REPORT #563

TAX SECTION

New York State Bar Association

Report of the Committee on Exempt Organizations

COMMENTS ON

PROPOSED LOBBYING REGULATIONS AFFECTING CHARITIES

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TAX SECTION
New York State Bar Association

May 18, 1987

BY FEDERAL EXPRESS

The Honorable Lawrence B. Gibbs
Commissioner of Internal Revenue
1111 Constitutions Avenue, N.W.
Washington, DC 20224

Attention: CC:LR:T:EE-154-78
Lobbying Expenditures for
Charitable Organizations

Dear Commissioner Gibbs:

I enclose a report by our Committee on Exempt Organizations commenting on the proposed regulations relating to lobbying expenditures by certain tax exempt public charities.

The report was written Sydney R. Rubin, Irving Salem and Michelle P. Scott. It also reflects contributions by William L. Burke, Herbert L. Camp, Arthur A. Feder, Sherman F. Levey, Donald Schapiro and David E. Watts.

The report was approved by the Executive Committee of the Tax Section.

Sincerely,

Donald Schapiro

Cc: The Honorable Roger J. Mentz
Assistant Secretary for Tax Policy

REPORT #563

May 18, 1987

NEW YORK STATE BAR ASSOCIATION TAX SECTION

Report of the Committee on Exempt Organizations

COMMENTS ON

PROPOSED LOBBYING REGULATIONS AFFECTING CHARITIES[*]

Introduction

On November 5, 1986, the Internal Revenue Service published proposed regulations on lobbying activities undertaken by public charities that qualify for tax-exempt status under Code section 501(c)(3)[1/] electing to be governed by the expenditure test of section 501(h) enacted in the Tax Reform Act of 1976. As part of the same notice, amendments were proposed to regulations applicable to "taxable expenditures" by private foundations under Code section 4945, which amendments, by cross reference, would also affect public charities making the section 501(h) election.

The 1976 legislation was enacted to allow eligible section 501(c)(3) organizations electing to be governed by the new "objective," numerical test ("electing public charities") to utilize specific expenditure limits as a baseline for a 25% tax, and for ultimate loss of exemption, to replace uncertain standards governing exempt organizations' lobbying activities.

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[*] This report was written by Sydney R. Rubin, Irving Salem and Michelle P. Scott. It also reflects contributions by William L. Burke, Herbert L. Camp, Arthur A. Feder, Sherman F. Levey, Donald Schapiro, and David E. Watts.

[1/] Unless otherwise noted, all references are to the Internal Revenue Code of 1986.

I. Summary of Recommendations

Our Committee's recommendations and conclusions can be summarized as follows:

(A) The proposed regulations should contain a clear objective standard which would permit electing public charities to avoid lobbying treatment by complying with a requirement of widespread dissemination of legislative information, as compared with the proposed lobbying treatment for dissemination of such information to a targeted group of persons who "would reasonably be expected to share a common view of the legislation." Widespread dissemination of information would be distinguished from "targeted" dissemination in three cases:

> (1) If the distribution meets the widespread dissemination standard, expenditures for communications which express no "explicit view on the legislation" would not be converted to either direct or grass roots lobbying expenditures even though, as part of the dissemination, distribution was made to persons reasonably expected to share a common view.[2/]
>
> (2) As stated in paragraph (B) below, if the distribution meets the widespread dissemination standard, an exemption from lobbying expenditures similar to that contained in regulations section 53.4945-2(d)(4) for private foundations[3/] should be applicable for comments on broad social, economic and similar problems so long as the discussion does not address itself to the merits of a specific legislative proposal.

[2/] See Prop. Regs. sec. 56.4911-2(b)(2)(ii) and -2(c)(1)(ii) reprinted in Exhibit A annexed.

[3/] Reprinted in Exhibit B annexed.

(3) If the distribution meets the widespread dissemination standard, distribution of nonpartisan analysis, study or research would not be disqualified even though the distribution was also directed towards persons who are interested solely in one side of a particular issue. We recommend this test be substituted for the proposed amendment to regulations section 53.4945-2(d)(1)(iv) which, as now written, would disqualify nonpartisan analysis if it would “favor in any manner” persons interested solely in one side of an issue.

Our Committee proposes that the widespread dissemination standard be deemed met unless the principal purpose of a targeted dissemination is shown to be the influencing of views on legislation. Further, we strongly urge that the regulations contain a safe harbor rule which will enable a charity clearly to meet the widespread dissemination test. We recommend for consideration a safe harbor rule to the effect that the widespread dissemination standard will be deemed met whenever the charity takes action in good faith necessary to satisfy either of the following tests: (a) the number of persons reached who are reasonably expected to share a common view of the legislation is equaled or exceeded by the aggregate number of other persons reasonably expected either to hold a view contrary to, or to be open-minded on, the issue involved, who are reached by a similar means of communication; or (b) the cost incurred by the charity in reaching persons who are reasonably expected to share a common view of the legislation is equalled or exceeded by costs incurred by the charity which are reasonably expected to be equally effective in reaching other persons reasonably expected either to hold a view contrary to, or to be open-minded on, the issue involved. Persons (e.g., young children or incompetents) whose status is known to the organization and who may have reasonably been expected to have no interest in the communications would not count as “other people” for purposes of the safe harbor.

(B) The proposed regulations should incorporate the rule now contained in regulations section 53.4945-2(d)(4) (reproduced in Exhibit B) which, in the case of private foundations, does not treat as lobbying certain expenditures for the examination and discussion of broad social and economic problems of the type the government would be expected to deal with. However, in adapting this rule to section 4911 and public charities, widespread dissemination of information should be explicitly added as a requirement for the exemption. The requirement of widespread dissemination could be complied with by meeting the safe harbor test set forth in paragraph (A) above.

(C) Expenditures should be classified as lobbying expenditures only if, as provided in the statute, they are made "for the purpose" of influencing legislation as now provided in regulations section 53.4945-2(c). The apparently broader test of expenditures "in connection with" influencing legislation first proposed in 1980[4/] and 56.4911-2(b)(1) and -2(c)(1) (Exhibit A attached) should not be adopted for purposes of public charities or private foundations.[5/]

(D) Where a public charity in fact expends funds for the purpose of influencing legislation in a manner which is not exempt, calculation of the amount of the lobbying expenditure should be made as follows:

[4/] Proposed amendments to Treas. regs. sec. 53.4945-2(c) (November 25, 1980).

[5/] Under the terms of the statute, the broader "in connection with" test is appropriately utilized for disallowing business expenditures under Code section 162(e) since this follows the language of Code section 162(e)(2)(B).

(1) Costs incurred in connection with producing or obtaining the material which becomes part of, or is utilized in the lobbying activity, should be considered lobbying expenditures only if incurred after the time it becomes "more likely than not" that the product being produced will be utilized to influence legislation in a manner not qualifying for statutory exemption from classification as a lobbying expenditure; and

(2) The rules of the proposed regulations as set forth in section 56.4911-2(d) providing for the allocation of "mixed expenditures" are reasonable and should be adopted.

(E) In determining whether or not a general support grant by a private foundation to a public foundation is a lobbying expenditure, the private foundation should be permitted to rely on written representations of the public charity as to its expenditures for prior years and its budget for the current year so long as the private foundation acts in good faith.

(F) The administration of the affiliated group rules could be improved if (1) a clear procedure were adopted to enable single organization to be designated as the agent for the group, and (2) an opinion letter procedure were encouraged. Further, it appears that double counting is possible with respect to organizations which are members of multiple groups. This should be corrected.

(G) It appears likely to the Committee that many of the organizations concerned with the impact of the proposed regulations operate with limited budgets, and, therefore, cannot afford the services of expert attorneys or accountants to help them interpret the regulations. For these organizations, it would be very helpful if a “practical” explanation of the most important parts of the regulations, suitable for interpretation by laymen, could be made available as quickly as possible,

preferably at the same time that the final regulations appear. This explanatory material might well be in question and answer form, and cast as a series of practical problems focusing on the most important areas of concern. Safe harbor guidelines should be provided whenever possible. Further, we recommend that, because of the complexity of the entire area, the Service should consider adopting a liberal enforcement policy taking into account such criteria as good faith efforts to comply, reliance on professional advice and non-repetition of tainted activities.

II. Expenditures for Lobbying

(A) Background

(1) 1969 Rules for Private Foundations. For an organization to qualify as tax-exempt under section 101(a)(6) of the 1939 Code and section 501(c)(3) originally enacted in the 1954 Code, "the carrying on of propaganda, or otherwise attemping to, influence legislation" can constitute no substantial part of its activities. Participation or intervention in political campaigns on behalf of any candidate is totally proscribed.

Reacting to activities that it considered abusive of the benefit of tax-exempt status,[6/] the Congress in 1969 imposed an excise tax under section 4945 on expenditures for a broad range of legislative lobbying by private foundations. The Tax Reform Act of 1969 defined both direct lobbying and grass roots efforts as "taxable expenditures." Both foundations and their managers are subject to excise taxes with respect to these taxable expenditures. Repeated actions giving rise to such excise tax liabilities can result in revocation of exempt status under Code section 507.

The 1969 legislation exempts expenditures for the following three items from tax:[7/]

[6/] See H. Rep. No. 413, 91st Cong., 1st Sess. 3d, August 2, 1969; S. Rep. No. 13270, 91st Cong., 1st Sess. 47, November 25, 1969; H. Rep. No. 91-782, 91st Cong., 2d Session. 284, December 21, 1969 (Conference Report). See also General Explanation of the Tax Reform Act of 1969, H.R. 13270, 91st Cong., Pub. L. 91-172, Staff of the Joint Committee on Internal Revenue Taxation, December 3, 1970.

[7/] Code sec. 4945(e) and Treas. regs. sec. 53.4945-2(d).

(a) Direct lobbying on behalf of the organization's own existence, power, duties and status (“self-defense”);

(b) Responding to written legislative requests for assistance; and

(c) Making available nonpartisan analysis, study or research, including advancing a particular position or viewpoint so long as there is a sufficiently full and fair exposition of pertinent facts to enable the public or an individual to form an independent opinion or conclusion. Making such analysis, in oral or written presentations or otherwise, available to the public, or governmental bodies, officials or employees is also permitted.

The regulations under section 4945, which were promulgated in 1972, incorporate statements in the legislative history of the 1969 Act,[8/] which exempt from tax expenditures for examination and discussion of broad social issues including communications with legislators on topics such as environmental pollution and population growth so long as the discussion does not address itself to the merits of a particular proposal. (See Exhibit B attached.)

[8/] Regs. sec. 53.4945-2(d)(4); see H. Rep. No. 13270, 91st Cong., 1st Sess. 32, August 2, 1969; S. Rep. No. 13270, 91st Cong. 1st Sess. 47, November 25, 1969; H. Rep. No. 91-782, 91st Cong., 2d Sess. 284, December 21, 1969 (Conference Report).

(2) 1976 Rules for Electing Public Charities.

The Tax Reform Act of 1976 added sections 501(h) and 4911 to the Code. Section 501(h) permits certain exempt organizations to elect to be governed by objective percentage tests with respect to lobbying activities instead of the "vague" substantial part test.[9/] Electing organizations could incur lobbying expenditures below specified ceiling amounts without suffering an excise tax or risking loss of exempt status. The percentage tests were intended to provide managers of electing organizations and government administrators with greater certainty than did the substantial part test. This election is not available to private foundations, churches and certain support organizations.

Under the 1976 rules, an electing organization must pay the section 4911 excise tax if its lobbying expenses exceed the lesser of $1 million or a graduated percentage of its expenditures base. A lower limitation applies to grass roots lobbying expenditures, which are also counted in the overall limit on lobbying expenditures. The grass roots limit is 25% of the overall limit. Repeated excess expenditures in excess of 150% of either ceiling will result in loss of exempt status.

[9/] See S. Rep. 94-938, 94th Cong., 2d Sess., Part 2, 79, July 20, 1976; H. Rep. 94-1515, 94th Cong., 2d Sess. 536, September 13, 1976 (Conference Report); General Explanation of the Tax Reform Act of 1976, H.R. 10612, 94th Cong., Pub. L. 94-455, Staff of the Joint Committee on Taxation 407, December 29, 1976.

As will become clear from the discussion in this report, the Committee does not believe that sections 501(h) and 4911 succeeded in providing complete objectivity, and we doubt whether the elimination of subjectivity is an attainable goal, at least in this area. Nevertheless, we believe that significant changes can be made in the proposed regulations which would provide clearer rules and reduce areas of uncertainty.

(3) 1980 Proposed Regulations under Code Sections 162(e) and 4945. In 1980, the Internal Revenue Service (the "Service") proposed revisions to the lobbying regulations under sections 162(e) (relating to business expenses) and 4945 (relating to taxable expenditures by private foundations). These proposals were prompted by Congressional hearings in which the deduction of lobbying expenses as business expenses was criticized. The Service proposed amending the private foundation rules because it believed that the legislative history of section 4945 mandated conformity with the section 162(e) regulations applicable to business taxpayers.[10/] The Service also stated that it viewed the amendments as necessary to prevent abuses.

In early 1981, the Committee on Exempt Organizations of the Tax Section of the New York State Bar Association submitted a report on the proposed revisions to the private foundation regulations suggesting that these provisions were not required, and that the Service's view on conformity misinterpreted

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[10/] See explanatory introductory material to November 25, 1980 notice of proposed rule making which cites the Tax Reform Act of 1969, H. Rep. No. 91-413, 91st Cong., 1st Sess. 33, August 2, 1969; S. Rep. No. 91-552, 91st Cong., 1st Sess. 48, November 25, 1969.

legislative intent.[11/] The 1981 report recommended that any changes in the private foundation lobbying rules should await coordination with regulations to be prescribed under sections 501(h) and 4911. The report also objected to the retroactive application of the changes, and to several substantive provisions.

(4) Differing Policies behind Denial of Business Expense deductions and Imposition of Tax on Charities. As pointed out in our 1981 report, the draftsmen of the 1980 proposed regulations adopted a questionable policy in concluding that the legislative history of the private foundation provisions enacted in 1969 relating to lobbying by private foundations were "intended to be substantially similar to the rules applied to business taxpayers under section 162(e)(2)" and that the "proposed regulations accordingly conform the general rules for private foundations with respect to attempts to influence the public to the rules proposed by business taxpayers." [12/] As noted in the 1981 report, the legislative history cited in support of this conclusion does not state that the 1969 private foundation provisions were intended to be applied in the same manner as the disallowance of business deductions; and there are exemptions provided for private foundation expenditures which are not applicable to business taxpayers.

Thus, for example, private foundations, unlike business taxpayers, may make nonpartisan analyses, study or research available even if the communication would otherwise constitute an "attempt to affect the opinion of the general public," viz.,

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[11/] New York State Bar Association Tax Section, Committee on Exempt Organizations, Report #322, Comments on Proposed Grass Roots Lobbying Regulations Affecting Private Foundations, September 15, 1981.

[12/] Notice of proposed ruling making, November 25, 1980.

constitute grass roots lobbying. Further, the 1969 legislative history makes it clear that private foundations are not to be prevented from examining broad social, economic and similar problems of the type government would be expected to deal with ultimately, such as, for example, environmental pollution and population growth.[13/]

Thus, there are many fundamental differences in the legislative approach between disallowing deductions for business expenses and imposing tax on private foundations. Certain expenditures, in the case of business taxpayers, can be subject to disallowance, and, in the case of private foundations, can be free of excise tax.

When in 1976 Congress enacted the elective rule for public charity lobbying set out in Code sections 501(h) and 4911, it borrowed heavily in language and concept from Code section 4945. Section 4911 also added material not contained in section 4945 exempting certain communications of public charities to their members, and adopting rules as to affiliated groups. The affiliated group rules were regarded as necessary to prevent multiplication of the initially higher percentage limits, and avoidance of the overall ceiling of $1 million per charity.

It is worth observing that the 1976 provisions dealing with public charities, unlike either section 162(e) or 4945, exempt specified amounts of permitted lobbying expenditures. Representatives of public charities have expressed the view that the existence of a permitted amount of lobbying expenditures shows that Congress intended that various public charities and institutions should be free, and possibly encouraged, to express

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[13/] See Committee Reports cited note 10, supra, and H. Rep. 91-782, 91st Cong., 1st Sess. 284, December 21, 1969 (Conference Report).

their rather sophisticated views on the development of social policy by way of legislation.

Our Committee believes that regulations under sections 501(h) and 4911 should reflect the differing policies underlying sections 162(e), 4945 and 4911. Bright-line rules and safe harbors may be justified under section 4911, even though they might be inappropriate under section 162(e). As explained more fully below, there may well be sound policy reasons for holding that selective dissemination of information will cause a business expense deduction to be denied, while at the same time, sound policy might permit a charity a safe harbor under which it could expend its limited funds in a manner such as to assure a sufficiently broad dissemination of its communications to prevent characterization as lobbying expenses.

(5) Proposed 1986 Regulations. The public charity lobbying regulations issued in November, 1986, proved immediately controversial. In response to criticism from the Congress and the philanthropic community, the Internal Revenue Service announced on April 9, 1987, that it would consider whether it is appropriate to repropose all or part of the regulations before promulgating them in final form. [14/] The Service stated that the final regulations would not be retroactive but prospective only. Transition rules will be provided with respect to multiple-year grants awarded by private foundations to public charities. The Service also stated that the proposed regulations have no legal authority, may not be relied upon and cited by IRS agents, and will not be used in conducting examinations, issuing rulings, or otherwise disposing of any case.

[14/] IR-87-49.

The Committee believes it is appropriate to revisit the rules governing lobbying activities by tax-exempt organizations, and to provide guidance under provisions of the 1976 Act which were not borrowed from earlier legislation. The proposed regulations have been issued at a time when concern has been expressed that activities of certain tax-exempt organizations appear to conflict with the policy barring the use of tax-deductible funds donated to, or money earned by, tax-exempt organizations in lobbying activities.

Television commercials, newspaper advertisements and targeted mailings have been used to stimulate constituent interest in legislative issues and to influence legislators' positions as well as their election prospects. Think-tanks with narrow political orientations, some dealing with particular political views and issues and others serving as research organizations for candidates, are playing a greater role in public debate. The activities of some tandem organizations, i.e., organizations exempt under section 501(c)(3) that have relationships with less restricted organizations under section 501(c)(4), present practical questions about the independent governance and conduct of such entities.

The proposed regulations are confined to lobbying activities of public charities. They do not address questions about other types of organizations or activities. Some areas of concern, particularly questions about tandem organizations, may be beyond regulators' current jurisdiction and may require legislative action. Our Committee supports legislative attention to this problem.

Recognizing possible areas of abuse, the Committee is nevertheless concerned about protecting the ability of public charities to conduct their proper activities, particularly research and educational endeavors, including the ability to spend modest sums on influencing legislation, and work without inhibition and undue administrative difficulty. Thus, while the Committee agrees that regulations should be promulgated in this area, it is our view that the proposed regulations should be significantly modified.

The importance of modifying the proposed regulations under sections 501(h) and 4911 goes beyond ameliorating the position of charities electing to come under these provisions. This is true because the concepts and definitions of lobbying can readily be applied to private foundations and non-electing public charities.

(B) Requirement to Disseminate Communications beyond a Group Consisting of "Persons Reasonably Expected to Share a Common View of the Legislation"

The proposed regulations enunciate, as a pivotal point, distinctions between broadly based communications and those which are "selectively disseminated" to persons reasonably expected to share a common view of the legislation," or which "otherwise favor in any manner, persons who are interested solely in one side of a particular issue." [15/]

[15/] See Exhibit A and proposed amendments to Treas. Regs. sec. 53.4945-2(d)(1)(iv). The concept of characterizing a communication by reference to the group to which it is disseminated appears in regulations section 53.4945-2(d)(1)(iv) adopted in 1972 dealing with the making available of the results of analysis, study or research where it is stated "for purposes of this subparagraph, such presentations may not be limited to or directed towards persons who are interested solely in one side of a particular issue."

Further, it is appropriate to consider the question whether selective distribution of communications might be a factor in determining whether the expenditures described in private foundations regulations section 53.4945-2(d)(4) dealing with examinations and discussions of broad social, economic and similar problems (Exhibit B attached), should be characterized as non-lobbying expenditures under section 4911.

Finally, there is the question as to how selective dissemination of information might disqualify expenditures which would otherwise meet the test of Code section 4911(d)(2)(A) dealing with making available the results of nonpartisan analysis, study or research. See proposed regulations section 53.4945-2(d)(1)(iv) and proposed regulations section 56.4911-3(b), cross referencing the private foundations regulations.

Our Committee is of the view that public charities have an obligation to make broad distribution of their communications. On this basis, we conclude that distribution of otherwise nonpartisan information or communication to a narrow group which was “principally” intended to influence legislation should be treated as a lobbying expenditure. On the other hand, we also conclude that there should be a ready and objectively determinable standard which would demonstrate that the communication of information was not “principally” intended to influence legislation.

Taking into account the competing considerations involved, we recommend a safe harbor test with respect to dissemination he adopted. In the summary of conclusions set out in Section I(A) at page 5 above, we proposed that a distribution of information by a public charity be deemed purged of adverse consequences resulting from any targeted distribution, and deemed to quality as meeting a “widespread dissemination” test, so long as the charity acting in good faith takes steps necessary to satisfy either of two sate harbors, one relating to costs incurred, and the other relating to persons reached. These sate harbors would apply for purposes of (a) avoiding characterization of expenditures as lobbying expenditures,[16/] (b) meeting the broad public issue dissemination test, and (c) qualifying as a nonpartisan analysis.

As noted, the charity would have to act in good faith to reach persons who have views which are contrary to those held by the targeted group or who are open-minded on the issue involved. Thus a charity which mailed 1,000 copies of material relating to upcoming gun control legislation to members of a hunting club could not offset this targeted dissemination by mailing 1,000 copies of the same material to a group of junior high school students.

[16/] Under our Committee's view, the parenthetical material would be retained in proposed regs. sec. 56.4911-2(h)(2)(ii) and -2(c)(1)(ii), but material would he added stating that selective dissemination would not be deemed to have occurred it the safe harbor requirements were met.

It is possible that additional conditions, such as filing the targeted communication with some public forum might be imposed to satisfy the safe harbor. The important point, however, is that a charity should have a clear means of purging the adverse effects of any targeted dissemination.

We recognize that this safe harbor test might impose on public charities the obligation to spend substantial sums to reach non-targeted groups as well as to reach targeted groups for dissemination of information it such charities are to escape characterization of their expenditures as lobbying expenditures. On balance, we believe this is a reasonable result, given the various policy considerations supporting characterization of an organization as a charitable organization.

Insofar as the exemption for nonpartisan reports and analysis is concerned, consistent with our views above, we recommend that the change in regulations section 53.4945-2(d)(1)(iv) not be adopted in the form proposed. This change would make the nonpartisan analysis exemption unavailable if the communication were distributed in a manner which was “otherwise favorable in any manner” to persons interested solely in one side of the issue. The nonpartisan analysis exemption is contained in section 4945 and carried over by cross-reference to section 4911[17/] and should not be so restricted. The requirement of a public distribution should be satisfied if the distribution meets the widespread dissemination test above stated.

[17/] Prop. regs. sec. 56.4911-3(b).

In the view of the Committee, once the bedrock issue of characterization of a position by reference to the group to which it is disseminated has been adequately and reasonably dealt with, most of the rest of the issues raised by the proposed regulations appear to be amenable to consistent reasonable resolutions.

(C) Allocation of Costs to Lobbying Expenditures

The Committee believes that the proposed regulations unduly broaden the costs which are to be included as lobbying expenditures.

First, the change in the basic definition of lobbying to include costs incurred “in connection with” influencing legislation rather than those incurred “for the purpose of” influencing legislation is not supported by our Committee (See further, I(C), page 5, supra).

Second, where a public charity makes a lobbying expenditure, an issue always arises as to what costs are to be included. We believe that prior expenditures for investigation and research should he counted as lobbying expenditures only where it is “more likely than not,” determined at the time of incurring the expenditure, that the material will ultimately be the foundation for lobbying expenditures.

(D) Right of Private Foundations to Rely on Written Representations of Public Foundations

In dealing with a private foundation's support grants to public charities, our Committee is of the view that the regulations should permit private foundations to rely on written representations of the public charities as to the amount of their

prior year's non-lobbying expenditures and their budget for the current year.

(E) Discussion of Examples Contained in Proposed Regulations

We set out below our views as to how examples in the proposed regulations should be revised to reflect the recommendations discussed above.

(1) Direct Lobbying. While the examples in regulations section 56.4911-2(b)(3) (Exhibit A attached) by their terms illustrate that expenditures will not become lobbying expenditures if, in fact, the organization neither supports nor opposes legislation, the question raised by the examples is broader. Suppose that P's employee A were assigned the task of spending several weeks researching issues and contacting P's directors to clarify P's position on a pending bill. Assume further that no decision had been made as to whether P would support or oppose the bill, and that it was not “more likely than not” that the result of A's endeavors would cause P to adopt a position. In these circumstances, our Committee recommends that expenditures incurred from and after the time it becomes “more likely than not” that P will adopt a position should be treated as lobbying expenditures, but that expenditures incurred before that time should not be so treated.

(2) Grass Roots Lobbying. It is instructive to compare the eight examples set out in proposed regulations section 56.4911-2(c)(2) (promulgated in 1986) illustrating grass roots expenditures for a public charity with the corresponding eight examples set out in proposed regulations section 162-20(c)(4)(iii) (promulgated in 1980) (reproduced in Exhibit C attached) which deal with the concept of grass roots lobbying in the context of business expenses. In the following discussion, the 1986 proposed regulations examples are referred to as the "Charity examples" and the 1980 proposed regulations examples are referred to as the "Business Expense examples."

Charity example (2) and Business Expense example (2) illustrate the issue of different policies underlying Code sections 162(e) and 4911. Our Committee believes that the facts in Business Expense example (2) may well justify loss of a deduction. On the other hand, on the facts of Charity example (2), our Committee is of the view that the exemption for discussion of broad social issues should exempt the activity set out in Charity example (2) from classification as a grass roots expenditure so long as the advertisement is not published in a targeted manner, or, if it is so targeted, the public charity meets the widespread dissemination safe harbor test.

Charity example (4) and Business Expense example (4) also illustrate the distinctions which the Committee believes are properly applicable as between classification of expenditures as being nondeductible for purposes of section 162(e) and those constituting lobbying expenditures for purposes of section 4911. We express no objection to Business Expense example (4), but we believe that Charity example 4 should be revised to state that, if the qualified dissemination safe harbor test were met, the expenditures of the public charity would not be lobbying expenditures.

The Committee does not disagree with the position taken in Business Expense examples (5) and (6). On the other hand, the Committee believes that Charity example (6) is correct only if P was aware that it was more likely than not that the leaflet summarizing the report would be used by the academics through organization S (viz., the 501(c)(4) organization) to obtain publicity in opposition to the legislation. Further, the cost incurred by P in preparing the report referred to in Charity example (5) should be counted as part of the lobbying expenditures only if it was more likely than not at the time the report was prepared that the report would be used as a basis for preparation of a leaflet, which, it was more likely than not, would be circulated in the fashion described in Charity example (6).

The Committee has no comment on Business Expense example (7) insofar as it relates to business expense deductions. In the case of Charity example (7), the question whether, because of the advertisement, the entire expenditure should be characterized as a lobbying expenditure for a public charity, is a difficult one. On balance our Committee is of the view that the basic thrust of Charity example (7) is correct. However, we suggest that example (7) be expanded in two respects. First, the example should make clear that, in absence of the offer of the “free booklet,” the advertising expenditure is not a lobbying expense, and, second, that, if the “free booklet” presents both sides of the issue in a nonpartisan manner, none of the expenditures are lobbying expenses.

The concepts illustrated by the examples are complicated. In view of the fact that many persons who are concerned with administering charities will probably not have a business or tax background, our Committee strongly urges that expanded simplified guidance be provided through publication of questions and answers. This could be done either in the regulations or by way of a separate interpretive release. Further, safe harbor guidelines should be provided wherever possible.

III. Exempt Purposes Expenditures

Section 4911 of the Code imposes a tax equal to 25% of the "excess lobbying expenditures" for the year, which are defined as the amount by which an electing organization's lobbying expenditures exceed the lobbying non-taxable amount,[18] or the grass roots expenditures exceed the grass roots non-taxable amount.[19] The lobbying non-taxable amount for any year is set forth as a series of declining percentages of "exempt purpose expenditures" with a ceiling of $1 million.[20]

Exempt purpose expenditures are therefore key. The greater the exempt purpose expenditures, the less the "excess lobbying expenditures" upon which the tax is based. Exempt purpose expenditures include charitable program outlays, administrative expenses for such outlays, and lobbying expenses.[21] They exclude amounts paid to a separate fundraising unit of the organization, or to another organization if primarily for fundraising.[22]

The proposed regulations address in some detail what outlays constitute lobbying expenditures and what others constitute exempt purpose expenditures, and how to allocate when the expenditures have or may have a dual character.[23] With regard to such "mixed purpose expenditures," they provide that, in

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[18] Code sec. 4911(b)(1).

[19] Code sec. 4911(b)(2).

[20] Code sec. 4911(c).

[21] Lobbying expenses are properly included because they are also included in the other end of the equation.

[22] Code. sec. 4911(e)(1).

[23] Prop. Treas. regs. sec. 56.4911-2 and -4.

general and with certain exceptions, "a reasonable allocation, based on all the facts and circumstances, must be made between the portion of the expenditure incurred for lobbying purposes and the portion incurred for charitable or fundraising purposes."[24/] They cite as an example a pamphlet which has three articles of equal length, one of which is an attempt to influence the general public concerning legislation, while the other two relate to charitable non-lobbying purposes. One-third of the cost is treated as a grass roots expenditure.[25/]

The proposed regulations are severe where some types of potential grass roots lobbying is involved. As exceptions to the "reasonable allocation" rule just discussed, the proposals provide that, "[I]f any part of an advertisement constitutes grass roots lobbying, the entire amount expended for, or in connection with, the advertisement constitutes a grass roots expenditure."[26/] An allocation on the basis of space might be viewed as being reasonable in this case as in the pamphlet case. Nevertheless, our Committee believes the rule in the proposed regulations is justified on the basis that a charity ought not to be able to dilute its grass roots expenditures by adding possibly unimportant space-consuming material to an advertisement.

As another exception to the reasonable allocation method, the rules would provide that, if an expenditure (not relating to communications with members) is made for both grass roots lobbying and fundraising purposes, all of it will be treated as being for grass roots lobbying.[27/] And, if an

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[24/] Prop. Treas. regs. sec. 56.4911-2(d)(1).

[25/] Id.

[26/] Prop. Treas. regs. sec. 56.4911-2(c)(1).

[27/] Prop. Treas. regs. sec. 56-4911-3(d)(2).

expenditure is made for both direct and grass roots lobbying, it "will be treated as a grass roots expenditure except to the extent that the organization demonstrates that the expenditure was incurred solely for direct lobbying purposes."[28/] Because grass roots lobbying nontaxable amounts are only one-quarter of the lobbying nontaxable amounts,[29/] allocating heavily or entirely in the grass roots lobbying column reflects a possibly harsh approach. Nevertheless, we believe the result in the proposed regulations is justified for the reason, among others, that the grass roots audience of an item distributed to both the public and to legislators is likely to be far larger in terms of numbers than the direct lobbying audience.

With respect to section 4911(e)(1) of the Code which excludes from exempt purpose expenditures amounts paid to a separate fundraising unit, or to another fundraising organization, the proposed regulations define a separate fundraising unit as consisting of "two or more individuals a substantial part of whose time is spent on fundraising," or a "separate accounting unit of the organization that is devoted to fundraising."[30/] The definition of fundraising includes, among other things, soliciting dues or contributions from members of the organization, including persons whose dues are in arrears.[31/] Getting members to pay their dues, whether in arrears or not, is ordinary good administration and not fundraising in the usual sense. Nevertheless, it seems appropriate that such expenditures be excluded from what goes into exempt purpose expenditures.

[28//] Prop. Treas. regs. sec. 56.4911-2(d)(3).

[29/] Code sec. 4911(c)(4).

[30/] Prop. Treas. regs. sec. 56.4911-4(f)(2).

[31/] Prop. Treas. regs. sec. 56.4911-4(f)(1)(i).

Also excluded under the proposed regulations are "amounts paid or incurred in connection with the production of income, whether or not described in sec. 512(a)(1) [dealing with unrelated business income]."[32/] While investment advisory services would appear to be no less related to fulfilling charitable or education purposes than included expenditures such as the "allocable portion of administrative, overhead, and other general expenditures . . .,"[33/] the view taken in the proposed regulations appears supported by the statute and the private foundation rules of Code section 4945.

IV. Affiliated Groups of Organizations

(A) Designation of Controlling Entity as the Agent for the Group

Each member organization of the affiliated group is charged with all the investigatory and administrative tasks of reporting as a group. For example, each member must: (a) determine the appropriate taxable year of the group,[34/] and (b) cross file all information.[35/]

[32/] Prop. Treas. regs. sec. 56.4911-4(c)(7).

[33/] Prop. Treas. regs. sec. 56.4911-4(b)(3).

[34/] "The election [treating the group's year as the year of the member] may be made by an electing member organization by attaching to its annual return a statement from itself and every other member of the affiliated group." See Prop. regs. sec. 56-4911-7(e)(5).

[35/] "Each member of an affiliated group shall provide to every other member . . . its name, identification number, and the information required under sec. 1.6033-2(a)(2)(ii)(K) for its expenditures during the group's taxable year . . ." See prop. Treas. regs. sec. 56.4911-9(d)(2).

The regulations should place the administrative burden on the “controlling organization” of each affiliated group (a term which is defined throughout the regulations) whenever such controlling corporation can be identified and designated by all of the affected parties. With a central authority in charge and responsible, compliance is less likely to be sparse and chaotic.

(B) Eliminate Double Counting of Expenditures of Organizations Which Are Members of More than One Group

An organization can be a member of more than one affiliated group.[36/] However, each organization is required to pay only one tax (the highest).[37/] This doesn't go far enough to eliminate double counting. The expenditures of the organization are not also eliminated from the computation of the tax of each other affiliated group. Why should a controlled member's expenditures infect (or help) the group of which it is not ultimately treated as a member? This seems to be a case of double counting, which in extreme cases could also lead to denial of tax exemption for members of the various multiple groups.

We believe that expenditures of a member of an affiliated group should be eliminated from the computation of the taxes and penalties imposed by Code sections 501(h) and 4911 for all affiliated groups, except with respect to the group with respect to which the member must pay its portion of the tax due under Code section 4911.

(C) Need for Opinion Letter Procedure

[36/] Prop. Treas. regs. sec. 56.4911-7(e)(2).

[37/] Prop. Treas. regs. sec. 56.4911-8(d)(6).

Since affiliation can have such a significant impact on an organization, the legislative history specifically directed the Service to open up the opinion letter process: "Your committee intends that the Internal Revenue Service make provision for issuing opinion letters at the request of electing organizations to determine whether those organizations are members of affiliated groups and to determine which other organizations are members of such groups . . ."[38/] However, a willingness by the Service to rule on such questions would go far to further reduce the uncertainty that at present prevails in this part of the law. The regulations make no mention of this point.

The regulations (or the preamble thereto) should openly state the Service's willingness to issue opinion letters dealing with affiliations issues. We suggest that the Service issue a revenue procedure describing the manner of applying for such opinions. The revenue procedure should be as simple as possible and designed to he read by payment since many of the requests will he prepared by administrators or charitable organizations who are not likely to have a technical background.

[38/] H. Rep. No. 1210, 94th Cong., 2d. Sess. 12 (1976). This report deals with H.R. 13500, influencing Legislation by Public Charities, which became part of the history of the 1976 Act. See Conference Report cites in Note 9, supra.

EXHIBIT A

Proposed Treas. Regs. Sec. 56.4911-2(b) and -2(c)(1) Definitions of Direct Lobbying and Grass Roots Lobbying

(b) Expenditures for direct lobbying defined-(1) Expenditures. An expenditure for direct lobbying is any amount paid or incurred for, or in connection with, direct lobbying, or any amount treated as an expenditure for direct lobbying under paragraph (d) or (e) of this section or under §56.4911.5, or any amount included as an expenditure for direct lobbying under §56.4911.10(dX2). Expenditures for direct lobbying include amounts paid or incurred as current or deferred compensation for an employee's services in connection with direct lobbying, and the allocable portion of administrative, overhead, and other general expenditures attributable to direct lobbying.

(2) Direct lobbying communication defined. A communication is an attempt to influence legislation through direct lobbying if the communication-

(i) Pertains to legislation being considered by a legislative body, or seeks or opposes legislation,

(ii) Reflects a view with respect to the desirability of the legislation (for this purpose, a communication that pertains to legislation but expresses no explicit view on the legislation shall be deemed to reflect a view on legislation if the communication is selectively disseminated to persons reasonably expected to share a common view of the legislation), and

(iii) Is either-

(A) With a member or employee of a legislative body, or

(B) With a government official or employee (other than a member or employee of a legislative body) who may participate in the formulation of legislation, but only if the principal purpose of the communication is to influence legislation.

(3) Examples. The provisions of this paragraph (b) are illustrated by the following examples:

Example (1). P is an organization for which the expenditure test election under section 501(h) is in effect. Ps employee, A, is assigned to approach members of Congress to gain their support for a pending bill. A spends several weeks researching the issue and contacting Ps directors to clarify Ps position on the bill. P then prints a position letter that is distributed to members of Congress. Additionally, A personally contacts several members of Congress or their staffs to seek support for Ps position on the bill. Amounts paid or incurred for, or in connection with, A's research, A's discussions with Ps directors, the position letter, and A's Congressional contacts are expenditures for direct lobbying.

Example (2). Assume the same facts as in example (1), except that after A completes the research on the issue, it is decided by Ps directors that P will neither support nor oppose the bill. Under these circumstances, A has not engaged in any direct lobbying. Accordingly, Ps expenditures incurred for, or in connection with, A's research are not expenditures for direct lobbying.

(c) Grass roots expenditures--(1) Defined. A grass roots expenditure is any amount paid or incurred for, or in connection with, grass roots lobbying, or any amount treated as a grass roots expenditure under paragraphs (d) or (e) of this section or under §56.4911.5 or any amount included as a grass roots expenditure under §56.4911.10(dX3). Grass roots expenditures include amounts paid or incurred as current or deferred compensation for an employee's services in connection with grass roots lobbying, and the allocable portion of administrative, overhead, and other general expenditures attributable to grass roots lobbying. “Grass roots lobbying” means an attempt to influence the general public, or any segment thereof, with respect to any legislation. A communication shall be considered an attempt to influence the general public, or a segment thereof, with respect to legislation if the communication—

(i) Pertains to legislation being considered by a legislative body, or seeks or opposes legislation,

(ii) Reflects a view with respect to the desirability of the legislation (for this purpose, a communication that pertains to legislation but expresses no explicit view on the legislation shall be deemed to reflect a view on legislation if the communication is selectively disseminated to persons reasonably expected to share a common view of the legislation), and

(iii) Is communicated in a form and distributed in a manner so as to reach individuals as members of the general public, that is, as voters or constituents, as opposed to a communication designed for academic, scientific, or similar purposes. A communication may meet this test even if it reaches the public only indirectly, as in a news release submitted to the media.

If any part of an advertisement constitutes grass roots lobbying, the entire amount expended for, or in connection with, the advertisement constitutes a grass roots expenditure.

EXHIBIT B

Regulations Section 53.4945-2(d)(4)

(4) *Examinations and discussions of broad social, economic, and similar problems*. Expenditures for examinations and discussions of broad social, economic, and similar problems are not taxable even if the problems are of the type with which government would be expected to deal ultimately. Thus, the term “any attempt to influence any legislation” does 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. For example, a private foundation may, without incurring tax under section 4945, present discussions of problems such as environmental pollution or population growth which are being considered by Congress and various State legislatures, but only if the discussions are not directly addressed to specific legislation being considered. [Reg.§ 53.4945-2.]

[T.D. 7215, 10-30-72.]

EXHIBIT C

Proposed Treas. Regs. Sec. 1.162-20(c)(4)(iii)

Section 162(e) – 1980

Example(1). Several major businesses in State W place in local newspapers an advertisement asserting that lack of new capital is hurting the state's economy. The advertisement recommends that residents either invest more in local businesses or increase their savings so that funds will be available to either interested in making investments. Although the advertisement expresses a view with respect to a general problem that might receive legislative attention and is distributed in a manner so as to reach many individuals, it does not constitute an attempt to influence the public with respect to legislative matters because it pertains to private conduct rather than legislation.

Example(2). Assume the same facts as in example (1), except that the advertisement, although not expressly calling for legislative action, also asserts that particular kinds of state tax incentives (which could not be implemented without legislation) would substantially increase capital formation. Thus, the advertisement is seeking action by the legislature and, at least in part, is addressed to individuals as voters or constituents rather than as potential investors. The advertisement reflects a view with respect to the desirability of the legislation. The advertisement constitutes an attempt to influence the public with respect to a legislative matter, and me portion of any expenditures in connection with the advertisement may be deducted.

Example(3). There is pending in the legislature of State X a proposal to amend certain laws concerning voting in state elections. As a public service, M, a manufacturer in State X, places in local newspapers an advertisement that explain both the current voting laws and the proposed amendments. The advertisement takes as position on the merits of the proposal. Under these circumstances, the advertisement does not reflect a view with respect to the desirability of the proposal and does not constitute an attempt to influence the general public with respect to the proposal.

Example(4). The legislature of states Y is considering a proposal to prohibit hunting on land owned by the state. Hunters in State Y are generally opposed to the measure. N, a manufacturer of hunting equipment, prepares a pamphlet that outlines the proposal and its effects but expresses so view on its merits. N arranges for distribution of the pamphlet to customers of stores in State Y that specialize in hunting equipment. The pamphlet pertains to legislation and be deemed to reflect a view with respect to the desirability of the legislation by reason of its selective distribution to our audience likely to oppose the prohibition on hunting. The information is communicated la a form and distributed in a manner so as to reach individuals as voters or constituents. Expenditures in connection with the preparation and distribution of the pamphlet are nondeductible.

Section 162(e)

Example(5). The legislature in State Z In considering a proposal to require pharmaceutical firms to test the safety of their products through certain laboratory procedures. P, a pharmaceutical firm in State Z, prepares a detailed report on the usefulness of the tests that would be required under the proposal. The report concludes that the tests specified in the proposal are poorly designed. P distributes copies of the report to university professors in the field of health science without suggesting that the recipients make any attempt is influence the public with respect to the proposal. Although the report pertains to legislation and implies that the legislative proposal under consideration should not be casted, the form of the report and its limited distribution indicate that copies were furnished to the recipients as scholars in the field rather than as members of the general public, that is, as voters or constituents. The expenditures for the report, therefore, are not expenditures is connections with an attempt to influence the public with reaped to the proposal.

Example(6). Assume the name facts as in example (5) except that, instead of distributing copies of the report to university professors, P distributes to various civic groups leaflets summarizing the conclusions and recommendations of the report. The information is communicated in a form and distributed in a manner so as to reach individuals as voters or constituents. Expenditures in connection with the report and the leaflet are nondeductible.

Example(7). Corporation Q pays for the radio broadcast of an advertisement that refers to a current controversy and urges citizens to “become involved”. The advertisement does not discuss the merits of any legislative proposal, but it does offer a free booklet which analyzes and takes positions on various legislative proposals relating to the controversy. Expenditures in connection with the advertisement and the booklet are nondeductible because together they constitute an attempt by Q to influence the public with respect to this legislative matter.

Example(8). Corporation R makes the services of B, one of its executives, available to S, a trade association of which R is a member. B work for several weeks to assists S to develop materials designed to influence public opinion on legislation. In performing this work. B uses office space and clerical assistance provided by R. R pays full salary and benefits to B during this period and receives no reimbursement from S for these payments or for the other facilities and assistance provided. All expenditures of R, including the allocable office expenses that are attributable to this assignment are nondeductible because B was engaged in an attempt to influence the public on legislative matters.

Proposed Treas. Regs. Sec. 56.4911-2(c)(2)

Section 4911 – 1986

Example(1). L, an organization for which the expenditure test under section 501(h) is in effect, places in local newspapers in State. If an advertisement that asserts that lack of new capital is hurting the state's economy. The advertisement recommends that residents either invest more in local businesses or increase their savings so that funds will be available to others interested in making investments. Although the advertisement express a view with respect to a general problem that might receive legislative attention and is distributed in a manner to as to reach and influence many individuals, it does not constitute an attempt to influence the public with respect to legislation because it pertains to private conduct rather than legislation.

Example(2). Assume the same facts as in example (1) except that the advertisement, although not expressly calling for legislative action, also asserts that particular kinds of state tax incentives (which could not be implemented without legislation) would substantially increase capital formation. Thus, the advertisement is seeking action by the legislature and, at least in part, is addressed to individuals as voters or constituents rather than as potential investors. The advertisement reflects a view with respect to the desirability of the legislation. The advertisement constitutes an attempt to influence the public with respect to legislation, and the entire amount expended for, or in connection with, the advertisement is grass roots expenditure.

Example (3) There is pending in the legislature of State X a proposal to amend certain laws concerning voting in state elections. As a public service, M, an organization in State X for which the expenditure test election is in effect places in local newspapers of general circulation an advertisement that explains both the current voting laws and the proposed amendments. The advertisement takes no position on the merits of the proposal. Under these circumstances, the advertisement does not reflect a view with respect to the desirability of the proposal and does not constitute an attempt to influence the general public with respect to the proposal.

Example(4). The legislature of State Y is considering a proposal to prohibit hunting at land on by the State. N, an organization for which the expenditure test election is in effect, prepares a pamphlet that analyzes the proposal in detail but expresses no view on its merits. N arranges for distribution of the pamphlet to groups in State Y (with which it is not affiliated) that are opposed to hunting. The pamphlet pertains to legislation, and is deemed to reflect a view with respect to the desirability of the legislation by reason of its selective distribution to an audience reasonably expected to support the prohibition on hunting. The information is communicated in a form and distributed in a manner so as to reach individuals as voters or constituents. Expenditures for, or in connection with, the preparation and distribution of the pamphlet are grass roots expenditures.

Example(5). The legislature in State Z Is considering a proposal to require pharmaceutical firms to test the safety of their products through certain laboratory procedures. P, an organization in State Z for which the expenditure test is in effect, prepares a detailed report on the usefulness of the tests that would be required under the proposal. The report concludes that the tests specified in the proposal are poorly designed. P distributes copies of the report to university professors in the field of health science without suggesting that the recipients make any attempt to influence the public with respect to the proposal. Although the report pertains to legislation and implies that the legislative proposal under consideration should not be enacted, the limited distribution of the report indicates that copies were furnished to the recipients as scholars in the field rather than as members of the general public, that is, as voters or constituents. The expenditures for the report, therefore, are not grass roots expenditures.

Example(6). Assume the same facts as in example (5), except that P also prepares a leaflet summarizing the report and distributes both the report and the leaflet only to academics in the field of health science who are known to oppose the legislation. The academics publicize their position by using the leaflets provided by P. S, an organization described in section 501(c)(4), of which the academics are members, also publicizes its opposition to the legislation using the leaflets provided by P. All amounts expended by P in connection with the report and the leaflets are grass roots expenditures since they were not communications designed for academic, scientific, or similar purposes.

Example(7). Q, an organization for which the expenditure test is in correct, pays for the radio broadcast of an advertisement that refers to a current controversy involving legislation and urges citizens to “become involved.” The advertisement does not discuss the merits of any legislative proposal but it does offer a free booklet which analysis and takes positions on various legislative proposals relating to the controversy. All expenditures for, or in connection with, the advertisement and the booklet are grass roots expenditures because together they constitute an attempt by Q to influence the public with respect to legislation.

Example(8). R, an organization for which the expenditure test is ire effect, makes the services of B, one of its paid executives, available to S, an organization described in section 501(c)(4) of the Code. B works for several weeks to assist S in developing materials designed to influence public opinion on legislation. In performing this work, B uses office space and clerical assistance provided by R. R pays full salary and benefits to B during this period and receives no reimbursement from S for these payments or for the other facilities and assistance provided. All expenditures of R, including allocable office expenses, that are attributable to this assignment are grass roots expenditures because B was engaged in an attempt to influence the public on legislation.