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LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

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OF TAX-EXEMPT ORGANIZATIONS**

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LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS*

I. Introduction and Scope:

- A. The Code provides that an entity may qualify as a § 501(c)(3)¹ organization only if:

"no substantial part of [its] activities . . . is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)), and [it] does 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." § 501(c)(3).

See also Treas. Reg. § 1.501(c)(3)-1(c)(3); B. HOPKINS, *THE LAW OF TAX EXEMPT ORGANIZATIONS* chs. 13 and 14 (5th ed. 1987). This reflects a long-standing Congressional judgment that the double federal tax benefits of deductions for contributions to, and exempt status for, the organization should be denied with respect to political and substantial lobbying activities by these organizations. Subcomm. on Oversight of the House Ways and Means Comm., 100th Cong., 1st Sess., Report and Recommendations on Lobbying and Political Activities by Tax-Exempt Organizations 37 (Comm. Print 100-12 June 8, 1987).

- B. A fairly comprehensive bibliography is provided starting at page 34, below. This outline is thus "tilted" towards discussions of the issues which have *not* been the subject of extensive written analysis. Reference should be made to the items cited in the bibliography for additional commentary and analyses.
- C. This outline begins with a brief discussion of some conceptual issues (at ¶ II, p. 2, below). It then provides a brief history of the development of the current state of the law with respect to lobbying and political activities of charitable organizations (at ¶ III, p. 4, below). It next turns to a very brief analysis of the background to the current form of the proposed regulations under § 501(h) (at ¶ IV, p. 6, below), followed by a more detailed description of the 1987 legislation affecting

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1. Except as otherwise noted, all citations are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated under it.

these questions (at ¶ V, p. 7, below). A few concluding comments appear at ¶ VI, p. 32, below.

II. Conceptual Issues:

- A. The law here, as is often the case, has developed in fits and starts, as a result of legislation, regulations, and court decisions typically directed at particular instances of perceived abuses. It is *not* characterized by any overall coherent policy. Thus, history is extremely important (and a brief description of some of the more crucial historical developments is provided, at ¶ III, below).
- B. To perceive the legal landscape more clearly, it is useful to make distinctions among two sets of concepts:

1. The types of legal "persons" to which the rules are addressed, and
2. The types of activities which are the focus of the rules.

The rules treat differently *four* types of "persons" and *three* types of activities (as discussed at ¶¶ II.C and II.D below). These could be thought of as forming a grid, or decision table, with types of persons listed in separate rows and types of activities in separate columns, thus forming a 4-by-3 matrix of intersections (or boxes, or cells). A legal rule would then fall into each such intersection (or box or cell), and – by looking at the resulting matrix – one could get an overall perspective on the pattern (or *lack* of pattern) of the relevant rules. This outline does not attempt to provide all of such rules, but rather focusses only on selected intersections.

- C. Distinctions among four types of "persons" may be relevant:
1. Business taxpayers (typically but not always corporations);
 2. Non-business taxpayers (typically individuals);

3. Tax-exempt organizations;² and
 4. Political organizations (as defined in § 527(e)).
- D. Distinctions among three types of activities may be relevant:
1. Political campaign activities: activities aimed at influencing the election of candidates for public office.
 2. Lobbying activities: activities aimed at influencing, by direct contact, legislators or other public officials in the exercise of their authority, e.g., to vote a particular way on pending legislation.
 3. Grassroots lobbying activities: activities aimed at influencing, indirectly, by contact with constituents, legislators or other public officials in the exercise of their authority.
- Political campaign activities aim at influencing the election of candidates, whereas lobbying activities aim at influencing the conduct of already-elected public officials. Ordinary (or direct) lobbying involves contact with legislators and other public officials empowered to vote or act on laws and legislation, whereas grassroots lobbying involves indirect attempts to influence the same conduct by contacts with constituents rather than the legislators or public officials themselves.
- E. The above distinctions may be found helpful by some, but are clearly neither the only relevant differences nor the only way in which to organize or understand the legal regime.

2. Tax-exempt organizations technically *are* "taxpayers" within the meaning of § 7701(a)(14). Rev. Rul. 67-173, 1967-1 C.B. 101; Forrest City Production Credit Ass'n, 300 F. Supp. 609 (E.D. Ark. 1969), aff'd per curiam, 426 F.2d 819 (8th Cir. 1970). However, they are not, in general, liable for income tax on their net income, and have been treated differently, for purposes of lobbying and political activities, from persons which are so liable.

III. Selected Historical Trail Markers:

- A. Prior to 1934, there were no restrictions in the Code affecting political-campaign or lobbying activities by tax-exempt organizations. Quite early on, however, the IRS, had indicated that organizations disseminating partisan propaganda could not qualify as "educational" within the meaning of the predecessor to current 501(c)(3). Treas. Regs. 45, Art. 517 (1919).
- B. In Slee v. Commissioner, 42 F.2d 184 (2d Cir. 1930) (charitable deduction denied for contributions to organization primarily engaged in lobbying activities), Judge Learned Hand, in an often-quoted portion of the opinion, said that "[p]olitical agitation [activities] . . . must be conducted without public subvention; the Treasury stands aside from them." Id. at 185. This language seemed to apply generally to *all* charitable organizations, not merely "educational" ones, and the opinion was so cited in later decisions.
- C. The Revenue Act of 1934, Pub. L. 73-216, amended the predecessor to current § 501(c)(3) so that an organization would only qualify if "no substantial part of [its] activities . . . [constitutes] carrying on propaganda, or otherwise attempting, to influence legislation." Note that an *in*-substantial amount of such activity was not fatal. This limitation is typically referred to as involving "lobbying." The relevant portion of the 1934 legislation was added in the Senate as a floor amendment, aimed at curbing one specific organization (the National Economy League), and was *not*, according to its sponsor, intended to restrict legislative activities of other "worthy institutions." 78 CONG. REC. 5861 (1934) (remarks of Senator Reed). See Thompson, The Availability of the Federal Tax Exemption for Propaganda Organizations, 18 U.C. DAVIS L. REV. 487, 502 n. 33 (1985).
- D. The Internal Revenue Code of 1954 added a further restriction: § 501(c)(3) organizations were forbidden to intervene in support of any candidate "in any political campaign." Unlike the language dealing with lobbying, this new prohibition allowed no leeway even for *insubstantial* activity. This limitation is typically referred to as involving "political campaign activity."

- E. Prior to 1962, Treasury had, by regulation, denied business deductions to taxpayers for lobbying expenses. This was held to be constitutional in Cammarano v. United States, 358 U.S. 498 (1959).
- F. In 1962, Congress enacted § 162(e)(2), generally *permitting* a business deduction for lobbying expenses directly affecting the taxpayer's business. § 162(e)(2)(B), however, denies deductions for attempts to influence the general public on legislative matters. This limitation is typically referred to as involving "grassroots lobbying," and is so labelled in the regulations. Treas. Reg. § 1.162-20(c)(4).
- G. As part of the Tax Reform Act of 1969, which subjected private foundations to a newly-crafted and quite rigorous regulatory regime, Congress added § 4945(d)(1), imposing an excise tax on grassroots lobbying expenditures by a private foundation. Exceptions were included for non-partisan analyses, lobbying in self-defense, and providing technical information on request. § 4945(e)(2).
- H. In 1976, Congressional dissatisfaction with the lobbying restrictions on public charities led to the enactment of §§ 501(h) and 4911. Tax Reform Act of 1976, Pub. L. 94-455, § 1307, 90 Stat. 1720. These provided an elective regime in which – in lieu of the more vague substantiality standard – electing charities could choose a mathematical test, and be liable only for an excise tax (rather than capital punishment) for "excess lobbying expenditures."
- I. In 1980, regulations were proposed under §§ 162(e) and 4945. 45 Fed. Reg. 78167 (November 25, 1980). They represented the first proposal with respect to § 162(e), and amended the prior (1972) proposals with respect to § 4945.
- J. In 1983, the Supreme Court unanimously sustained the constitutional validity of the Code's lobbying restrictions on tax-exempt organizations, and rejected both free-speech and equal-protection arguments asserted against them. Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983). All of the Justices relied on the fact that the restrictions were content neutral and had been so administered. The three concurring Justices, Blackmun, Brennan, and Marshall, explicitly relied on the ability of a § 501(c)(3) to create a controlled § 501(c)(4)

affiliate to carry on lobbying activities in support of the § 501(c)(3) organization's charitable goals. See also Christian Echoes Nat'l Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972), sustaining the restrictions against free-exercise-of-religion arguments.

IV. The § 501(h) Regulations:

- A. This ¶ IV of the outline is extremely brief, precisely because the regulations are the subject of so much current attention. The first three articles cited in the bibliography, at p. 34, below, describe the currently-proposed regulations, provide background analysis of the developments leading to their issuance, and contrast them with the prior 1986 version of proposed regulations. The article cited at ¶ 1, p. 34, below, follows this outline in the materials; a more comprehensive work by the same author appears at ¶ 1, p. 40, below. The authors of the article cited at ¶ 3, p. 34, below, were also the principal draftsmen of the currently-proposed regulations.
- B. As noted in ¶ III.H, p. 5, above, the Tax Reform Act of 1976 added §§ 501(h) and 4911 to the Code. No regulations were proposed, however, until ten years later. 51 Fed. Reg. 40211 (November 5, 1986). The 1986 proposals provoked agitated opposition from the nonprofit community. Hearings were held on the 1986 proposals on May 11 and 12, 1987. In addition, in response to the public outcry and a suggestion from Chairman Rostenkowski, IRS Commissioner Gibbs formed an Exempt Organizations Advisory Group, which met – and discussed the 1986 proposed regulations (among other items) – on September 17, 1987, February 26, 1988, and January 10, 1989. The currently-pending, and substantially revised, version of the proposed regulations was issued at the very end of 1988. 53 Fed. Reg. 51826 (December 23, 1988).
- C. As of early 1989, very few – only about 1% of – eligible § 501(c)(3) organizations had elected § 501(h) treatment. The IRS is hopeful that the currently-proposed regulations are sufficiently clear and flexible to entice a much larger percentage of such organizations to choose the § 501(h) standards once the regulations become final. Some knowledgeable observers of the nonprofit world are skeptical, and expect the great bulk of such organizations to continue to choose to be governed by the "fuzzier" substantiality test of § 501(c)(3).

- D. A hearing on the currently-proposed regulations was held on April 3, 1989, but - as of the date of this outline - the regulations were not expected to be promulgated in final form until the Fall of 1989 at the earliest.

V. 1987 Legislation - "OBRA":³

A. Introduction:

1. Congress became concerned about various problems of implementation and enforcement of the rules restricting lobbying and political activities of tax-exempt organizations. The problems included: (1) willful efforts by tax-exempt organizations to ignore or evade rules constraining political and lobbying activities; (2) lack of certainty in the non-profit community as to the scope of the statutory language proscribing such activities; and (3) the inability of the IRS (and the public) to monitor or enforce rules against such activities.

2. In response, the Subcommittee on Oversight of the House Ways and Means Committee held hearings in March of 1987. The Staff of the Joint Committee on Taxation prepared materials for the use of the members at those hearings. Staff of the Joint Committee on Taxation, Lobbying and Political Activities of Tax-Exempt Organizations (JCS-5-87, March 11, 1987). The hearings themselves are reported in Lobbying and Political Activities of Tax-Exempt Organizations: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 100th Cong., 1st Sess. (1987). The Subcommittee subsequently issued its report, noted at ¶ 1A, p. 1, above. The Report's recommendations were generally adopted and expanded upon by the House Committee on the Budget, were also adopted with some modifications by the Conference Committee, and were incorporated into the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat.

3. Much of the material in this part V of the outline was prepared and published in a earlier form for ALI-ABA Section of Taxation Course of Study on Tax Exempt Charitable Organizations held in Washington, D.C., on November 17-18, 1988.

1330 (1987) [hereinafter referred to as "OBRA"], which was enacted into law on December 22, 1987. Because the Senate Finance Committee Report is silent with respect to all of the relevant provisions, and the Conference Committee Report deals only with new § 4955, virtually all of the legislative history resides in the House Budget Committee Report cited at ¶ V.B.2.b, p. 9, below.

3. The statutory changes will be analyzed under two main headings:
 - a. those imposing additional disclosure requirements on non-profits, primarily intended to make it easier to detect and monitor political and lobbying activities; and
 - b. those modifying and clarifying the rules affecting proscribed political and lobbying activities.

The first are considered in ¶ V.B, directly below; the second are considered in ¶ V.C, p. 21, below. Where relevant, mention is made of new or more vigorous penalties, and new or enhanced enforcement powers given to the IRS.

B. Disclosure Requirements:

1. Four new sets of rules were adopted by OBRA affecting information disclosure by certain charitable organizations: (1) rules requiring disclosure of the *non*-deductibility of certain amounts paid to such organizations (discussed at ¶ V.B.2, below); (2) rules mandating such organizations to make available certain information for public inspection (discussed at ¶ V.B.3, below); (3) rules increasing the information required to be disclosed on certain tax forms and applications filed by such organizations (discussed at ¶ V.B.4, below); and (4) rules compelling disclosure of the availability of free governmental information or services (discussed at ¶ V.B.5, below). Because only the first three are relevant here, the discussion of the fourth set of rules is extremely abbreviated.
2. Disclosure By Certain Tax-Exempt Organizations of Non-Deductibility of Contributions.

- a. Prior Law. There was no requirement under prior Federal law that a tax-exempt organization state in its solicitations for donations whether such amounts were deductible as charitable contributions.
- b. Abuses or Inadequacy of Prior Law. Some tax-exempt organizations, such as § 501(c)(4) lobbying organizations and § 527 political organizations, are allowed, within limitations, to engage in political and lobbying activity. Contributions to such organizations, however, are not tax-deductible. In some instances, these organizations were suggesting or implying in fundraising appeals that contributions *were* deductible.

The Report of the House Budget Committee on the Revenue Bill of 1987, which subsequently became part of OBRA, states:

"By virtue of this lack of disclosure or use of misleading statements, organizations that are allowed (within limitations) to engage in lobbying or political campaign activities are able to attract support from donors who then claim tax benefits that are available under law only for contributions to charitable organizations, which are precluded from engaging in any political campaign activities and are limited as to the extent of permissible lobbying activities." H.R. Rep. No. 391, 100th Cong., 1st Sess., pt. 2, at 1606-07, reprinted in 1987 U.S. Code Cong. & Admin. News 2313-1186, 2313-1187 [hereinafter referred to as the "House OBRA Report"].

The House OBRA Report noted that such conduct in effect "siphon[s] off tax benefits that are targeted to charitable organizations" and leads to donors unknowingly making improper claims for charitable deductions. House OBRA Report at 1607.

- c. Disclosure Required Under OBRA.

- (1) General Rule. New § 6113 requires that each "fundraising solicitation" by or on behalf of an organization which is subject to § 6113:

"shall contain an express statement (in a conspicuous and easily recognizable format) that contributions or gifts to such organization are not deductible as charitable contributions for Federal income tax purposes." § 6113(a).

The requirement is *not* satisfied by stating that the contributions are deductible only to the extent allowed by law, by stating that the contributor should consult with a tax advisor as to deductibility, or by making no statement at all. House OBRA Report at 1610. On the other hand, payments to noncharitable entities may sometimes be deductible as *business* expenses, rather than under § 170. No disclosure statement is necessary to deal with such cases. House OBRA Report at 1608 n. 3.

- (2) Organizations Subject to the Requirements of § 6113. Subject to an exception for small organizations (discussed at ¶ V.B.2.c.(3)(b), below), two types of entities are subject to this new rule:
 - (a) Any organization described in §§ 501(c) (other than in § 501(c)(1)) or 501(d) and which is exempt from federal income tax, *other than* an organization described in § 170(c). § 6113(b)(1)(A). The disclosure requirement thus applies:

"to fundraising solicitations by or on behalf of social welfare organizations (sec. 501(c)(4)); labor unions (sec. 501(c)(5)); trade associations (sec. 501(c)(6)); social clubs (sec. 501(c)(7)); and [to a certain extent to]

fraternal organizations (secs. 501(c)(8), (c)(10))." House OBRA Report at 1608.

I.R.S. News Release IR-88-31 (Feb. 10, 1988) confirms that the § 6113 applies to "labor unions, trade associations, social clubs, political organizations, political action committees and other noncharitable organizations." It also says that:

"the statement that a contribution or gift is not deductible as a charitable contribution for federal income tax purposes must be included in a conspicuous and easily recognizable format on billings of membership renewals and membership solicitations."

A special rule for fraternal organizations is set forth in § 6113(b)(3).

- (b) Any § 527 political organizations. § 6113(b)(1)(B).

There is a five-year "look-back" rule, making these rules applicable to organizations which *were* described in §§ 6113(b)(1)(A) or (B) at any time during the five-year period ending on the date of the fundraising solicitation, or which are "successors" to such organizations. § 6113(b)(1)(C).

- (3) Organizations Not Subject to the Requirements of § 6113.
 - (a) The disclosure requirement does not apply to organizations, such as those described in § 501(c)(3), which are eligible to receive tax-deductible contributions. Congress was, however, concerned that some such entities were

not adequately advising contributors about the proper amount to claim as a tax deduction, e.g., in connection with fundraising events like auctions, shows, banquets, and athletic events. House OBRA Report at 1607-08. In response to these concerns, the IRS has stepped up its audit activity of such instances, and has issued further guidance on how to determine the proper amount of a charitable deduction. See IR-88-120 (August 4, 1988) and Pub. 1391, Deductibility of Payments Made to Charities Conducting Fund-Raising Events (reprinting Rev. Rul. 67-246, 1967-2 C.B. 104). See also Special Report, IRS Official Explains New Examination-Education Program on Charitable Contributions to Tax-Exempt Organizations, BNA DAILY TAX REP., Sept. 26, 1988, at J-1 - J-3 (interview with Assistant Commissioner Brauer; Q's & A's - drafted by ABA Tax Section's Exempt Organization Committee - attached for further "guidance"). Interestingly, the IRS recently ruled that neither an organization's failure to comply with Rev. Rul. 67-246, nor even its providing *incorrect* information about deductibility of payments, will result in any sanctions against the organization under the current state of the law. TAM 8832003 (May 6, 1988). In LTR 8909004 (Dec. 2, 1988), however, the Service urged that a field investigation be conducted of the organization involved in the earlier ruling. And, in comments at the Commissioner's Exempt Organizations Advisory Group meeting in January 1989, Assistant Commissioner Robert Brauer indicated that LTR 8832003 was under reconsideration.

- (b) The disclosure requirement does not apply if the soliciting organization normally does not

have gross receipts in excess of \$100,000. § 6113(b)(2).

- (4) Definition of Fundraising Solicitation. § 6113 applies to any solicitation of contributions made in writing, by television, by radio, or by telephone. § 6113(c)(1). It does not apply to face-to-face oral solicitations, but it would apply to any written materials distributed at the time of the oral solicitation. House OBRA Report at 1610. A de minimis exception is provided for fundraising solicitations which are "not part of a coordinated fundraising campaign soliciting more than 10 persons during the calendar year." § 6113(c)(2).
- (5) Penalties. New § 6710 provides for a penalty of \$1,000 for each day on which there was a failure to comply with § 6113, unless the failure was "due to reasonable cause." §§ 6710(a), (b). IR-88-13 (January 27, 1988), after describing the new requirements, gave an example which would fit within the "reasonable cause" exception. It:

"occurs when an organization had on hand at the time of the enactment of the law a printed supply of time-sensitive fund-raising solicitations without the disclosure statement, the costs to add a statement of nondeductibility would be a financial hardship, and the organization distributes them before April 1, 1988."

The maximum penalty for any year is \$10,000, but a higher penalty, not subject to this maximum, applies if the failure to comply was "due to intentional disregard" of the rules. §§ 6710(a), (c).

3. Public Inspection of Exemption Application and Annual Information Returns of Tax-Exempt Organizations.

- a. Prior Law. Certain information about tax-exempt organizations was (and continues to be) available through requests to the IRS; other information was (and continues to be) available at the offices of tax-exempt organizations. Thus:
 - (1) The annual information return (Form 990) of a tax-exempt organization was (and continues to be) disclosable to the public through requests to the Service, except for the names of contributors. § 6104(b); Treas. Reg. § 6104(b)-1
 - (2) An exemption application filed by a tax-exempt organization, and the Service determination of its exempt status, were (and continue to be) disclosable to the public through requests to the Service. § 6104(a)(1)(A); Treas. Reg. §§ 301.6104-1, 301.6104(a)-1, 301.6104(a)-5(a), 301.6104(a)-6.
 - (3) Private foundations were (and still are) required to make their annual information returns (Form 990-PF) available for public inspection at their principal office. § 6104(d); Treas. Reg. § 301.6104(d)-1.
- b. Abuses and Inadequacy of Prior Law. The House OBRA Report states that the prior procedure under which the public could obtain copies of annual information returns and exemption applications of tax-exempt organizations only through requests to the Service:

"[did] not result in full and timely public disclosure of the activities of charitable organizations, as needed to facilitate accountability of such organizations to the public from whom they solicit tax-deductible funds." House OBRA Report at 1612.

The Committee believed that the abuses outlined in ¶ V.B.2.b, above, could be curtailed by making information returns and exemption applications more readily available to the public. The major aim of the expanded availability of information returns and exemption applications is thus

to help insure that the "double tax benefits of deductibility of contributions and exemption from income tax are limited to organizations whose assets are devoted exclusively to charitable purposes" and not to political campaign activity or prohibited lobbying. House OBRA Report at 1612.

- c. Inspection Requirements Under OBRA. The main thrust of the new rules is to make more information available at the offices of the tax-exempt organization, rather than only via requests to the IRS.
- (1) Annual Information Returns. New § 6104(e) requires that tax-exempt organizations (other than private foundations) must make available for inspection, during regular business hours, by any individual, at the organization's principal office, a copy of its three most recent annual information returns. If the organization regularly maintains regional or district offices having at least three employees, the returns must be made available at each such office as well. §§ 6104(e)(1)(A), (B). Names of contributors to the organization need not be disclosed. § 6104(e)(1)(C). Private foundations remain subject to the prior-law requirement that their current annual return be made available for public inspection at their principal office. § 6104(d).
 - (2) Exemption Applications. A tax-exempt organization must make available for inspection, during regular business hours, at the same offices described above, a copy of its application for recognition of exemption under § 501, along with any supporting papers, and any determination letter or other document issued by the Service with respect to such application. § 6104(e)(2)(A). This rule does not apply to organizations, such as churches, which are not required to file, and in fact have not filed, annual returns or exemption applications. However, if such an organization *has* nonetheless filed an exemption application, the exemption application dis-

closure rule applies.

- (3) Penalties. § 6652(c) was amended by OBRA to provide that any person under a duty to comply with the inspection provisions who, without reasonable cause, fails to make annual information returns available for public inspection, is subject to a penalty of \$10 for each day the disclosure requirement is not satisfied. A maximum penalty of \$5,000 applies for all failures to disclose any one annual information return, but there is no limit on the penalty for failure to disclose an exemption application. §§ 6652(c)(1)(C), (D); 6652(c)(3). Additional penalties of \$1,000 with respect to each return or exemption application may be assessed if the failure to permit public inspection was willful. § 6685.
 - (4) Effective Date. The new provisions generally apply to returns for years beginning after December 31, 1986. OBRA § 10702(b)(1). They apply to exemption applications after January 20, 1988, unless the exemption application was submitted to the IRS before July 16, 1987, and the organization does not have a copy of the application. OBRA § 10702(b)(2).
4. Additional Information on Annual Returns and Exemption Applications of § 501(c)(3) Organizations.
- a. Prior Law.
 - (1) Annual Information Returns. Except for churches, religious organizations, and a very few other entities, any organization that is tax-exempt under § 501(a) must file an annual information return - Form 990 - with the Service, setting forth, among other things, the organization's items of gross income, receipts, and disbursements. § 6033(a). A § 501(c)(3) organization must also provide additional information relating to contributions received by the

organization and to compensation paid to its employees. § 6033(b). The Form does not request information about relationships with other exempt organizations, except as to "common membership, governing bodies, trustees, officers, etc." Form 990 (1987), Part VII, question 80.

An organization which, without reasonable cause, failed to file a required annual information return was subject to a penalty of \$10 per day for each day the failure continued, with a maximum penalty of \$5,000 with regard to any one return. In addition, the organization's managers were subject to a similar penalty if, without reasonable cause, they refused to file the return after demand from the IRS. §§ 6652(c)(1), (2).

- (2) Exemption Applications. The exemption application for § 501(c)(3) organizations asks whether the applicant controls, is controlled by, or is financially accountable to, another organization; whether the applicant is "the outgrowth of another organization"; and whether the applicant has "a special relationship" (such as interlocking directorships) with another organization. Form 1023 (Rev. April 1984), Part III, questions 5 and 6. The application form and instructions do not require more detailed information about affiliated or predecessor organizations.

- b. Abuses and Inadequacy of Prior Law. The House Budget Committee believed that the disclosures required on exemption applications and annual returns were not sufficient to allow the Service to determine whether tax-deductible contributions were being diverted to noncharitable uses. The Committee noted, "[i]n particular," that the returns did not require sufficient information as to whether the charitable organization was affiliated with other types of exempt organizations which *are* permitted to carry on substantial lobbying or political activities. Thus:

"[f]or example, full disclosure is not specifically required with respect to the sharing of salaried employees, office space, mailing lists, or other expenses, or the sale, lease, loan, contribution or grant, or other transfer of funds and assets between such organizations, even though these types of relationships or transactions may give rise to abuses of tax-exempt status as a charitable organization and diversion of tax-deductible contributions to political campaign expenditures or other impermissible uses." House OBRA Report at 1616.

Under prior law, there was also no penalty for failing to include required information on Forms 990 or 990-PF. The House Committee observed that the "mere filing of a return without fully and accurately furnishing the required information does not serve the enforcement and accountability objectives of the return requirement." House OBRA Report at 1616. A subsequent report, prepared by the General Accounting Office at the request of House Subcommittee on Commerce, Consumer, and Monetary Affairs, found that almost one-half of all Form 990's filed were incomplete, and lacked one or more supporting schedules. General Accounting Office, Availability and Completeness of Returns for Tax-Exempt Organizations (GAO/GGD-88-128 September 1988).

c. Disclosure Required Under OBRA.

- (1) Annual Information Returns. § 6033(b) was amended to provide that the annual return filed by a § 501(c)(3) organization must include such information as may be required by the IRS with respect to "direct or indirect transfers to, and other direct or indirect transactions and relationships with" any other organization described in § 501(c) (other than another § 501(c)(3) organization) and with any political organization described in § 527. § 6033(b)(9). The regulations are to prescribe the required information to prevent "diversion of funds

from the organization's exempt purpose" and the "misallocation of revenues or expenses" between organizations. § 6033(b)(9)(A) and (B). Broad authority is granted to adopt other so-called legislative regulations. § 6033(b)(10).

- (2) Penalties. OBRA amended § 6652(c) to impose penalties on a tax-exempt organization which, without reasonable cause, fails to include any information required on a filed return, or furnishes incorrect information. The penalty is \$10 for each day during which the failure continues, but not more than the lesser of (1) \$5,000 or (2) 5 percent of the organization's gross receipts for the year. § 6652(c)(1)(A). If the organizations's managers refuse to furnish the required information after written demand by the IRS, they are subject to a similar penalty (not to exceed \$5,000 on all persons with respect to one return), unless the failure is due to reasonable cause. § 6652(c)(2)(B). Thus, to avoid the possibility of penalties, if a question on the annual information return is inapplicable to an organization, the organization might well so indicate on the return, rather than leaving a question unanswered or a line on the return blank.
- (3) Effective Date. The additional information must be furnished on annual returns for years beginning after December 31, 1987. The penalty for failure to provide required or correct information applies to returns for years beginning after December 31, 1986. OBRA §§ 10703(b), 10704(d)(1).
- (4) Exemption Applications. OBRA did not amend the statute with respect to information required to be included in exemption applications. The legislative history, however, requests the Service to revise Form 1023 or its instructions to provide more detailed information:

"relating to whether the applicant is controlled by or is the outgrowth of another organization, or has a special relationship with another organization, . . . [or] was controlled by or had interlocking boards of directors with any other exempt organization within the last five years, and whether the applicant has taken over or plans to take over any assets (such as mailing lists or intangible assets) of any other exempt organization." House OBRA Report at 1618.

As of the end of May 1, 1989, however, no revisions to Form 1023 or its instructions had been issued, and the current version of the Form will be in effect until September 30, 1989, at the earliest. Ann. 89-59, 1989-18 I.R.B. 22, however, states that "a revised version of [the] form will be issued before that date."

5. Disclosure That Certain Information or Services Sold By Tax-Exempt Organizations Are Available Free from the Federal Government.
 - a. Prior Law. There was no tax penalty if a tax-exempt organization selling information or services to the public failed to disclose that such information or services could be obtained free (or for nominal charge) directly from the Federal Government.
 - b. Disclosure Required Under OBRA.
 - (1) General Rule. New § 6711 imposes a penalty on any tax-exempt organization that intentionally offers to sell:

"specific information or a routine service for any individual which could be readily obtained by such individual free of charge (or for a nominal charge) from an agency of the

Federal Government"

without making "an express statement (in a conspicuous and easily recognizable format) that the information or service can be so obtained." The penalty is only imposed if the failure to disclose is due to "intentional disregard" of the disclosure requirement. § 6711(a).

- (2) Penalty. The intentional failure to disclose subjects the organization to a penalty equal to the greater of (1) \$1,000 for each day the failure occurred, or (2) 50 percent of the aggregate cost of solicitations made. § 6711(b).
- (3) Effective Date. The new provisions apply to offers after January 31, 1988. OBRA § 10705(c).

C. Modification and Clarification of Rules:

- 1. Five new sets of rules were adopted by OBRA modifying or clarifying the prior law on proscribed political and lobbying activities: (1) a modification to the scope of political campaign activities (discussed at ¶ V.C.2, below), (2) tax status of organizations after losing § 501(c)(3) status because of prohibited activity (discussed at ¶ V.C.3, below), (3) excise tax on certain political expenditures (discussed at ¶ V.C.4, below), (4) additional enforcement authority to deal with flagrant abuses (discussed at ¶ V.C.5, below), and (5) excise tax on certain lobbying expenditures (discussed at ¶ V.C.6, below).
- 2. Clarification of Prohibited Political Campaign Activities.
 - a. Prior Law. An organization did not qualify for tax-exempt status as a charitable organization, and was not eligible to receive tax-deductible contributions, unless the organization did "not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." E.g., §§ 501(c)(3), 170(c)(2)(D). The quoted language was ad-

ded as part of the 1954 Internal Revenue Code. Treasury regulations interpreted it as covering such activities either on behalf of or in opposition to any candidate for public office. Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii). See generally Cummings, Political Expenditures, Tax MGMT. (BNA) 231-3rd (1988), at A-30 et seq.

- b. Inadequacy of Prior Law. The House Committee felt that the statutory language:

"should be clarified to make specific reference to such activities in opposition to, as well as such activities on behalf of, a candidate for public office. This clarification reflects the present-law interpretation of the statute." House OBRA Report at 1621.

- c. Definition of Prohibited Political Activity Under OBRA. The relevant Code provisions were amended to add the parenthetical phrase "(or in opposition to)" to the pre-existing statutory language. §§ 170(c)(2)(D); 501(c)(3); 504(a)(2)(B); 2055(a)(2) and (3); 2106(a)(2)(A)(ii) and (iii); 2522(a)(2); 2522(b)(2) and (3).

3. Status of Organization After Loss of Exemption Under § 501(c)(3) Because of Certain Activities.

- a. Prior Law. Prior law provided (and still provides) that a charitable organization might lose its tax-exempt status under § 501(c)(3) because of its lobbying or political-campaign activities. See Cummings, Political Expenditures, Tax MGMT. (BNA) 231-3rd (1988), at A-47 et seq. A distinction existed, however, under the pre-OBRA version of § 504(a), as to qualification as a § 510(c)(4) (social welfare) organization following such loss of § 501(c)(3) status:

- (1) If § 501(c)(3) status was lost by virtue of *lobbying* activities, the organization could *not* be treated thereafter as a tax-exempt social welfare organization.

- (2) If, however, § 501(c)(3) status was lost through prohibited *political campaign activities*, the organization *was* sometimes eligible to be automatically reclassified as tax-exempt under § 501(c)(4).
- b. Abuses or Inadequacy of Prior Law. There was no logical rationale for the above distinction.

"If . . . an organization could simply convert from one category of tax-exempt status to another, the revocation of its exempt status under section 501(c)(3) would not constitute a sufficient penalty (particularly if the organization did not plan to seek tax-deductible contributions thereafter) for violating the flat prohibition on political campaign activities, or operate as a sufficient deterrent to dissuade charitable organizations from engaging in such prohibited activities." House OBRA Report at 1622.

- c. Change in Law Under OBRA. § 504(a)(2) was amended to deny § 501(c)(4) status to any § 501(c)(3) organization losing its exemption by virtue of political-campaign activities. The House OBRA Report adds that:

"the Treasury Department may issue regulations as necessary or appropriate to prevent the avoidance of the rule, e.g., as where the disqualified organization directly or indirectly transfers all or part of its assets to an organization controlled (directly or indirectly) by the same persons who controlled the transferor." House OBRA Report at 1622.

4. Excise Taxes on Political Expenditures of Charitable Organizations.

- a. Prior Law. As mentioned in ¶ V.C.3.a, above, under prior (and present) law, any § 501(c)(3) organization, whether or not a private foundation, ceases to qualify for tax-exemption and for eligibility to receive tax-deductible contributions if it engages in political-campaign activities. Under

prior (and present) law a private foundation (but not a public charity) is also subject to various excise-tax "penalties" under § 4945 for engaging in certain types of lobbying or political activities. See also § 6684.

- b. Abuses or Inadequacy of Prior Law. For § 501(c)(3) organizations other than private foundations, the pre-OBRA sanctions for engaging in political activities – loss of tax-exempt status and eligibility for tax-deductible contributions, but no excise taxes – were sometimes either too harsh or too weak:
- (1) The IRS might "hesitate to revoke the exempt status of a charitable organization . . . in circumstances where that penalty may seem disproportionate," such as "where the expenditure was unintentional and involved only a small amount" and the organization subsequently corrected its procedures. House OBRA Report at 1623-24.
 - (2) Conversely, "revocation of exempt status may be ineffective as a penalty or as a deterrent, particularly if the organization ceases operations after it has diverted all its assets to improper purposes." House OBRA Report at 1624.

The latter may have been more significant than the former. In the months preceding the enactment of OBRA, there was considerable concern among members of Congress that organizations claiming tax-exempt status had been engaging in prohibited political activities. The most celebrated instance of this abuse was the National Endowment for the Preservation of Liberty (NEPL). NEPL was an exempt organization which supported the Administration's policy toward Nicaragua. NEPL allegedly received funds from the sale of arms to Iran and used them to finance the campaigns of conservative members of Congress and to fund advertisements against members of Congress who opposed aid to the Contras. Among the members opposed by NEPL was Congressman J.J. Pickle, the Chairman

of the Subcommittee on Oversight which held the hearings (see ¶ V.A.2, above) which ultimately led to the relevant OBRA legislation. The Service revoked NEPL's exempt status after its president, Carl Channell, pleaded guilty to conspiracy to defraud the government by using tax-deductible contributions to fund the Contras. See The Political Activities of Exempt Groups - What the Experts Say, 34 TAX NOTES 1147-49 (March 23, 1987).

c. Excise Taxes On Political Expenditures Under OBRA.

- (1) General Rule. New § 4955, entitled "Taxes on Political Expenditures of Section 501(c)(3) Organizations," provides that a charitable organization that makes a "political expenditure" is subject to essentially the same first-tier and second-tier excise taxes to which private foundations have been (and continue to be) subject under § 4945. § 4955(a), (b). The adoption of the excise tax sanction "does not modify the present-law rule that an organization does not qualify for tax-exempt status as a charitable organization, and is not eligible to receive tax-deductible contributions," if it engages in political-campaign activities. House OBRA Report at 1624. The § 4955 excise tax may be avoided if the "taxable event" was "not willful and flagrant" and has been "corrected." § 4962(a), (c). § 4962(c) was added in Conference. See H.R. Conf. Rep. No. 100-495, 100th Cong., 1st sess. 1020, reprinted in 1987 U.S. Code Cong. & Admin. News 2313-1760, 2313-1767 [hereinafter referred to as the "Conference OBRA Report"].
- (2) Definition of Political Expenditures Subject to the Excise Tax. The House bill imposed the excise tax on two categories of expenditures, the first of which (called the "general" rule) applies to all charitable entities, but the second of which (styled "other expenditures") would have applied only in more limited situations:

- (a) All § 501(c)(3) entities are subject to the excise tax with respect to

"any amount paid or incurred . . . in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

The quoted language was accepted in Conference and was enacted as § 4955(d)(1).

- (b) A more limited group of charitable organizations - those "formed, or availed of, substantially for purposes of promoting the candidacy or potential candidacy of an individual for public office" - would also have been subject to the excise tax with respect to five additional types of expenditures enumerated in the bill. House OBRA Report at 1627. As modified by the Conference Agreement, this provision is § 4955(d)(2).

The Conference Agreement modified the House Bill by narrowing the definition of the organizations subject to excise tax on the second (and expanded) types of expenditures. They include only entities either formed or "effectively controlled by" a candidate, and only if such entities are "primarily" formed or availed of to promote such candidacy.

- (3) Statutory Interpretation. The legislative history gives some guidance as to the interpretation of "effectively controlled by," "primary" purpose, and the scope of the enumerated additional categories of expenses. Thus:

- (a) The Conference Report states that:

"an organization is to be considered as effectively controlled by a candidate or prospective candidate only if the individual has a continuing, substantial involvement in the day-to-day operations or management of the organization. An organization is not to be considered as effectively controlled by a candidate or a prospective candidate merely because it is affiliated with such candidate, or merely because the candidate knows the directors, officers, or employees of the organization. Likewise, the effectively controlled test is not met merely because the organization carries on its research, study, or educational activities with respect to issues in which the individual is interested or with which the individual is associated." Conference OBRA Report at 1021.

(b) The House OBRA Report states that:

"the determination of whether the primary purposes of an organization . . . are promoting the candidacy or prospective candidacy of an individual for public office is to be made on the basis of all relevant facts and circumstances." House OBRA Report at 1021.

Various relevant factors are set forth in the Conference OBRA Report at 1021-22.

(c) The five categories of additional expenses which are subject to the excise tax, under § 4955(d)(2), are:

"(A) Amounts paid or incurred to

such individual for speeches or other services;

"(B) Travel expenses of such individual;

"(C) Expenses of conducting polls, surveys, or other studies, or preparing papers or other materials, for use by such individual;

"(D) Expenses of advertising, publicity, and fundraising for such individual.

"(E) Any other expense which has the primary effect of promoting public recognition, or otherwise primarily accruing to the benefit, of such individual."

Some additional guidance on the intended scope of these categories is provided by the House OBRA Report at 1627 and the Conference OBRA Report at 1021.

(4) Enforcement. The House Committee directed the Service to report periodically to the committee concerning its enforcement of the prohibition against political campaign activities. House OBRA Report at 1627-28. See also ¶ V.C.5.c, below.

5. Additional Enforcement Authority in the Case of Flagrant Political Expenditures by Charitable Organizations.

a. Prior Law. The Service did not have authority to make immediate "termination" tax assessments or to seek a court injunction against continuing political expenditures of a charitable organization even if the organization was fla-

grantly violating the prohibition on any political campaign activities. The Service does, however, have such authority in other areas of the tax law.

- b. Abuses and Inadequacy of Prior Law. The House Committee found that certain organizations which engaged in prohibited political activities (and thus ceased to qualify for tax-exempt status and eligibility to receive tax-deductible contributions) nonetheless continued to represent themselves as eligible to receive tax-deductible contributions and then used these funds for prohibited activities. Under prior law, the Service might not be able to revoke an organization's exemption status until the organization filed its information return and the return was selected for audit. House OBRA Report at 1628-29. As the legislative history stated:

"By that time, all contributions received by the organization (for which the donors have claimed charitable deductions) and its other assets may have been spent on nonexempt activities, and the organization may have ceased operations. As a result, the subsequent issuance of the exemption revocation does not have a deterrent effect on the organization or operate as an effective penalty, particularly since the organization no longer may have any assets out of which tax liabilities could be collected." House OBRA Report at 1629.

- c. Enforcement Authority Under OBRA.

- (1) Determination and Assessment of Income Tax. New § 6852 authorizes the IRS to make an immediate determination and assessment of income tax, or of the excise tax on political expenditures, for the current or preceding taxable year, of a § 501(c)(3) organization if the Service finds that (i) the organization has made political expenditures, and (ii) such expenditures constitute a flagrant violation of the prohibition against political expenditures.

- (2) Authority to Enjoin Flagrant Political Expenditures of § 501(c)(3) Organizations. New § 7409 authorizes the Service to seek an injunction from a federal district court prohibiting a charitable organization from making any further political expenditures. The injunction action may be instituted only if the Service notifies the organization of its intention to seek an injunction if the making of the political expenditures does not immediately cease, and only if the Commissioner of Internal Revenue has personally determined that (1) the organization has flagrantly participated or intervened in a political campaign, and (2) injunctive relief is appropriate to prevent future political expenditures.
6. Excise Tax on Disqualifying Lobbying Expenditures of Certain Charitable Organizations.
 - a. Prior Law. A charitable organization (including a private foundation) ceases to qualify for tax-exempt status under § 501(c)(3), or for eligibility to receive tax-deductible contributions, if more than an insubstantial part of its activities consists of carrying on propaganda or otherwise attempting to influence legislation, except as provided in § 501(h). A private foundation is subject to an excise tax equal to ten percent of any expenditure to carry on propaganda or otherwise to attempt to influence legislation or for any other noncharitable purposes. § 4945. If the foundation is liable for the excise tax, any manager of the foundation who, without reasonable cause, agreed to making the expenditure knowing it was a taxable expenditure is subject to an excise tax equal to 2-1/2 percent of the expenditure (not to exceed \$5,000 per expenditure).

Certain tax-exempt charities may elect to have the amount of permitted lobbying expenditures they may make measured under the arithmetical tests of § 501(h). If lobbying expenditures exceed the amounts allowed under § 501(h), a tax equal to twenty-five percent of the excess lobbying

expenditures is imposed on the organization. If the electing organization's lobbying expenditures are normally more than 150 percent of the allowed amounts, the organization is disqualified from tax-exempt status.

- b. Abuses or Inadequacy of Prior Law. The House OBRA Report noted that:

"revocation of exempt status may be ineffective in the case of certain charitable organizations as a penalty or as a deterrent to engaging in more than insubstantial lobbying activities, particularly if the organization ceases operations after it has diverted all its tax-deductible contributions and exempt income to improper purposes but before it has been audited and any income tax liability has been assessed." House OBRA Report at 1631.

It was believed that a more effective sanction against prohibited lobbying activities would be to supplement the sanction of revocation of exempt status with an excise tax similar to the excise taxes applicable to private foundations and § 501(h)-electing organizations.

- c. Excise Taxes Disqualifying Political Expenditures Under OBRA.

- (1) General Rule. New § 4912, added by OBRA, imposes a 5-percent excise tax on the lobbying expenditures of certain charitable organizations if the organization ceases to qualify for tax-exempt status under § 501(c)(3) by engaging in more than an insubstantial amount of lobbying activities. § 4912(a). The excise tax does not apply to (i) organizations that have made the 501(h) election; (ii) organizations not eligible to make the 501(h) election; and (iii) private foundations (which are subject to the § 4945 excise tax). § 4912(c)(2).

- (2) Managers' Liability. The Conference Agreement mo-

dified the House Bill to provide that if an organization whose exempt status has been revoked is liable for the new excise tax on disqualifying lobbying expenditures, a tax equal to five percent of such lobbying expenditure is imposed on any manager of the organization who agreed to the making of such expenditures "knowing that such expenditures are likely to result" in revocation of the organization's exempt status, unless the manager's agreement was not willful and was due to reasonable cause. § 4912(b). The House Bill would have imposed the tax on a manager who agreed to the making of such expenditures knowing that such expenditures "could" result in revocation of the organization's tax-exempt status. A manager is liable for the excise tax only if the Service demonstrates that the manager knew the expenditures constituted lobbying expenditures, knew that the organization was likely to lose its tax exempt status as a result of the expenditures, and only if the manager failed to obtain an opinion of counsel that would protect the manager under the reasonable cause exception.

VI. Concluding Observations:

- A. Although tax-exempt organizations' lobbying and political activities have been scrutinized by Congress, courts, and the Service for over 70 years, the current status of the rules is neither satisfactory nor stable. Regulation of such activities strikes close to the core of constitutionally-protected rights, but existing cases do not set forth doctrines or lines adequate to guide future legislative or regulatory initiatives. Yet the issues remain volatile, by virtue of both increased advocacy by tax-exempt entities and increased concern by members of Congress. Thus, further developments seem certain, but their thrust seems impossible to predict.
- B. As a corollary, there is good reason here for encouraging further analysis of and writing about the issues. The nonprofit community needs better guidelines for the permitted scope of its lobbying activities, and legislators, legislative staffers, and regulators need firmer ground on

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which to stand when proposing new or amending old legislation, regulations, or the like.

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