

MEMORANDUM

TO: Maryam Zar
FROM: Abraham Reinherz & Elizabeth Evashwick
DATE: Oct. 20, 2017
RE: IRS lobbying tests for 501(c)(3) nonprofits

I. Introduction

The Westside Regional Alliance of Councils (WRAC) has asked the Community Justice Clinic for advice about political lobbying activities related to 501(c)(3) nonprofits. Specifically, what types of lobbying activities may WRAC undertake and maintain its tax exemption? This memo will first define political lobbying and how it pertains to nonprofits. Second, this memo will detail the two IRS tests to determine what activities the IRS permits for tax-exempt organization. Finally, we will recommend a course of action for WRAC.

II. Definition of Lobbying

According to the IRS, an organization will not qualify for 501(c)(3) status “if a substantial part of its activities is attempting to influence legislation (commonly known as lobbying).”¹ Exceeding a relative threshold of lobbying activity may cause the nonprofit to lose its tax exemption.² The IRS defines “legislation” as an act “by Congress, any state legislature, any local council, or similar governing body, with respect to acts, bills, resolutions, or similar items (such as legislative confirmation of appointive office), or by the public in referendum, ballot initiative, constitutional amendment, or similar procedure.”³ It does not include actions by executive, judicial, or administrative bodies.”⁴

Influencing legislation occurs when an organization personally contacts or urges the public to contact an employee of a legislative body to propose, support, or oppose legislation.⁵ Involvement in public policy issues is not considered lobbying.⁶ The IRS provides the following examples of public policy activities that are not considered lobbying: educational meetings,

¹ <https://www.irs.gov/charities-non-profits/lobbying>

² *Id.*

³ “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.” 26 C.F.R. § 56.4911-2(d)(1)(i).

⁴ <https://www.irs.gov/charities-non-profits/lobbying>

⁵ *Id.*

⁶ *Id.*

distributing educational materials, and any other manner of addressing public policy through education.⁷

III. Measuring Lobbying Activity

The IRS has two tests for measuring lobbying activity, the Substantial Part Test and the Expenditure Test.

1. Substantial Part Test

The IRS's Substantial Part Test evaluates whether lobbying is a substantial part of an organization's activities by examining the pertinent facts and circumstances of the case.⁸ Some factors include the time paid and unpaid workers devoted to the lobbying activity and how much money the organization spent on the lobbying activity.⁹

An organization that engages in excessive lobbying under this test in a taxable year may lose its tax exemption, resulting in all the organization's income being taxed.¹⁰ A 501(c)(3) organization that loses tax exemption will be subject to a five percent excise tax on lobbying expenditures.¹¹ In addition, the IRS may impose a five percent tax on organization managers, jointly and severally, if they agreed to the expenditures knowing that it would result in a loss of tax-exemption.¹²

Several cases have discussed the Substantial Part Test.¹³ In one case, the Sixth Circuit held that lobbying activity was not substantial because the organization did not spend any money and spent less than five percent of its total time and effort on lobbying activities according to testimony that was not challenged by adverse witnesses or other evidence.¹⁴ The improper conduct was the endorsement of candidates for political office and sponsoring or opposing legislation.¹⁵

In another case, the court held that the organization exceeded the limits in the Substantial Part Test because it spent a substantial amount of time actively promoting or opposing specific legislation.¹⁶ The organization in *League of Woman Voters* attempted to influence legislation by Congress, the United Nations, or by international treaties, which the court considered problematic.¹⁷ The court reasoned that according to the accounting of hours presented by the

⁷ *Id.*; Exceptions also include results of a nonpartisan analysis, study, or research, giving advice to the government after a written request, and communicating with a legislative body regarding matters pertaining to the organization's existence. 26 U.S.C. § 4911 (2012).

⁸ <https://www.irs.gov/charities-non-profits/measuring-lobbying-substantial-part-test>

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ See *League of Women Voters of U.S. v. United State*, 180 F. Supp. 379, 382-83 (Ct.Cl. 1960); *Seasongood v. C.I.R.*, 227 F.2d 907, 912 (6th Cir. 1955).

¹⁴ *Seasongood*, 227 F.2d at 912.

¹⁵ *Id.* at 909.

¹⁶ *League of Women Voters of U.S.*, 180 F. Supp. at 382-83.

¹⁷ *Id.* at 382.

League of Woman Voters they spent their time deliberating methods to influence legislation, which was unacceptable.¹⁸

In yet another case, the Court of Claims determined that a substantial part of an organization's activities involved attempts to influence legislation.¹⁹ In this case, the organization spent 20.5% of its expenditures on political activities in a single year.²⁰ Based on this case, spending 16.5% to 20.5% of an organization's time on legislative activities is substantial.

Although there is no bright-line rule on how much lobbying is too much, these cases indicate that an organization opting for the Substantial Part Test should not spend more than approximately 15% of its time and/or money on lobbying. These cases demonstrate the lack of certainty associated with the Substantial Part Test. Even if an organization spends less than 16.5% on lobbying, there is no guarantee that a court would conclude that this amount of lobbying is "insubstantial."

2. Expenditure Test

The Expenditure Test under 26 U.S.C. § 501(h) (2012) provides a different method for calculating lobbying activity.²¹ Under the Expenditure Test, there are two types of lobbying: direct and grassroots lobbying.²² Direct lobbying pertains to efforts to influence legislation by communicating with a member or employee of a legislative body and by communicating with other government officials or employees who participate in legislative activities. Grassroots lobbying refers to attempts to influence legislation by attempting to change the opinions of members of the general public.²³ Grassroots lobbying includes calls to action and encouraging the public to contact a legislator.

Under the Expenditure Test, the IRS places specific dollar limits on the amount of money that can be spent on lobbying based on an organization's total exempt purpose expenditures. Limits are based on the size of an organization, with a maximum limit of \$1,000,000.²⁴ An organization's lobbying expenditures will not harm the organization's tax-exempt status if the expenditures do not exceed the amounts specified in 26 U.S.C. § 4911 (2012).²⁵ The following table provides the IRS' limits based on the amount of exempt purpose expenditures:²⁶

¹⁸ *Id.* at 383.

¹⁹ *Haswell v. United States*, 500 F.2d 1133, 1136 (Ct. Cl. 1974).

²⁰ *Id.* at 1146.

²¹ <https://www.irs.gov/charities-non-profits/measuring-lobbying-activity-expenditure-test>

²² According to 26 U.S.C. § 4911(b), "[t]he grass roots nontaxable amount for any organization for any taxable year is 25 percent of the lobbying nontaxable amount (determined under paragraph (2)) for such organization for such taxable year." Therefore, an organization can spend up to 25% of the limit for overall lobbying on grass roots lobbying.

²³ Note how the grassroots definition of lobbying is included in the broader definition of lobbying about influencing the general public. *See supra* note 5. The Substantial Part test measures the broad definition of lobbying that includes both direct and grassroots.

²⁴ <https://www.irs.gov/charities-non-profits/measuring-lobbying-activity-expenditure-test>

²⁵ *Id.*

²⁶ *Id.*; 26 U.S.C. § 4911(c)(2) (2012). Exempt purpose expenditures are paid by a "public charity to accomplish the organization's exempt purpose." <https://www.irs.gov/instructions/i990sc/ch01.html>

Amount of Expenditure	Lobbying Non-Taxable Amount
≤ \$500,000	20% of the exempt purpose expenditures
>\$500,00 but ≤ \$1,000,000	\$100,000 plus 15% of the excess of exempt purpose expenditures over \$500,000
> \$1,000,000 but ≤ \$1,500,000	\$175,000 plus 10% of the excess of exempt purpose expenditures over \$1,000,000
>\$1,500,000 but ≤ \$17,000,000	\$225,000 plus 5% of the exempt purpose expenditures over \$1,500,000
>\$17,000,000	\$1,000,000

Organizations that elect the Expenditure Test must file Form 5768 (Election/Revocation of Election by an Eligible 501(c)(3) Organization to Make Expenditures to Influence Legislation).²⁷ This form only requires the organization’s name, address, and an indication of which tax year to which the election will apply.²⁸ The filed Form 5768 will remain in effect unless it is revoked by the organization.²⁹ If an organization engages in excessive lobbying over a period of four years, it may lose its tax-exemption, meaning that all income accrued during that period is taxable.³⁰ For any given year in which the organization exceeds the designated limit on lobbying expenditures, the organization must pay an excise tax equal to twenty-five percent of the excess lobbying expenditure.³¹

The Expenditures Test has several benefits that provides more generous lobbying limits than the Substantial Part Test.³² First, the Expenditures Test is easier to calculate and gives the organization certainty regarding whether the organization will remain tax-exempt. In addition to the designated threshold amounts specified above, 26 U.S.C. § 4911 defines certain activities that are not considered lobbying.³³ Second, the Expenditures Test does not take into account volunteer efforts that do not cost the organization any money in calculating the amount of lobbying activity. Third, unlike the Substantial Part Test, which subjects managers to liability for excessive lobbying activity, the Expenditures Test does not personally penalize individual managers. Fourth, unlike the Substantial Part Test, the Expenditures Test does not penalize

²⁷ <https://www.irs.gov/pub/irs-pdf/f5768.pdf>

²⁸ *Id.*

²⁹ <https://www.irs.gov/charities-non-profits/measuring-lobbying-activity-expenditure-test>

³⁰ *Id.*

³¹ *Id.*

³² <https://www.bolderadvocacy.org/blog/9-questions-about-the-501h-election>

³³ 26 U.S.C. § 4911. The exceptions to lobbying include: (1) making available the results of nonpartisan analysis, study, or research; (2) providing technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or to a committee or other subdivision thereof in response to written requests by such body...; (3) appearing before, or communicating to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization [otherwise known as “self-defense communications”]; (4) communications between the organization and its bona fide members regarding legislation or proposed legislation of direct interest to the organization and such members [other than communications that “directly encourage” the members to engage in direct or grass roots lobbying]; and (5) any communications with a government official or employee” that are not for the purpose of influencing legislation. *Id.*

communications with the general public about specific legislation, unless they involve a call to action.

IV. Conclusion

Given the potential uncertainty with the Substantial Part Test and the clear benefits of the Expenditures Test, we suggest that WRAC should elect the Expenditures Test for measuring lobbying activity and, accordingly, should file Form 5768 with the IRS.