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LOBBYING BY SECTION 501(c)(3) ORGANIZATIONS: LEGAL ISSUES

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June 2004

A. Sources of Restrictions

- Federal and state income tax laws
- Federal and state grant rules
- Federal Lobbying Disclosure Act; State Political Reform Act

B. Federal Income Tax Laws (affecting public charities) – Substantial Part Test

1. For Section 501(c)(3) organizations, no substantial part of their activities may consist of carrying on propaganda or otherwise attempting to influence legislation, except as provided in Section 501(h). This is known as the "substantial part test."

2. Section 501(c)(3) does not define "substantial." It might be anything more than 5% of an organization's activities or income.

3. "Attempting to influence legislation" means contacting, or urging the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation. It also means advocating the adoption or rejection of legislation. It includes requesting that an executive body support or oppose legislation, and attempting to influence the Senate's confirmation of a federal judicial nominee. See Reg. 1.501(c)(3) – 1(c)(3)(ii); Rev. Rul. 67-293, 1967-2 C.B.185; Notice 88-76, 1988-27 I.R.B. 34.

4. Whether a communication constitutes an attempt to influence legislation is determined by the facts and circumstances involved. Supporting activities, such as research, might be included as part of the attempt to influence legislation. Thus, attempts to influence legislation may begin before an organization first contacts the public or the legislature.

5. Legislation includes the introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or other actions by Congress, a state legislature, local councils, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. It includes already introduced legislation and legislative proposals. No distinction is made between “good” and “bad” legislation. See Reg. 1.501(c)(3) – 1(c)(3)(ii).

6. Lobbying is treated differently from political campaign activity. Section 501(c)(3) completely prohibits participation or intervention in a political campaign on behalf of or in opposition to a candidate for public office.

7. Exceptions to the limitations on lobbying.

   a. Individuals can lobby on their own time and not as spokespersons for an organization or while using its resources.

   b. Engage in nonpartisan analysis, study, or research and make the results available to the public or to government bodies. See Rev. Rul. 64-195, 1964-2 C.B. 138; Rev. Rul. 70-79, 1970-1 C.B. 127.

      (1) Involves an independent and objective discussion of a subject. Considered an educational activity.

      (2) May advocate a particular position as long as the organization presents enough information to permit an individual to form an independent opinion. Does not include presentation of unsupported opinion. Can reflect a view on specific legislation if the organization does not directly encourage action with respect to such legislation.

      (3) An organization can choose any means to distribute results, with or without charge, but may not limit communication to persons who are interested solely in one side of an issue.

   c. Examine and discuss broad social, economic, and similar problems, including problems for which government action is expected.

      (1) Can engage in public discussion or communication with members of legislative bodies on subjects that are the subject of legislation, as long as the discussion does not address the merits of the legislation and does not directly encourage action with respect to legislation.

      (2) Is distinguished from lobbying because it does not involve reference to and viewpoint on specific legislation.

d. Respond to a written request by a legislative body for technical advice or assistance. See Rev. Rul. 70-449, 1970-2 C.B. 111.

e. Communicate with executive, judicial, or administrative bodies such as school boards, housing authorities, and zoning boards, whether elected or appointed, even if proposing matters that require legislation.

f. Form a Section 501(c)(4) organization.

(1) Not limited as to amount of lobbying.

(2) Cannot receive tax-deductible charitable contributions. Can sometimes receive tax-deductible business expense payments.

(3) Can receive funds from a Section 501(c)(3) organization but only for charitable or educational purposes. Funds received from a 501(c)(3) organization and used for lobbying will count against the 501(c)(3) organization's lobbying limits.

(4) It is permissible to have overlapping officers and directors between a 501(c)(3) and 501(c)(4). The 501(c)(3) can control the 501(c)(4). Maintain a clear separation between the organizations.

(5) A Section 501(c)(3) organization that loses tax-exemption due to its lobbying activity cannot qualify as a Section 501(c)(4) organization. See Section 504.

8. Sanctions

a. A private foundation may be liable for excise taxes on its legislative expenditures under Section 4945, even though the foundation's lobbying is insubstantial and its tax-exempt status is not jeopardized.

b. If an organization loses its tax-exemption because of substantial lobbying, it is also subject to a 5% excise tax on its lobbying expenditures for that year. See Section 4912.

c. If an organization is subject to the 5% excise tax, then the organization's managers may be personally subject to a 5% excise tax on the organization's lobbying expenditures to which they agree knowingly and without reasonable cause. See Section 4912.

d. Section 4912 taxes do not apply to organizations that elect under Section 501(h), to churches, and to private foundations.

C. Federal Income Tax Laws (affecting public charities) – Expenditure Test

1. Under Section 501(h), public charities, other than churches, may elect the "expenditure test" as a substitute for the substantial part test. The expenditure test permits an organization to make lobbying expenditures within specified dollar limits without tax or loss of tax-exempt status. See Reg. 1.501(h)-1.

2. An organization makes the election by filing Form 5768, effective from the beginning of the tax year in which the form is filed, and effective for each succeeding tax year until revoked. A new organization may submit Form 5768 at the time it submits its application for recognition of exemption (Form 1023). An organization can file a notice of voluntary revocation on Form 5768, effective from the beginning of the next tax year, becoming subject to the substantial part test. An organization can re-elect the expenditure test after at least one year on the substantial part test. See Reg. 1.501(h)-2.

3. The expenditure test permits an organization to spend up to the following amounts on lobbying activity each year ("lobbying non-taxable amount"):

   a. 20% of the first $500,000 in exempt purpose expenditures;

   b. $100,000 plus 15% of exempt purpose expenditures from $500,001 to $1 million;

   c. $175,000 plus 10% of exempt purpose expenditures from $1,000,001 to $1,500,000;

   d. $225,000 plus 5% of exempt purpose expenditures from $1,500,001 to $17 million, and 0% of exempt purpose expenditures above that.

   The maximum is $1,000,000 in lobbying expenditures. See Section 4911.

4. Lobbying is either "direct" or "grass roots." The maximum grass roots lobbying expenditure ("grass roots non-taxable amount") is 25% of the lobbying non-taxable amount:

   a. 5% of the first $500,000 in exempt purpose expenditures;

   b. $25,000 plus 3.75% of exempt purpose expenditures from $500,001 to $1 million;

   c. $43,750 plus 2.5% of exempt purpose expenditures from $1,000,001 to $1,500,000;

   d. $56,250 plus 1.25% of exempt purpose expenditures from $1,500,001 to $17 million, and 0% of exempt purpose expenditures above that.

The maximum is $250,000 in grass roots lobbying expenditures.

5. "Exempt purpose expenditures" are the amounts paid or incurred to accomplish charitable and educational purposes, including administrative expenses and lobbying expenses. Property purchases (capital additions) are not included, but depreciation is allowed on a straight-line basis. Also not included are payments to a separate fundraising unit consisting of two or more employees who spend a majority of their time fundraising, payments to non-employees for fundraising, and amounts paid or incurred for the production of income. See Reg. 56.4911-4.

6. "Direct" lobbying involves an attempt to influence legislation through communication with a legislator or employee of a legislative body, or any government official or employee who may participate in the formulation of legislation. The communication must refer to specific legislation and reflect a view on such legislation. See Reg. 56.4911-2.

7. "Grass roots lobbying" involves an attempt to influence legislation through an attempt to affect the opinions of the general public or any part of it. The communication must refer to specific legislation, reflect a view on the legislation, and encourage the recipient to take action with respect to the legislation, such as by urging the recipient to contact a legislator, by providing the address or phone number of a legislator, by providing a petition or tear off post card or similar material for the recipient to send, or, except for communications to members, by identifying legislators who will vote on the legislation. See Reg. 56.4911-2.

    a. However, a communication on a referendum, ballot initiative, or similar procedure in which the general public will vote is direct, not grass roots, lobbying because the general public constitutes the legislative body. See Reg. 56.4911-2(b)(1)(iii).

    b. Certain mass media advertisements are presumed to be grass roots lobbying even in the absence of a "call to action." The legislation in question must be well publicized and known to the general public; the organization must have bought paid advertising in a mass media such as television, radio, billboards, or general circulation newspapers or magazines; the advertising must appear within two weeks before a vote will be taken in a full house or committee; and the advertisement must either refer directly to the legislation or state a view about the subject of the legislation and urge the public to communicate with legislators about that subject. An organization can rebut the presumption by demonstrating that the timing of the paid advertisement was unrelated to the legislative action. See Reg. 56.4911-2(b)(5).

8. “Lobbying expenditures” include employee compensation and an allocable portion of administrative and overhead costs attributable to the lobbying communication, as well as direct out-of-pocket expenses such as for travel, duplication, and mailing.

    a. Expenditures that have both lobbying and non-lobbying purposes require an allocation of costs. The cost of communications with members may be allocated on any reasonable basis. The cost of communications primarily to non-members can be allocated to non-lobbying purposes only to the extent that the communication does not address the same specific subject as the lobbying message in the communication. See Reg. 56.4911-3.

    b. The costs of preparing and researching materials later used in lobbying generally are not treated as lobbying expenditures, except when the materials both refer to and reflect a view on specific legislation, the lobbying use occurs within six months after completion of the research, the organization does not make a substantial non-lobbying distribution of the materials before the lobbying use, and the organization’s primary purpose in creating the materials was to use them (directly or through another organization) in lobbying. See Reg. 56.4911-2(b)(2)(v).

    c. A non-member communication that is both a direct and a grass roots lobbying communication is treated as a grass roots lobbying communication, unless the organization demonstrates that the communication was made primarily for direct lobbying purposes, in which case a reasonable allocation is made. See Reg. 56.4911-3(a)(3).

9. Affiliated Section 501(c)(3) organizations, in which at least one organization has elected the Section 501(h) expenditure test, are treated as one organization for purposes of calculating the lobbying expenditure limits. Organizations are affiliated when one organization can bind another organization to decisions on legislative issues.

10. Additional exceptions to the limitations on lobbying (in addition to the exceptions described above).

    a. Appear before or communicate with a legislative body about a possible decision by the body that might affect the organization’s existence, powers and duties, tax-exempt status, or the deduction of contributions to the organization. This exception includes, for example, communications in opposition to proposals that would curtail lobbying by Section 501(c)(3) organizations. This exception does not include communications that seek approval of funding for the organization specifically or for the general nature of its activities. See Section 4911(d)(2)(C).

b. Communicate with members of the organization, even if the communication reflects a view on legislation, as long as the communication is directed only to members, the legislation is of direct interest to the organization and its members, and the communication does not directly encourage the members to engage in lobbying, such as urging them to contact a legislator or the public about legislation. See Section 4911(d)(2)(D).

c. Contact the public about legislation, but do not encourage them to take action such as by contacting a legislator.

d. Utilize volunteers for lobbying. Lobbying by volunteers is considered a lobbying expenditure only to the extent that the organization incurs expenses associated with the volunteers' lobbying.

11. Sanctions

a. If the lobbying non-taxable amount or the grass roots non-taxable amount is exceeded, an excise tax of 25% is imposed on the excess lobbying expenditures. See Section 4911.

b. Tax-exempt status is lost if an organization normally exceeds 150% of either the lobbying non-taxable amount or the grass roots non-taxable amount. "Normally" involves aggregating the current year with the three previous years in which the Section 501(h) election is in effect. See Reg. 1.501(h)-3. An organization that so loses its tax-exempt status cannot then qualify as a Section 501(c)(4) organization. See Section 504.

12. Advantages of the Section 501(h) election.

a. The uncertainty of the "insubstantial" test is replaced with the certainty of the "expenditure" test.

b. Excess lobbying might not result in immediate loss of tax exemption, just the payment of an excise tax.

c. Unpaid volunteers who conduct substantial lobbying activities with no reimbursement are not counted toward the expenditure limits.

d. More exceptions to the limitations on lobbying.

13. Disadvantages of the Section 501(h) election.

    a. Must keep detailed records and calculations of lobbying activities and report expenditures on IRS Form 990, Schedule A. Note, however, that making the election and providing the information does not expose an organization to an increased risk of IRS audit.

    b. Must follow complex, detailed regulations.

D. Federal Income Tax Laws (affecting private foundation grants to public charities)

1. A private foundation may make a grant to a public charity to support a project that includes lobbying, if the grant is not earmarked for lobbying and is not more than the amount budgeted for the non-lobbying part of the project.

2. General support grants may be used for lobbying, unless prohibited by the terms of the grant.

3. Grants may be used for public policy activities that are not considered lobbying, such as responding to written requests from a legislative body for technical advice on pending legislation, unless prohibited by the terms of the grant.

4. Community foundations that are public charities are subject to the lobbying rules that apply to other public charities. A community foundation may lobby and may make grants earmarked for lobbying, which count against the community foundation's own lobbying limits.

E. California Income Tax Laws

1. California income tax limitations on lobbying are substantially the same as the federal limitations. California has enacted provisions analogous to Section 501(h).

2. The California lobbying election is made by furnishing the Franchise Tax Board with a copy of Form 5768 filed with the IRS. See FTB Form 3509.

F. Federal and State Grant Rules

1. Uniform federal grant allowable cost rules in OMB Circular A-122 make unallowable the costs of lobbying and political campaign activity, but do not restrict lobbying paid with non-federal funds. The principal sanction is cost recovery of misspent funds. Lobbying costs are treated as unallowable costs in determining an organization's indirect cost rate.

2. The definition of lobbying is similar to the tax code definition, except that it is permissible to attempt to influence local (but not State) legislation.

3. Time logs, calendars, or similar records documenting employee time devoted to lobbying during a calendar month are not required when the employee spends 25% or less of his or her compensated hours lobbying in that month, and the organization has not materially misstated any of its allowable or unallowable costs in the preceding five year period.

4. A new provision makes unallowable the costs incurred in attempting to improperly influence an employee or officer of a federal agency regarding a regulatory matter. Improper influence means any influence that induces or tends to induce the person to give consideration or to act regarding a regulatory matter on any basis other than the merits.

5. State grant rules might or might not follow the federal grant rules. Check with each funding source.

6. Review the terms of grant awards from private foundations and other funders.

G. Federal Lobbying Disclosure Act (2 U.S.C. 1601 et seq.)

1. The Act provides for the disclosure of efforts by paid lobbyists to influence federal legislative or executive branch officials. The Act requires registration and reporting of federal lobbying expenses and activities by Section 501(c)(3) organizations and other persons who employ a lobbyist and spend $20,000 or more (adjusted for inflation every four years) on lobbying in a six-month period beginning on January 1 and July 1 each year. A lobbyist is an individual who makes more than one lobbying contact and engages in lobbying activities at least 20% of the time in the six-month period.

2. Additional rules, not described here, apply to a 501(c)(3) organization engaged in lobbying on behalf of other persons, and to a self-employed individual or employee of another organization who is retained by a 501(c)(3) organization to lobby on its behalf.

3. A lobbying contact is any communication to a federal legislative or executive branch official with regard to the formulation, modification, or adoption of federal legislation or a federal rule, regulation, or executive order; the administration or execution of a federal program, such as the negotiation, award, or administration of a federal contract, grant, or loan; or the nomination or confirmation of a person for a position subject to confirmation by the Senate.

4. Exceptions to the definition of lobbying contact include a request made to a covered official for information or for a meeting, if the request does not include an attempt to influence the official; testimony at Congressional hearings or a written response to a request from a covered official; and the preparation of materials for a non-lobbying purpose (such as a non-partisan study or analysis) even if later used in lobbying.

5. A Section 501(c)(3) organization that has elected the expenditure test and reports its lobbying expenditures pursuant to the requirements of Section 501(h) and Section 6033(b)(8) may exclude from the definition of lobbying contact a communication with an executive branch official regarding a federal rule, regulation, or executive order, or the administration or execution of a federal program.

6. Organizations must register with the Secretary of the Senate and the Clerk of the House of Representatives within 45 days after employing a lobbyist. An organization must file a lobbying activities report no later than February 14 or August 14 for the previous six-month period. The report includes a list of issues on which the lobbyist engaged, the agencies contacted, and an estimate of lobbying expenses during the period. A Section 501(c)(3) organization that has elected the expenditure test and reports its lobbying expenditures pursuant to the requirements of Section 501(h) and Section 6033(b)(8) may report the amount that would be reported on its federal information return (Form 990).

7. A Section 501(c)(4) organization that engages in any lobbying of federal legislative or executive branch officials is not eligible to receive federal grants or loans.

H. State Political Reform Act (Government Code Sections 81000 et seq.)

1. The Act requires the filing of periodic disclosure reports by Section 501(c)(3) organizations and other persons who are lobbyists, lobbying firms (individuals or entities compensated to lobby for others), lobbyist employers, or who spend $5,000 in a calendar quarter for the purpose of influencing or attempting to influence legislative or administrative action. The Fair Political Practices Commission has the primary responsibility for interpretation and administration of the Act.

2. “Legislative or administrative action” includes action of the state legislature and state agencies, and the action of the Governor in approving or vetoing legislation. However, efforts to obtain a permit, license, grant, or contract from a state agency are not counted as lobbying. The Act does not apply to lobbying of local or federal officials.

3. A “lobbyist” is an individual who is compensated for directly communicating with a qualifying official when trying to influence legislative or administrative action, and is either (a) an “in-house lobbyist,” that is, a person who lobbies on behalf of their employer only, and spends at least one-third of their time in direct communication with qualifying officials, or (b) a “contract lobbyist,” that is, a person who lobbies for someone other than their employer and receives or is entitled to receive $2,000 in a calendar month for direct communication with qualifying officials. Direct communication does not include responding to a request by an official for technical data or analyses, or providing administrative testimony at a public hearing.

4. A “lobbyist employer” is a Section 501(c)(3) organization or other person who employs an in-house lobbyist to lobby, or who retains a lobbying firm to lobby. An organization that belongs to a bona fide association is not a lobbyist employer if the association uses a portion of regular dues payments to lobby (the association may be a lobbyist employer). An organization is not a lobbyist employer if it makes payments to a lobbying coalition of ten or more entities formed primarily to share the expenses of employing a lobbyist or retaining a lobbying firm to lobby (the lobbying coalition is a lobbyist employer). However, each member of a group of less than ten entities formed primarily to share such expenses is a lobbyist employer.

5. To determine whether an organization qualifies as a “$5,000 filer,” that is, an organization that does not employ an in-house lobbyist or contract with a lobbying firm but spends $5,000 in a calendar quarter on lobbying, include compensation paid to an employee who spends 10% or more of his or her time lobbying. Payments for travel and expenses incurred in lobbying are included whether or not the employee spends 10% time on lobbying.

6. All reports are filed with the Secretary of State. Lobbyists, lobbying firms, and lobbyist employers with an in-house lobbyist must register and must file quarterly disclosure reports. Lobbyist employers that only contract with a lobbying firm must complete an authorization for the firm to lobby, and must file quarterly disclosure reports. A $5,000 filer is not required to register, and must file a quarterly disclosure report only for a calendar quarter in which it makes payments totaling $5,000.

7. The Act also regulates expenditures to support or oppose ballot measures.

   a. A Section 501(c)(3) organization or other person that makes independent expenditures totaling $1,000 or more in a calendar year to support or oppose ballot measures must file periodic campaign statements and must file expenditure reports. An “independent expenditure” is an expenditure made in connection with a communication that expressly advocates the qualification, passage, or defeat of a clearly identified measure submitted or intended to be submitted to a popular vote by initiative, referendum, or action of the

legislature, whether or not it qualifies for the ballot, but which is not made to or at the behest of a committee formed to support or oppose the ballot measure. Local cities and counties may impose additional filing requirements.

b. A Section 501(c)(3) organization or other person that makes monetary or non-monetary (in-kind) contributions totaling $10,000 or more in a calendar year (a "major donor") to a committee formed to support or oppose a ballot measure must file periodic campaign statements. An organization that makes in-kind contributions totaling $100 or more in a calendar year to such a committee must report to the committee the value of the contributions. In-kind contributions include paying staff to perform services on behalf of the committee without full cost reimbursement.