DESCRIPTION OF PRESENT-LAW RULES RELATING TO POLITICAL AND OTHER ACTIVITIES OF ORGANIZATIONS DESCRIBED IN SECTION 501(C)(3) AND PROPOSALS REGARDING CHURCHES

Scheduled for a Hearing
before the
SUBCOMMITTEE ON OVERSIGHT
of the
HOUSE COMMITTEE ON WAYS AND MEANS
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Prepared by
the Staff of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Subcommittee on Oversight of the House Committee on Ways and Means has scheduled a hearing on a review of Internal Revenue Code section 501(c)(3) requirements for religious organizations.

This document,[1] prepared by the staff of the Joint Committee on Taxation, contains a general overview of certain present-law rules applicable to section 501(c)(3) organizations, an overview of the rules governing the political activities of "public charities," and a description of two pending bills that are intended to revise present law rules for the political activities of religious organizations.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Present-Law Rules Relating to Political and Other Activities of Organizations Described in Section 501(c)(3) and Proposals Regarding Churches* (JCX-39-02), May 14, 2002.

I. GENERAL OVERVIEW OF CERTAIN RULES APPLICABLE TO SECTION 501(C)(3) ORGANIZATIONS

In general

At present, 27 different types of organizations qualify for tax-exempt status under section 501(c) of the Internal Revenue Code (the "Code").[2] However, only organizations described in section 501(c)(3) of the Code generally are considered "charitable." Such charitable organizations are subject to organizational and operational restrictions not faced by other tax-exempt organizations.

A section 501(c)(3) organization must operate primarily in pursuance of one or more tax exempt purposes constituting the basis of its tax exemption.[3] The Code specifies such purposes as religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster international amateur sports competition, or for the prevention of cruelty to children or animals. Failure to operate primarily for exempt purposes may result in loss of tax exemption or imposition of excise taxes depending on the type and severity of the violation.

In order to qualify as operating primarily for an exempt purpose, the organization must satisfy the following operational requirements: (1) the net earnings of the organization may not inure to the benefit of any person in a position to influence the activities of the organization;[4] (2) the organization must operate to provide a public benefit, not a private benefit;[5] (3) the organization may not be operated primarily to conduct an unrelated trade or business;[6] (4) the

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[2] For example, certain title and real property holding companies (sec. 501(c)(2)), social welfare organizations (sec. 501(c)(4)), labor, agricultural or horticultural organizations (sec. 501(c)(5)), trade associations (sec. 501(c)(6)), social clubs (sec. 501(c)(7)), cemetery companies (sec. 501(c)(13)), and credit unions (sec. 501(c)(14)). In addition, other Code sections provide general tax-exempt status for other entities, such as political organizations (sec. 527) and qualified pension plans (secs. 401(a) and 501(a)).

[3] Treas. Reg. sec. 1.501(c)(3)-1(c)(1).

[4] Violations of the "private inurement" prohibition may result in the imposition of excise taxes (commonly referred to as "intermediate sanctions") on certain persons who engage in "excess benefit transactions" with section 501(c)(3) (or section 501(c)(4)) organizations (other than private foundations), and on organization managers who knowingly approve such transactions. Sec. 4958. In particularly severe cases of private inurement, the IRS may revoke an organization's tax exemption in addition to imposing intermediate sanctions.

[5] Treas. Reg. sec. 1.501(c)(3)-1(d)(1)(ii).

[6] Treas. Reg. sec. 1.501(c)(3)-1(e)(1). Conducting a certain level of unrelated trade or business activity will not jeopardize tax-exempt status; however, the organization will be subject to tax on its unrelated trade or business activities. Sec. 511. In addition, the unrelated trade or business activity will result in loss of tax-exempt status if it becomes too substantial. There are

organization may not engage in substantial legislative lobbying;[7] and (5) the organization may not participate or intervene in any political campaign. As discussed in more detail below, violation of the lobbying limitation may subject a section 501(c)(3) organization to excise taxes and/or loss of tax-exempt status. Further, the political activities prohibition for section 501(c)(3) organizations is absolute. Thus, it is not necessary for such activities to constitute a substantial part of an organization's activities before the organization's tax exemption will be in jeopardy.[8]

Section 501(c)(3) organizations generally are not subject to Federal income tax on contributions received, on income from activities that are substantially related to the purpose of the organization's tax exemption, or (except for certain private foundations) on investment income. If a section 501(c)(3) organization engages in business activities unrelated to its exempt purpose, the organization may be subject to unrelated business income tax.[9]

Within certain limitations, donors to section 501(c)(3) organizations are entitled to deduct their contributions for Federal income tax purposes (if they itemize their deductions) and for Federal estate and gift tax purposes. In turn, recipients of charitable assistance may exclude the assistance from income as a gift.[10] By contrast, contributions to other nongovernmental, tax-exempt organizations generally are not deductible[11] and such organizations are eligible only for the exemption from Federal income tax. Section 501(c)(3) organizations also may use the proceeds of tax-exempt financing and may qualify for exemption from State and local taxes, preferential postal rates, and, in certain cases, are exempt from some Federal excise taxes (e.g., taxes on highway fuels used by section 501(c)(3) school buses).

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no clear arithmetic standards for determining how much unrelated activity an organization may conduct without jeopardizing its tax-exempt status. Rather, the determination is made based on a series of facts and circumstances determinations.

[7] Treas. Reg. sec. 1.501(c)(3)-1(c)(3).

[8] The Code provides three penalties that may be applied either as alternatives to revocation of tax exemption or in addition to loss of tax-exempt status: an excise tax (sec. 4955), termination assessment of all taxes due (sec. 6852(a)(1)), and an injunction against further political expenditures (sec. 7409).

[9] Secs. 511-514.

[10] Sec. 102.

[11] Exceptions to the general rule of non-deductibility include certain gifts made to a veterans' organization or a domestic fraternal society. In addition, contributions to certain nonprofit cemetery companies are deductible for Federal income tax purposes, but generally are not deductible for Federal estate or gift tax purposes. Secs. 170(c)(3), 170(c)(4), 170(c)(5), 2055(a)(3), 2055(a)(4), 2106(a)(2)(A)(iii), 2522(a)(3), and 2522(a)(4).

Private foundations

Section 501(c)(3) organizations are classified as either "public charities" or "private foundations."[12] Private foundations are defined under section 509(a) as all organizations described in section 501(c)(3) other than an organization granted public charity status by reason of (1) being a specified type of organization (i.e., churches, educational institutions, hospitals and certain other medical organizations, certain organizations providing assistance to colleges and universities, or a governmental unit); (2) receiving a substantial part of its support from governmental units or direct or indirect contributions from the general public; or (3) providing support to another section 501(c)(3) entity that is not a private foundation.

In contrast to public charities, private foundations often are funded from one or a limited number of sources (an individual, family, or corporation) and are subject to a number of restrictions not applicable to public charities.[13] For example, private foundations generally are subject to a two percent excise tax on their net investment income, as well as excise taxes for certain acts of self-dealing, failure to make sufficient charitable distributions, excess business holdings, jeopardizing business investments, and taxable expenditures. Taxable expenditures include expenditures for lobbying, political activities, grants to individuals (without prior IRS approval), grants to organizations other than public charities unless special procedures are followed, and expenditures for noncharitable purposes.[14] Thus, unlike a public charity, a private foundation is subject to tax on all of its lobbying activity, and the tax is substantial.[15] In general, more generous charitable contribution deduction rules apply to gifts made to public charities than the rules that apply to gifts made to private foundations.

Certain filing requirements of section 501(c)(3) organizations

In general, section 501(c)(3) organizations are required to seek formal recognition of tax-exempt status by filing an application with the IRS.[16] In response to the application, the IRS

[12] Sec. 509(a). Private foundations are either private operating foundations or private non-operating foundations. In general, private operating foundations operate their own charitable programs in contrast to private non-operating foundations, which generally are grant-making organizations. Most private foundations are non-operating foundations.

[13] Secs. 4940-4945.

[14] *Id.*

[15] A tax of 10 percent of the amount of the taxable expenditure is imposed on the private foundation and a tax of 2.5 percent is imposed on knowing violations by a foundation manager (unless the violation is not willful and is due to reasonable cause). Sec. 4945(a). In addition, if the taxable expenditure is not corrected, the foundation is subject to an additional tax equal to 100 percent of the amount of the expenditure. If the additional tax is imposed on the foundation, a foundation manager who refused to agree to part or all of the correction is subject to a tax equal to 50 percent of the expenditure. Sec. 4945(b).

[16] Form 1023 -- Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.

issues a determination letter or ruling either recognizing the applicant as tax-exempt or not. Certain organizations are not required to apply for recognition of tax-exempt status in order to qualify as tax-exempt under section 501(c)(3) but may elect to do so. These organizations include churches, certain church-related organizations, organizations (other than private foundations) the gross receipts of which in each taxable year are normally not more than $5,000, organizations (other than private foundations) subordinate to another tax-exempt organization that are covered by a group exemption letter, and for certain purposes only, charitable trusts described in section 4947(a)(1) that were organized before October 9, 1969.

Section 501(c)(3) organizations generally are required to file an annual information return with the IRS.[17] The requirement of filing an annual information return does not apply to churches, their integrated auxiliaries, and conventions or associations of churches; certain organizations (other than private foundations), the gross receipts of which in each taxable year are normally not more than $25,000; the exclusively religious activities of any religious order; an interchurch organization of local units of a church; certain mission societies; and certain church-affiliated elementary and high schools.[18] Public charities must file Form 990 (Return of Organization Exempt From Income Tax) and an additional form, Schedule A, which requests information specific to section 501(c)(3) organizations. An organization that is required to file Form 990, but that has gross receipts of less than $100,000 during its taxable year, and total assets of less than $250,000 at the end of its taxable year, may file Form 990-EZ instead of Form 990. Private foundations are required to file Form 990-PF rather than Form 990.[19]

On the applicable annual information return, organizations are required to report their gross income, information on their finances, functional expenses, compensation, activities, and other information required by the IRS in order to review the organization's activities and operations during the previous taxable year and to review whether the organization continues to meet the statutory requirements for exemption. Examples of the information required by Form 990 include (1) a statement of program accomplishments, (2) a description of the relationship of the organization's activities to the accomplishment of the organization's exempt purposes, (3) a description of payments to individuals, including compensation to officers and directors, highly

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[17] An organization that has not received a determination of its tax-exempt status, but that claims tax-exempt status under section 501(a), is subject to the same annual reporting requirements and exceptions as organizations that have received a tax-exemption determination.

[18] Sec. 6033(a)(2)(A); Treas. Reg. sec. 1.6033-2(a)(2)(i); Treas. Reg. sec. 1.6033-2(g)(1).

[19] Form 990-PF requires, among other things: information about the foundation's gross income for the year; information about expenses attributable to such income; information about disbursements for exempt purposes; information about total contributions and gifts received, and the names of all substantial contributors; names, addresses, and compensation of officers and directors; an itemized statement of securities and other assets held at the close of the year; an itemized statement of all grants made or approved; and information about whether the organization has complied with the restrictions applicable to private foundations (secs. 4941-4945).

paid employees and contractors, grants, and certain insider transactions and loans, (4) disclosure of certain activities, such as lobbying activities, political expenditures, expenses of conferences and conventions, and compliance with public inspection requirements.

II. POLITICAL ACTIVITIES OF PUBLIC CHARITIES

Political campaign activity

By statute, section 501(c)(3) organizations may not "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."[20] The prohibition is absolute.

The statute requires three elements: there must be a "candidate," for "public office," and "participation" or "intervention" in a political campaign. Treasury regulations define a candidate as "an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local."[21] The definition includes persons who have declared an intention to run for office and generally would include incumbents until such time as an incumbent declared an intention not to run for reelection. Treasury regulations do not define "public office"; however, the definition of candidate refers to an "elective public office, whether . . . national, State, or local." The IRS has interpreted "public office" to include elective positions in political parties.

Section 501(c)(3) states that participation in a political campaign includes "the publishing or distribution of statements." Treasury regulations also provide that "publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to . . . a candidate" is intervention in a political campaign, and that intervention is not limited to such activities.[22]

In general, political activities that are educational are permitted. Educational activities are those that present "a sufficiently full and fair exposition of the pertinent facts," are not biased, and "permit an individual or the public to form an independent opinion or conclusion."[23] Public charities also generally may provide a forum for debates by candidates, so long as the forum is fair and neutral and all qualified candidates are given equal time for debate.[24] Voter registration by public charities generally is permitted by section 501(c)(3) so long as the activity is conducted in a nonpartisan and fair manner. Other forms of voter education, such as publication of voter guides, also may be permissible if certain guidelines are followed.[25]

Impermissible political expenditures are subject to an excise tax. In addition, the IRS retains the discretion to seek revocation of exemption, even for "minor" violations of the

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[20] Sec. 501(c)(3).

[21] Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii).

[22] *Id.*

[23] Treas. Reg. sec. 1.501(c)(3)-1(d)(3).

[24] See Rev. Rul. 86-95, 1986-2 C.B. 73.

[25] Rev. Rul. 78-248, 1978-1 C.B. 154.

political activity prohibition. The excise tax is a two-tiered tax -- the first tier is a tax on the organization of 10 percent of the amount of the expenditure.[26] If the violation is not corrected, then a second tier tax of 100 percent of the amount of the expenditure is imposed. There also is a 2.5 percent excise tax (up to $5,000 per expenditure) on managers of the organization who knowingly approve an improper political expenditure and the approval was not willful and was due to reasonable cause. If the violation is not corrected, a second-tier tax of 50 percent of the amount of the expenditure (up to $10,000 per expenditure) is imposed on managers who refused to agree to part or all of the correction.

Lobbying activity

In general

An organization does not qualify for tax-exempt status as a charitable organization described in section 501(c)(3) unless "no substantial part" of its activities constitutes "carrying on propaganda, or otherwise attempting, to influence legislation" (commonly referred to as "lobbying").[27] Thus, public charities may engage in limited lobbying activities, provided that such activities are not substantial, without losing their tax-exempt status and generally without being subject to tax.[28] For purposes of determining whether lobbying activities are a substantial part of a public charity's overall functions, a public charity may choose between two standards, the "substantial part" test or the "expenditure" test.[29]

The substantial part test derives from the statutory language quoted above and uses a facts and circumstances approach to measure the permissible level of lobbying activities. Because there is no statutory or regulatory guidance clarifying this standard, it is not clear whether the determination is based on the organization's activities, its expenditures, or both. If public charities exceed the substantial part standard, they risk losing their tax exemption.

The expenditure test sets specific dollar limits, calculated as a percentage of a charity's total exempt purpose expenditures, on the amount a charity may spend to influence legislation.[30] A charity wishing to be subject to the expenditure test must affirmatively elect to do so (the "section 501(h) election");[31] charities that do not file an election are subject to the substantial

[26] Sec. 4955.

[27] Sec. 501(c)(3).

[28] In contrast, private foundations are subject to the restriction that lobbying activities, even if insubstantial, may result in the foundation being subject to penalty excise taxes.

[29] Secs. 501(c)(3), 501(h), and 4911.

[30] Secs. 501(h) and 4911.

[31] As of September 31, 1999, 7,221 organizations had elected to be subject to the expenditure test.

part test. Organizations that do not make the section 501(h) election are referred to below as non-electing public charities.

"Substantial part" test

Definition of lobbying

There is no statutory definition under section 501(c)(3) of "propaganda, or otherwise attempting, to influence legislation." However, Treasury regulations provide that an organization is not entitled to tax-exempt status under section 501(c)(3) due to its lobbying activities if a substantial part of the organization's activities is: (1) contacting, or urging the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or (2) advocating the adoption or rejection of legislation.[32] Thus, attempts to influence legislation under section 501(c)(3) include directly contacting members of a legislative body (and their staffs) to propose, support, or oppose legislation (so-called "direct lobbying"), and also include urging the public to contact legislative bodies, or otherwise attempting to influence public opinion, with respect to legislation (so-called "grass roots lobbying").

For purposes of section 501(c)(3), the term "legislation" includes action by the Congress, any State legislature, any local council or similar governing body, or the public in a referendum, initiative, constitutional amendment, or similar procedure.[33] "Action" by the Congress or a State legislature or local council refers to introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items.[34]

Exceptions for non-electing public charities

Although the regulations under section 501(c)(3) do not contain any exceptions for activities that are not considered to be lobbying, the private foundation rules under section 4945 describe four exceptions, described below, that generally are considered applicable to public charities as well.[35]

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[32] Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(ii).

[33] Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(ii).

[34] See Sec. 4911(e)(3).

[35] Although there is no precedential ruling from the IRS applying the section 4945 exceptions to lobbying for private foundations to nonelecting public charities, the IRS has stated that the section 4945 definitions and exceptions apply to section 501(c)(3) because of a statement in the legislative history that section 4945 intended no change to the substantive law of lobbying other than the substantial part rule. GCM 34289 (May 8, 1970). See *Haswell v.United States*, 500 F.2d 1133, 1141-44 (Ct. Cl.), cert. denied, 419 U.S. 1107 (1974) (using the section 4945 regulations to clarify the section 501(c)(3) lobbying provisions); see also Judith E. Kindell & John F. Reilly, *Lobbying Issues, in Continuing Professional Education Exempt Organizations Technical Instruction Program for FY 1997* 277 n.20 (1996).

Nonpartisan analysis, study, or research.--Lobbying does not include the conduct of nonpartisan analysis, study, or research, as long as the dissemination of such analysis does not advocate the adoption of legislation to implement its findings. "Nonpartisan analysis, study, or research" is defined as "an independent exposition of a particular subject matter."[36] The analysis may conclude that legislation is appropriate to achieve a particular objective if it contains a "sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion."[37]

The results of nonpartisan analysis, study, or research must be made available to "the general public or a segment or members thereof or to governmental bodies, officials, or employees."[38] Such results may be distributed by "any suitable means, including oral or written presentations" provided that the communications are not limited to or directed toward those interested in only one side of a particular issue.[39] Examples of suitable means of distribution include "reprints of speeches, articles, and reports; presentation of information through conferences, meetings, and discussion; and dissemination to the news media, including radio, television, and newspapers, and to other public forums."[40]

Examinations of broad social, economic, and similar problems.--Discussions of broad social or public policy issues that do not advocate a specific legislative proposal generally do not constitute attempts to influence legislation for purposes of section 501(c)(3). Specifically, lobbying communications do not include "public discussion, or communications with members of legislative bodies or governmental employees, the general subject of which is also the subject of legislation before a legislative body, so long as such discussion does not address itself to the merits of a specific legislative proposal and so long as such discussion does not directly encourage recipients to take actions with respect to legislation."[41]

Requests for technical advice or assistance.--Lobbying does not include the provision of technical advice to a governmental body or committee in response to a written request.[42] Likewise, responding to a governmental request for testimony is not treated as a lobbying activity. A request from an individual committee member or a subset of members will not fall within this exception.[43] The offering of opinions or recommendations ordinarily will qualify

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[36] Treas. Reg. sec. 53.4945-2(d)(1)(ii).

[37] *Id.*

[38] Treas. Reg. sec. 53.4945-2(d)(1)(i).

[39] Treas. Reg. sec. 53.4945-2(d)(1)(iv).

[40] *Id.*

[41] Treas. Reg. sec. 53.4945-2(d)(4).

[42] Treas. Reg. sec. 53.4945-2(d)(2); Rev. Rul. 70-449, 1970-2 C.B.111.

[43] Treas. Reg. sec. 53.4945-2(d)(2).

under this exception only if such opinions or recommendations are specifically requested by the governmental body or committee or are directly related to the materials requested.[44]

Self-defense communications.--There is an exception for direct lobbying with respect to proposed legislation that might affect a charity's existence, powers and duties, tax-exempt status, or the deductibility of contributions (so-called "self-defense lobbying").[45] Within these specific areas, an organization may communicate with legislators or their staff and may initiate legislation. However, this exception does not cover proposed legislation involving public policy issues that may be of importance to an organization in carrying out future charitable programs.

Application of substantial part test

For charities that do not elect the expenditure test (discussed below), there is no bright-line, mechanical rule for determining whether lobbying activities constitute "no substantial part" of the organization's overall activities. Rather, the particular facts and circumstances surrounding all activities of the organization (including, staff and volunteer time, expenditures, and significance of the activities to the organization) must be examined. In particular, an arithmetical percentage test (e.g., looking only at the percentage of the budget, or employee's time spent on lobbying), while relevant, has been held not determinative.[46]

Expenditure test

In general

As an alternative to the substantial part test, the expenditure test permits certain public charities to elect to be governed by specific expenditure limitations on their lobbying activities.[47] Public charities eligible to make the section 501(h) election include organizations receiving a certain proportion of support from the general public, educational institutions, hospitals, but not churches and certain church-related entities.[48] Churches and church related entities were precluded from making a 501(h) election in response to their specific request. At the time

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[44] Treas. Reg. sec. 53.4945-2(d)(2)(ii).

[45] Treas. Reg. sec. 53.4945-2(d)(3).

[46] See *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974); (holding that an organization's lobbying activities were substantial when roughly 16-20 percent of its expenditures were for lobbying and the organization's lobbying activities were in other respects an important part of its mission); *Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849 (10th Cir. 1972) (rejecting a percentage test in favor of weighing an organization's lobbying activities in light of the organization's overall purposes and activities); *Seasongood v. Commissioner*, 227 F.2d 907 (6th Cir. 1955) (deciding that lobbying that accounted for less than 5 percent of an organization's activities is not substantial).

[47] Secs. 501(h) and 4911.

[48] Secs. 501(h)(4) and (5).

section 501(h) was enacted, churches were concerned that accepting eligibility for the election would undermine their position that constitutional law prohibits limitations on their free speech.[49] Churches also were concerned that extending the law to churches could be construed as Congressional approval for a court decision that upheld the revocation of a church's tax-exemption for excess lobbying activity.[50]

The test establishes two expenditure limits: one restricts the total amount of lobbying expenditures the public charity can make, the other restricts grass roots lobbying expenditures as a subset of total lobbying expenditures. A public charity's total lobbying expenditures for a year are the sum of its expenditures for direct lobbying and its expenditures for grass roots lobbying.

For a public charity electing to be subject to the expenditure test, the allowable amount of lobbying expenditures that can be made for any tax year is determined under a sliding-scale formula. Specifically, the allowable amount of total lobbying expenditures is limited to the sum of (1) 20 percent of the first $500,000 of the organization's exempt purpose expenditures for the year, (2) 15 percent of the next $500,000 of such expenditures, (3) 10 percent of the third $500,000 of such expenditures, and (4) 5 percent of any additional such expenditures.[51] In no event, however, can the allowable amount of lobbying for a charity electing the expenditure test exceed $1 million for any year.[52] For this purpose, "exempt purpose expenditures" are defined as expenditures to accomplish the organization's exempt purposes, including properly allocable salary payments, overhead, an allowance for depreciation on a straight-line basis, and all lobbying expenditures, but not including fundraising costs and certain capital expenditures. Grass roots lobbying is subject to a separate limitation, equal to 25 percent of the overall permissible lobbying amount.[53] In order to prevent organizations from avoiding the dollar limitations of the expenditure test by dividing themselves into technically separate but related entities, certain affiliated organizations under common control are treated as one organization for purpose of applying the arithmetical tests.[54]

Definition of lobbying

For purposes of the expenditure test, lobbying expenditures are defined as "expenditures for the purpose of influencing legislation (as defined in section 4911(d))." Section 4911(d), in turn, defines the term "influencing legislation" as:

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[49] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976* (JCS-33-76), December 29, 1976 at 415.

[50] *Id.* at 415-16; *Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849 (10th Cir. 1972).

[51] Sec. 4911(c)(2); Treas. Reg. sec. 56.4911-1(c)(1).

[52] Sec. 4911(c)(2).

[53] Sec. 4911(c)(4).

[54] Treas. Reg. sec. 56.4911-7.

(A) any attempt to influence any legislation[55] through an attempt to affect the opinions of the general public or any segment thereof [i.e., "grass roots lobbying communications"], and

(B) any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation [i.e., "direct lobbying communications"].[56]

With respect to communications with legislators and government officials, Treasury regulations provide a two-part test for determining if such a communication by an organization making the section 501(h) election constitutes a "direct lobbying communication." Under this two-part test, a communication with a legislator or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation (provided that the principal purpose of the communication is to influence legislation), will be treated as a "direct lobbying communication" under section 4911 *only if* the communication *both* (1) refers to "specific legislation" (meaning legislation that has already been introduced in a legislative body or a specific legislative proposal that the organization either supports or opposes), *and* (2) reflects a view on such legislation.

With respect to communications with the general public, Treasury regulations provide a three-part test for determining whether such a communication by an organization electing the expenditure test constitutes a "grass roots lobbying communication." Under this three-part test, a communication with the general public will be treated as a "grass roots lobbying communication" only if the communication: (1) refers to specific legislation; (2) reflects a view on such legislation; and (3) encourages the recipient to take action with respect to the legislation (referred to as a "call to action" requirement) in at least one of four specifically enumerated ways.[57]

Exceptions for electing public charities

The Code and regulations governing the expenditure test incorporate the same exceptions to the definition of lobbying discussed above with respect to the substantial part test and add an additional exception for certain communications between a charity and its members. The

[55] "Legislation" includes action by legislative bodies but does not include action by "executive, judicial, or administrative bodies." Treas. Reg. sec. 56.4911-2(d)(3). The term "administrative bodies" includes school boards, housing authorities, sewer and water districts, zoning boards, and other similar Federal, State, or local special purpose bodies, whether elective or appointive. Treas. Reg. sec. 56.4911-2(d)(4).

[56] Lobbying with respect to a referendum or ballot initiative subject to a vote by the general public (unless it comes within the nonpartisan analysis exception) is considered "direct lobbying," based on the rationale that, in this context, members of the general public are functioning as legislators. See Treas. Reg. sec. 56.4911-2(b)(1)(iii).

[57] Treas. Reg. sec. 56.4911-2(b)(2)(ii).

regulations also clarify the exception for non-partisan analysis, research or study and the exception for examinations of broad social, economic, and similar problems exception.

Nonpartisan study, analysis, and research.--Treasury regulations provide that nonpartisan analysis that reflects a view on specific legislation is not within the expenditure test exception if the communication "directly encourages" the recipient to take action--meaning that the communication expressly states that the recipient should contact a legislative or government official or employee, includes the address, telephone number or similar information of a such official or employee, or includes a petition tear-off postcard, or similar material for the recipient to send to such an official or employee. However, nonpartisan analysis within the exception is allowed to include a limited (or implicit) "call to action" that specifically identifies one or more legislators who will vote on the legislation as (1) opposing the organization's views with respect to the legislation, (2) being undecided with respect to the legislation, (3) being the recipient's representative in the legislature, or (4) being a member of the legislative committee or subcommittee that will consider the legislation.[58]

An organization may choose any suitable means, including oral or written presentations or disseminations to the news media, to distribute its nonpartisan analysis or research.[59] However, communications may not be limited to, or be directed toward, persons who are interested solely in one side of a particular issue.[60]

Examinations of broad social, economic, and similar problems.--Treasury regulations provide that "[e]xaminations and discussions of broad social, economic, and similar problems are neither direct lobbying communications under section 56.4911-2(b)(1) nor grass roots lobbying communications under section 56.4911-2(b)(2) even if the problems are of the type with which government would be expected to deal ultimately."[61] Consequently, lobbying communications do not include public discussion, or communications with members of legislative bodies or governmental employees, the general subject of which is also the subject of legislation before a legislative body, so long as such discussion does not address itself to the merits of a specific legislative proposal and so long as such discussion does not directly encourage recipients to take action with respect to legislation.

Membership communications.--Certain communications between an electing public charity and its members that would be treated as grassroots communications if they were directed to nonmembers will not treated as lobbying if directed solely to members.[62] For purposes of this rule, a member is someone who provides more than a nominal amount of time or money to the

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[58] Treas. Reg. secs. 56.4911-2(b)(2)(iii) and 56.4911-2(c)(1)(vi).

[59] Sec. 4911(d)(2)(A).

[60] Treas. Reg. sec. 56.4911-2(c)(1).

[61] Treas. Reg. sec. 56.4911-2(c)(2).

[62] Sec. 4911(d)(3); Treas. Reg. sec. 56.4911-5.

organization.[63] A communication to a member that refers to and reflects a view on specific legislation will not be treated as a lobbying communication if: (1) the communication is directed only to members of the organization; (2) the specific legislation is of direct interest to the organization and its members; (3) the communication does not directly encourage the member to engage in direct lobbying; and (4) the communication does not directly encourage the member to engage in grassroots lobbying.[64] Expenditures for a communication that satisfies (1), (2), and (4), but not (3) are treated as direct lobbying.[65] Expenditures for a communication that satisfies (1), (2), and (3), but not (4) are treated as grassroots lobbying.[66]

There is also a self-defense communication exception for communications with members. If a communication by a public charity directly encourages members to engage in direct lobbying activities that would meet the definition of self-defense lobbying if conducted by the organization, that membership communication will not be treated as direct lobbying by the organization.[67]

Lobbying expense allocations

In addition to defining direct and grass roots lobbying communications and the five statutory exceptions, Treasury regulations provide detailed guidance for allocating particular expenditures to lobbying communications. In general, public charities electing the expenditure test are required to treat as lobbying expenditures all direct costs of producing the

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[63] Treas. Reg. sec. 56.4911-5(f)(1).

[64] Treas. Reg. sec. 56.4911-5(b).

[65] Treas. Reg. sec. 56.4911-5(c). A communication "directly encourages" a member to engage in direct lobbying if it incorporates any of the following: (1) it urges the recipient to contact a legislator, a legislator's staff, or other government employee who participates in the formulation of legislation for the principal purpose of influencing legislation; (2) it states the address, telephone number, or similar information for a legislator or employee of a legislative body; or (3) it provides a petition or tear-off postcard for the principal purpose of influencing legislation. Treas. Reg. sec. 56.4911-5(f)(6)(i)(A).

[66] Treas. Reg. sec. 56.4911-5(d). A communication "directly encourages" a member to engage in grassroots lobbying if it incorporates any of the following: (1) it states that the recipient should encourage any nonmember to contact a legislator, a legislator's staff, or other government employee who participates in the formulation of legislation for the principal purpose of influencing legislation; (2) it states that the recipient should provide to any nonmember the address, telephone number, or similar information for a legislator or employee of a legislative body; or (3) it provides (or requests that the member provide) a petition or tear-off postcard to use to ask any nonmember to communicate views to a legislator, a legislator's staff, or other government employee who participates in the formulation of legislation for the principal purpose of influencing legislation. Treas. Reg. sec. 56.4911-5(f)(6)(ii).

[67] Treas. Reg. sec. 56.4911-5(f)(6)(B).

communication, as well as an allocable share of overhead costs.[68] In addition, rules are provided for so-called "mixed purpose" expenditures and for allocating costs when non-lobbying materials (e.g., nonpartisan analysis) subsequently are used by an organization as part of a grass roots lobbying campaign.

Penalties applicable to public charities

If an electing public charity exceeds either the limit on total lobbying expenditures or on grassroots lobbying expenditures for a particular year, it is subject to a 25-percent excise tax on the excess amounts. The charity's exemption will not be in jeopardy, however, unless either limit is exceeded by more than 50 percent, calculated using an average of lobbying expenditures over the four most recent years.

For nonelecting public charities, excessive lobbying activities result in loss of tax-exempt status. In addition, in 1987, section 4912 was enacted to provide for the imposition of penalty excise taxes due to improper lobbying expenditures made by a nonelecting public charity (other than a church). However, the section 4912 excise taxes may be imposed only if the charity ceases to qualify for tax-exempt status under section 501(c)(3) due to its substantial lobbying activities. Section 4912 imposes on such a disqualified organization an excise tax equal to five percent of the amount of lobbying expenditures incurred during the year in which the organization has ceased to qualify under section 501(c)(3) due to making lobbying expenditures. Organization managers who, without reasonable cause, agree to make lobbying expenditures knowing that they are likely to result in revocation of the organization's tax-exempt status under section 501(c)(3) also are subject to an excise tax equal to five percent of such lobbying expenditures.

There is no present-law rule preventing an organization that loses its tax-exempt status under section 501(c)(3) because it engages in substantial lobbying (or normally exceeds the lobbying expenditure limits) from applying for restoration of its section 501(c)(3) status in a subsequent taxable year, at which time the organization will again be subject to the lobbying limitation. However, section 504(a)(2)(A) provides that a charitable organization (other than a church) that loses its tax-exempt status under section 501(c)(3) because of excessive lobbying activities may not attempt thereafter to escape the lobbying limitation by being treated as a tax-exempt social welfare organization under section 501(c)(4).

Lobbying by other 501(c) organizations

Section 501(c) organizations other than charities described in section 501(c)(3) are not subject to any specific provision that restricts their lobbying activities. In general, the only limit imposed by the Code is that the lobbying activities must be germane to the accomplishment of the organization's exempt purposes. For some organizations, such as social welfare organizations or business leagues, lobbying may be the organization's primary, or even sole, activity.

[68] Treas. Reg. sec. 56.4911-3(a)(1).

Associations that receive tax-deductible dues.--As a result of the Omnibus Budget Reconciliation Act of 1993, tax-exempt trade associations and certain other tax-exempt organizations (but not charities described in section 501(c)(3)) generally are required to provide annual information disclosure to members (sometimes referred to as "flow-through information disclosure") estimating the portion of their dues allocable to lobbying activities as defined under section 162(e)(1). The purpose of this rule is to prevent taxpayers from avoiding section 162(e) (which disallows trade or business expense deductions for political campaign and lobbying expenditures) by paying otherwise deductible dues to a trade association or other tax-exempt entity which, in turn, makes political campaign or lobbying expenditures on behalf of its dues-paying members. Accordingly, section 162(e)(3) specifically provides that no trade or business expense deduction is allowed for the portion of dues paid to a tax-exempt organization which the organization notifies the taxpayer under section 6033(e) is allocable to political campaign or lobbying expenditures made by the organization.

Flow-through information disclosure is not required for an organization that (1) incurs only a de minimis amount (i.e., $2,000 or less) of in-house political campaign and lobbying expenditures during the taxable year; (2) elects to pay a 35-percent proxy tax on its political campaign and lobbying expenditures incurred during the taxable year rather than provide flow-through information disclosure to its members; or (3) establishes pursuant to Treasury Department rules that substantially all of its dues monies are paid by members not entitled to deduct such dues in computing their taxable income (sec. 6033(e)).

Disclosure of lobbying expenses

For Federal tax purposes, public charities are required to disclose their lobbying expenditures on Schedule A of Form 990, and to maintain records that will enable them to calculate and report these expenditures. Public charities electing the expenditure test report their expenditures on two tables. The first table requires the organization to list the amounts spent on grassroots lobbying, on direct lobbying, and on the organization's exempt purposes. The table requires this information both for the electing public charity and for its affiliated group, if the charity is part of one. The second table requires the organization to fill in its lobbying expenditures for the four most recent years in order to determine whether, on average, the organization has exceeded the lobbying expenditure limits during that period. Public charities that incur tax for excess lobbying expenditures also must file an excise tax return.[69] Schedule A does not provide any information on the issues the organization lobbied nor does it require disclosure of whether the organization engaged in activities that come within one of the statutory exceptions to lobbying. Expenditures for activities that come within one of the exceptions to the definition of lobbying will be disclosed elsewhere on the return, although they are unlikely to be identified specifically by activity. For example, nonpartisan study, analysis, or research projects typically will be disclosed as part of a charity's educational activities in Part III of Form 990, which requires disclosure of program service expenses for each of the charity's exempt purpose accomplishments.

[69] Form 4720 -- Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code.

Nonelecting public charities complete a different table on Schedule A requesting information about whether the organization attempted to influence national, state or local legislation through the use of: volunteers; paid staff or management; media advertisements; mailings to members, legislators, or the public; publications, or published or broadcast statements; grants to other organizations for lobbying purposes; direct contact with legislators, their staffs, government officials, or a legislative body; or rallies, demonstrations, seminars, conventions, speeches, lectures, or any other means. If the organization used any of the above methods of lobbying, it must disclose the amount spent on the lobbying activity and provide a detailed description of its lobbying activities. According to the instructions for Schedule A of Form 990, the detailed description should include all lobbying activities, whether expenses are incurred or not. Thus, lobbying activities carried out by unreimbursed volunteers must be disclosed. As is the case for electing public charities, there is no requirement that a nonelecting public charity disclose on Schedule A activities or amounts spent on activities that are defined as an exception to the definition of lobbying; however, expenditures for such activities will be disclosed elsewhere on the return, although they are unlikely to be identified specifically by activity.

III. DESCRIPTION OF BILLS RELATING TO POLITICAL ACTIVITY BY CHURCHES

H.R. 2357

H.R. 2357, "The Houses of Worship Political Speech Protection Act" was introduced in the House of Representatives by Mr. Jones of North Carolina on June 28, 2001. The bill would amend section 501(c)(3) of the Code to permit churches, their integrated auxiliaries, and conventions or associations of churches to participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office. The bill would permit such campaign activity only to the extent that the activity was not a substantial part of the organization's activities.

H.R. 2931

H.R. 2931, the "Bright-Line Act of 2001" was introduced in the House of Representatives by Mr. Crane on September 21, 2001. The bill would change the rules on political activity and lobbying activity by churches and church-related entities. Church-related entities include an association or convention of churches, an integrated auxiliary of a church, or a member of an affiliated group of organizations if one or more members of the group is a church or church-related entity. (Hereinafter, references to churches will include church-related entities.)

The bill would codify the present law "no substantial part" test that is applicable to the lobbying activities of churches. Under the bill, churches would be permitted to lobby to the extent lobbying expenditures normally do not exceed 20 percent of the organization's gross revenues for each taxable year. Under the bill, gross revenues would mean the sum of the church's gross income for the taxable year, and the aggregate contributions and gifts received by the church during the taxable year.

The bill also would remove the present law prohibition on political campaign activity and would permit churches (but not other organizations exempt from tax under section 501(c)(3)) to participate, or intervene in, political campaigns. Under the bill, churches could engage in political campaign activity to the extent that expenditures for such activity normally do not exceed five percent of the organization's gross revenues for each taxable year.

The bill also would subject the lobbying and political campaign expenditures that a church normally makes to an aggregate expenditure limit of 20 percent of the church's gross revenues for a taxable year.

If two or more churches are members of an affiliated group, the provisions of the bill would apply to the affiliated group as if the group were one organization.

A church that exceeds any of the bill's expenditure limitations would be denied exemption from taxation under section 501(a). If an affiliated group exceeds the expenditure limitations, each member of the group would no longer be an organization described in section 501(c)(3).