501(h) election on form 5768 is given a ceiling dollar amount that it may spend on lobbying. It is available to all public charities except "churches." The election may be made midyear and such expenditures must be reported in the organization's annual form 990 on schedule C. Additionally, lobbying expenditures must be reported on form 4720 for the current year and the prior three years.

The organization would be required to separately keep track of its direct and grassroots lobbying, as different limits apply to each. Should the organization exceed either of the limits, a tax will be imposed and the organization risks loss of tax exemption if it exceeds its yearly ceiling by a specified percentage over a specified number of years.

Certain organizations should consider making an election: one that has a highly visible lobbying program, an organization that wants to do much lobbying for a short period of time, one that has a strong web presence (since this test looks to expense and the cost associated with posting information on a web page is likely minimal), one that has many volunteers, and an organization that has a smaller budget. There are many rules and restrictions associated with a §501(h) election; thus, an organization considering this option must seek specific legal guidance.

§501(c)(4) Organizations

Organizations that wish to lobby may form a separate sister organization organized as a §501(c)(4) "social welfare" organization. §501(c)(4) organizations may conduct unlimited lobbying. These organizations operate to promote the common good of the people in the community and their net earnings are devoted to charitable, educational or recreational purposes. They are entitled to most of the benefits of (c)(3) organizations with the notable exception that donations made to them are not deductible from income tax. The (c)(3) may control the (c)(4), they may share office space, and share a board of trustees, but they must be separate legal entities, expenses from each must be kept separate and monies of each may not be commingled. Most importantly, tax deductible contributions given to the (c)(3) may not be used by the (c)(4).

Conclusion

Lobbying activity includes more than one would expect. Urging constituents to contact their elected official may also constitute lobbying. Exempt organizations may conduct insubstantial lobbying. Determining what is substantial is not simple under the default balancing test and thus, many organizations may opt to make the §501(h) election, imposing a ceiling on the dollar amount to be spent on influencing legislation. It is important to reiterate that these rules are complicated and much detail has been omitted and so, it is important for the organization to seek legal guidance from its own professional.

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