REPORT #612

TAX SECTION

New York State Bar Association

Committee on Exempt Organizations

COMMENTS ON

1988 PROPOSED LOBBYING REGULATIONS AFFECTING CHARITIES

May 12, 1989

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May 11, 1989

The Honorable Michael J. Murphy
Acting Commissioner of Internal
Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Mr. Murphy:

Enclosed are Comments on the 1988 Proposed Lobbying Regulations Affecting Charities by the Committee on Exempt Organizations. The draftsman of this report is Michelle P. Scott.

The Report supports the 1988 Regulations as a substantial improvement over the 1986 proposals and favors the adoption of the 1988 Regulations with certain modifications. It concludes that the 1988 Regulations, while narrower than the earlier proposals and less stringent in some respects than the statutory rules would allow, generally achieve a reasonable balance for objectives of abuse curtailment, administrability, and encouragement of exempt organizations' involvement in public issues.

The Report also recommends, however, the following further modifications:

(1) the new rule treating certain mass media communications as grass roots lobbying be adopted with its two-week time limitation modified;

(2) the regulations be expanded to provide an opinion letter procedure;

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(3) the regulations reconfirm that the section 501(h) statutory expenditure tests and regulations in no way affect the interpretation or administration of the "substantial part" test if section 501(h) is not (or cannot be) elected.

In addition, the Report urges that sufficient IRS resources then be allocated to enforcement of the rules governing lobbying by public charities and private foundations.

Sincerely,

WLB/JAPP
Enclosure

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cc: The Honorable Frederick Goldberg
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Tax Report #612

May 12, 1989

NEW YORK BAR ASSOCIATION TAX SECTION

Committee on Exempt Organizations

COMMENTS ON

1988 PROPOSED LOBBYING REGULATIONS AFFECTING CHARITIES*

On December 23, 1988, the Internal Revenue Service published revised proposed regulations on lobbying activities by public charities electing to be governed by the expenditure test of Code section 501(h)[1] and on certain related matters affecting private foundations (the "1988 Regulations"). The 1988 Regulations amend controversial proposed regulations issued in 1986 pursuant to provisions of the Tax Reform Act of 1976 (the "1986 Regulations"). They would apply prospectively only for tax years beginning after the publication of final regulations.

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* This report was written by Michelle Scott. It also reflects contributions by William L. Burke, Harvey Dale and David E. Watts.

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

SUMMARY

This report describes the major new features of the 1988 Regulations and indicates their adoption or rejection of recommendations made by this committee in a prior report on the 1986 Regulations.[2] The committee supports the 1988 Regulations as a substantial improvement over the 1986 proposals and favors the adoption of the 1988 Regulations with certain modifications. The Report concludes that the 1988 Regulations, while narrower than the earlier proposals and less stringent in some respects than the statutory rules would allow, generally achieve a reasonable balance for objectives of abuse curtailment, administrability, and encouragement of exempt organizations' involvement in public issues. The Report also recommends, however, the following further modifications:

(1) the new rule treating certain mass media communications as grass roots lobbying be adopted with its two-week time limitation modified;

(2) the regulations be expanded to provide an opinion letter procedure;

[2] "Comments on Proposed Lobbying Regulations Affecting Charities," Committee on Exempt Organizations, Tax Section of the New York State Bar Association (May 18, 1987).

(3) the regulations reconfirm that the section 501(h) statutory expenditure tests and regulations in no way affect the interpretation or administration of the "substantial part" test if section 501(h) is not (or cannot be) elected.

In addition, the Report urges that sufficient IRS resources then be allocated to enforcement of the rules governing lobbying by public charities and private foundations.

BACKGROUND

Qualification of an organization as a public charity under section 501(c)(3) requires that no "substantial part" of the organization's activities be lobbying or propaganda, or otherwise attempting to influence legislation. To try to alleviate the problems of the vagueness in this requirement, the 1976 Act permitted eligible section 501(c)(3) organizations to elect to be subject to objective, quantitative tests ("electing public charities"). The tests utilize specific expenditure limits, which if exceeded would result in a 25% tax, and if repeatedly failed, loss of exemption. In 1986, Treasury proposed implementing regulations that were criticized on the grounds that their complex and uncertain provisions would inhibit legitimate activities of public charities. In 1988, revised regulations were proposed in response to comments received on the 1986 proposed regulations. In particular, the 1988 Regulations substantially change the definitions of direct lobbying and grass roots lobbying, relax allocation rules, and reaffirm the importance and propriety of the exempt sector's participation in nonpartisan analysis, study or research, and in the discussion of broad social, economic and similar problems.

DISCUSSION

1. Need for Clear Tests

The Committee's 1987 report emphasized that the regulations should contain clear, objective standards. In particular, it criticized the "selective dissemination" test in the 1986 Regulations that would have characterized a communication as lobbying if its distribution was targeted to persons who "would be expected to share a common view of the legislation."[3] The Committee advocated a widespread dissemination safe-harbor as an alternative for avoiding lobbying treatment.

The 1988 Regulations have simplified and narrowed the definitions and have eliminated dissemination as a general test.[4] By adopting more precise definitions, the 1988 Regulations also should reduce the problems arising under the operative provisions of the regulations because fewer threshold questions will exist about what activities constitute lobbying.

a. Lobbying Definitions

The 1986 rules treated as lobbying all communications that "pertain to legislation" even where a message about the desirability of legislation was merely implicit. The revised 1988 definition of a "lobbying communication" requires that the communication meet two tests: (1) it must refer to specific legislation, and (2) it must reflect a view on the legislation.

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[3] Prop. Regs. sec. 56.4911-2 (b)(2)(ii) and -2(c)(1)(ii)(1986).

[4] See Prop. Reg. secs. 56.4911-2(b)(1) and (2)(1988).

“Grass roots lobbying”, in addition to meeting the two tests for a lobbying communication, must encourage the recipient to take action with respect to the legislation. The 1988 Regulations list four factors, any one of which will constitute such grass roots encouragement:

> (1) The communication states that the recipient should contact legislators or their employees for the principal purpose of influencing legislation;
>
> (2) The communication provides the address, telephone number or similar information about a legislator or legislative employee;
>
> (3) The communication provides a petition, postcard or similar material for communicating views to a legislator or legislative employee; or
>
> (4) The communication specifically identifies one or more legislators who will vote on legislation as (a) opposing the communication's views; (b) being the recipient's legislative representative; or (c) being a member of the committee that will consider the legislation. Naming the main sponsors of legislation for identification purposes is, however, not treated as encouraging legislation.

The new definitions significantly reduce the areas of uncertainty. These changes are a welcome improvement. The reference to “specific legislation” indicates a far narrower range of application than was the case with the 1986 terms that encompassed almost any subject that could be achieved through legislation. Left unexplained by the revision,

however, is exactly when an idea becomes sufficiently discrete or identifiable to qualify as specific legislation.

Some communications prior to a bill's official introduction clearly should be treated as lobbying: often the most effective lobbying campaigns are conducted prior to the introduction of legislation. The regulations should expressly cover some pre-introduction activities. However, the point at which an idea or proposal evolves from a general topic for discussion into “specific legislation” is imprecise.

Long-standing regulations governing private foundations' lobbying activities have applied to legislation whose introduction was “imminent,”[5] a test that would be dropped by the 1988 Regulations. Retaining the idea of imminent introduction in the private foundation provisions and applying it in the private charity area as well, while leaving some uncertainty, may be an acceptable compromise in view of the overall narrowing of the definitions' scope and the effectiveness of pre-introduction lobbying. As a general policy, there is no reason for subjecting public charities to rules stricter than those applicable to private foundations. Examples describing circumstances that would constitute safe-harbors would be helpful. Activities might be presumed to be outside the scope of the lobbying limitations if they occur at a time when no legislator has introduced legislation or announced any intention to introduce legislation or to hold hearings on the subject of the activities.

[5] Treas. Reg. sec. 53.4945-2(a)(1) applies to "legislation being considered by, or to be submitted imminently to, a legislative body."

Even more significantly, the general definition of grass roots lobbying is narrowed both directly and indirectly by the revisions. The requirement for a specific call to action is less inclusive than the statutory language but we believe is a justified, administrable narrowing designed to attack clear abuses while protecting the “educational” role of many exempt organizations. A new special rule governs mass media communications, see below.

b. Nonpartisan Analysis, Study or Research

The 1986 Regulations merely cross referenced for guidance the provision in the private foundation regulations stating that engagement in and making available nonpartisan analysis, study or research does not constitute lobbying. The 1988 Regulations incorporate the full statement of the exception and add examples indicating the application of this exception. However, the 1988 Regulations will treat a communication by either a public charity or a private foundation as lobbying and not eligible for the exception for nonpartisan analysis, study or research if the communication directly encourages a recipient to take action with respect to legislation.[6] A communication would encourage a recipient to take action but would not directly encourage such an action if it does no more than specifically identify one or more legislators who will vote on legislation as opposing the communication's view on the legislation, being undecided about the legislation, being the recipient's representative, or being a member of the committee that will consider the legislation.[7]

[6] Prop. Reg. secs. 53.4945-2(d)(v); 56.4911-2(c)(1)(vi) (1988).

[7] Prop. Reg. secs. 59.4945-2(d)(vi) and 56.4911-2(b)(2)(iv) and -2(c)(1)(vi).

c. Discussion of Broad Social, Economic, and Similar Problems

The 1988 Regulations also incorporate in the public charity rules the language of the private foundation regulations that exclude the discussion of broad social, economic and similar problems from the definition of lobbying. These rules provide that this exception does not apply, under code sections 4945 and 4911, if a communication directly encourages recipients to take action with respect to legislation.[8] We endorse these provisions.

2. Special Rule: Mass Media Communications

The 1988 Regulations contain a new rule for certain mass media communications, i.e., television, radio, and general circulation newspapers and magazines. Under this rule, communications will be presumed to be grass roots lobbying if the communication is made in the mass media within two weeks of a vote by a legislative body or committee on highly publicized legislation, that reflects a view on the legislation and either (1) refers to the highly publicized legislation or (2) encourages the public to communicate with legislators on the general subject of such legislation. An organization can rebut the presumption by showing that the communication is of a type regularly made by the organization (a customary course of business exception) or that its timing was unrelated to the upcoming legislative action.[9] The Committee generally agrees with this new rule.

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[8] Prop. Reg. sec. 53.4945-2 (d)(4) and 56.4911-2(c)(2) (1988).

[9] Prop. Reg. sec. 56.4911-2 (b)(5)(1988).

This revision would treat certain mass media communications as grass roots lobbying under looser standards than are applicable to communications through other media. Neither an express call to action nor a reference to the specific legislation is required. However, the rule's timing requirement and the highly publicized test limit its application.

The two-week time period affecting mass media communications presents two types of questions. First, is the time period long or short enough to be effective for curbing abuses. Second, and perhaps more significantly, given the unpredictable scheduling of legislative bodies, is the two-week test practical - can it be relied upon by organization administrators, when they cannot be certain when a vote may occur. Moreover, successful mass media lobbying may itself be the reason a vote does not occur. The success of such mass media communications in preventing a vote may be the reason that a communication escapes classification as grass roots lobbying. If there is never a vote, how can two weeks prior to the vote be determined? The two-week test may create certainty, but it would allow some very significant and successful lobbying to escape adverse classification. The Committee suggests that in lieu of the two-week test, a reference to an imminent legislative vote would be more effective at curbing abuse without causing undue uncertainty, coupled with a “safe-harbor” that legislation would not be “imminent” before a specific bill was introduced (or perhaps before a legislator stated an intention to introduce a bill or to conduct hearings).

A further legal question is posed by an example under the mass media exception. Example 4 treats mass media communications made in connection with a statewide referendum of the voting public as grass roots lobbying. If the public votes directly on legislative types of propositions, it might be more correct to treat related communications as direct lobbying.

3. Subsequent Use Test

The 1986 Regulations strongly implied that research and preparation costs for a communication could be treated as a lobbying expenditure because the communication, which itself might not qualify as a lobbying communication, was subsequently used in connection with lobbying. This retroactive reclassification of expenditures as lobbying costs might occur not only if the same organization that produced the communication conducted the subsequent lobbying, but also whether or not the lobbying party were related or totally unrelated.[10]

The 1988 Regulations refine the subsequent use test for nonlobbying communications. The Committee believes that these 1988 amendments improve the regulations. A communication that reflects a view on specific legislation but is not a lobbying communication will be treated as a lobbying communication because of subsequent use only if the primary purpose of the organization for preparing it was for use in lobbying.[11] A safe-harbor also is provided. If prior to, or contemporaneously with, the lobbying use of an otherwise nonlobbying communication, there is a "substantial distribution"

[10] Prop. Reg. secs. 56.4911-2(c)(1)(iii) and Example (6) (1986).

[11] Prop. Reg. secs. 53.4945-2(d)(1)(v) and 56.4911-2 (c)(1)(v) (1988).

of the communication with no lobbying involved, the communication will not suffer adverse classification. The determination of whether a distribution is substantial depends on all the facts and circumstances, including the normal distribution pattern of similar nonpartisan analyses, studies, or research. The comparative extent of the two distributions and whether the lobbying use is by the organization that prepared the communication, a related organization, or an unrelated organization are factors in determining a distribution's primary purpose. If the subsequent lobbying use is by an unrelated organization, the regulations require clear and convincing evidence to establish that the primary purpose for preparing the communication was its use for lobbying.[12]

4. Allocation Rules

The 1986 Regulations contained a general reasonable allocation rule and several special allocation rules for mixed purpose expenditures. The special rules aroused substantial criticism. The rule for mixed direct lobbying and grass roots lobbying expenditures allocated the entire amount of the expenditures to the more limited category of grass roots lobbying, except to the extent that the expenditures were shown to be solely for direct lobbying. All advertising and public fund raising expenditures were treated as grass roots lobbying if any part of their costs was for grass roots lobbying.[13]

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[12] Prop. Reg. secs. 53.4945-2(d)(1)(v) (last sentence) and 56.4911-2(c)(1)(v) (last sentence) (1988).

[13] Prop. Reg. sec. 56.4911-2(d)(1986).

The 1988 Regulations are less severe. Mixed direct lobbying and grass roots lobbying expenditures are treated as grass roots lobbying except to the extent they can be shown to be primarily (not solely) for direct lobbying. If expenditures are shown to be primarily for direct lobbying, a reasonable allocation is permitted.[14] The special rule for the allocation of advertising and fundraising costs is eliminated.

The 1988 Regulations contain new provisions dealing with mixed purpose, lobbying and nonlobbying expenditures. Different standards apply depending on whether a communication is intended primarily for members or primarily for nonmembers. If a communication has both lobbying and bona fide nonlobbying purposes and is sent only or primarily to members, i.e., more than 50% of the recipients are members, the organization must make a reasonable allocation between the amount expended for the lobbying purpose and the amount expended for the nonlobbying purpose. An allocation to lobbying solely for the sentence or sentences encouraging recipients to take action will not be respected. The lobbying expenditures for a communication with lobbying and bona fide nonlobbying purposes that is sent primarily to nonmembers must include all costs attributable to all parts of the communication dealing with the same subject as the lobbying message. Excluded are costs for those sections not dealing with the same subject as the explicit lobbying portion.[15]

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[14] Prop. Reg. sec. 56.4911-3(a)(3)(1988).

[15] Prop. Reg. sec. 56.4911-3(a)(2)(1988).

These rules recognize that a significant function of some membership organizations is providing educational material to members. They permit a fair allocation between lobbying and nonlobbying expenditures. The assumption that communications directed primarily to nonmembers are more likely to involve lobbying seems a reasonable method of attacking creative accounting. By treating more severely those communications directed primarily to nonmembers than ones directed primarily to members, the regulations may encourage organizations to try to avoid the limitations merely by increasing the size of their mailing list, but we believe that it is reasonable to expect that mailing lists and attendant mailing costs can be that readily manipulated on a cost efficient basis.

5. Private Foundation Grants

The 1988 Regulations significantly amend the 1986 version by curtailing restrictions proposed for grants by private foundations to electing public charities. The new proposed regulations adopt the positions taken by the Service in a 1977 private Letter Ruling[16] and permit a private foundation to rely on written representations by the public charities about the nonlobbying purposes and costs of funded programs, unless the grantor doubts or should doubt the accuracy or reliability of a grantee's representations.[17] These changes are consistent with the Committee's 1987 recommendation and are welcomed accordingly.

[16] Letter Ruling 7810041, the so-called McIntosh ruling.

[17] Prop. Reg. sec. 53.4945-2(a)(6)(iii)(1988).

6. Need for Opinion Letter Procedure

The Committee's 1987 report urged that the Service open up the opinion letter process, in conformity with a directive in the 1976 Act's legislative history, for determinations of whether organizations are members of affiliated groups.[18] The affiliation rules continue to have a significant impact on public charities under the 1988 Regulations which again fail to address the Congressional mandate supported in our original report. A rulings procedure would alleviate uncertainties caused by the affiliation rules.

The Committee again urges that the Service clearly state a willingness to rule on affiliation issues. We suggest that the Service issue a revenue procedure describing the method of applying for such opinions. We reiterate that the procedure should be as simple as possible, designed to be followed by lay persons because many requests would likely be prepared by administrators who are not tax technicians.

7. No Impact on “Substantial Part” Test

The quantitative tests enacted in 1976 were intended to provide greater certainty for eligible electing organizations than is provided by the generally applicable requirement that “no substantial part of the activities of [a section 501(c)(3) organization] is carrying on propaganda, or otherwise

[18] 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 H. Rep. 94-1515, 94th Cong., 2d Sess. 536, September 13, 1976 (Conference Report).

attempting, to influence legislation".[19] The Tax Reform Act of 1976 explicitly stated that the new elective rules were not to affect the interpretation of the substantial part test in any way, either with respect to nonelecting organizations, or with respect to organizations, such as churches, which are barred from its election.[20]

The Committee believes that this statutory mandate means that the interpretation and application of the substantial part test for organizations remaining subject to that test is to be neither more or less liberal, nor more or less strict, as a result of the 1976 legislation. The Congress clearly intended that the more objective, quantitative test be different in nature from the vaguer, qualitative substantial part test. Interpreting the 1976 legislation as affecting organizations that are not covered by the quantitative tests could harm either the organizations' or the government's interest, and would conflict directly with the law.

8. Enforcement

In its original report, the Committee recognized the occurrence of lobbying abuses of tax-exempt status and stated that regulations on this subject were necessary. As the administrative process approaches final regulations, it is now important to recognize that the regulations must be enforced to be fully effective.

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[19] See. H. Rep. No. 1210, 94th Cong. 2d Sess. 12 (1976) on H. R. 13500; S. Rep. 94-938, 94th Cong. 2d. Sess. pt. 2, 79 (1976), and H. Rep. 94-1515, 94th Cong. 2d Sess 533 (1976) (Conference Report).

[20] Section 501(h)(7)

The IRS' policy decision, supported by this committee, to revise the initial proposals to increase certainty and administrability at the risk of allowing some potential abuses to escape the regulations' explicit coverage makes active enforcement especially important. The Committee strongly urges that the Service allocate on a continuing basis audit and other resources sufficient to insure compliance with the statutory and regulatory restrictions on lobbying by tax-exempt organizations.