Nonprofit Legislative Speech: Aligning Policy, Law, and Reality

Jill S. Manny

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NONPROFIT LEGISLATIVE SPEECH: ALIGNING POLICY, LAW, AND REALITY

Jill S. Manny

CONTENTS

INTRODUCTION .................................................................................. 758
I. THE SUBSTANTIAL PART TEST .................................................. 760
    A. What We Can Surmise from the Legislative History ... 762
    B. IRS and Treasury Illumination .................................................. 767
    C. Hints from the Courts ............................................................... 768
II. THE EXPENDITURE TEST ............................................................. 769
    A. Legislative History ................................................................. 770
    B. How it Works ........................................................................... 778
    C. Benefits of the Expenditure Test .............................................. 780
III. PROPOSAL I: ABANDON RESTRICTIONS ON LEGISLATIVE ACTIVITY BY PUBLIC CHARITIES .......... 783
    A. Policy Reasons For and Against Permitting
       Unlimited Charitable Legislative Speech ................................. 783
       1. Policy Arguments For Unlimited Lobbying ....................... 783
       2. Policy Arguments Against Lobbying ................................. 784
    B. Technical Reasons For and Against Permitting
       Unlimited Charitable Legislative Speech ................................. 787
       1. Technical Reasons For Permitting
          Unlimited Charitable Legislative Speech ............................. 787

† This article is dedicated to the memory of Professor Laura Brown Chisolm, a leading scholar in the area of nonprofit speech, a dear friend and mentor, and an all-around wonderful person.

† Copyright © 2012 by Professor Jill S. Manny, New York University School of Law. I would like to thank Harvey Dale for many years of friendship and mentoring, Ellen Aprill for her incomparable insights and support, and Daniel Schumeister and Margaret Cremin for their invaluable research assistance.
2. Technical Reasons Against Permitting Unlimited Charitable Legislative Speech .......... 789

IV. PROPOSAL II: FIX THE EXPENDITURE TEST .................. 791
A. Expand the List of Eligible Organizations ............... 792
  1. Private Foundations .................................. 792
  2. Churches ............................................. 795
B. Eliminate the $1 Million Cap and Regressive Sliding Scale .................................. 796
C. Eliminate the Distinction Between Direct and Grassroots Lobbying ...................... 797
D. Other Corrections ..................................... 798
E. Make the Expenditure Test the Default Test ........ 798

CONCLUSION ........................................... 799

INTRODUCTION

There is a common misperception among charity leaders and the public that public charities are prohibited from lobbying and legislative activities. Nothing could be further from the truth. As discussed more fully below, section 501(c)(3) of the Internal Revenue Code does restrict the amount of lobbying that charities can do by prohibiting a charity qualifying for exemption from federal income tax under that provision from engaging in legislative activities as a “substantial part” of its activities. Section 170(c)(2)(D) contains a similar restriction for organizations eligible to receive tax-deductible contributions. But charities making an election under section 501(h)

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1 “Charity” refers to all organizations defined in sections 501(c)(3) and 509(a) of the Internal Revenue Code of 1986, as amended (the “Code”). I.R.C. §§ 501(c)(3), 509(a) (2006).
2 I.R.C. § 501(c)(3). Section 501(a) exempts from income tax, inter alia, organizations described in section 501(c)(3):

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (b)), and which 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.

Id.

3 I.R.C. § 170(c)(2)(D). Section 170(c) defines “charitable contribution” as “a contribution or gift to or for the use of,” inter alia, the following:

(2) A corporation, trust, or community chest, fund, or foundation—
are not subject to the “substantial part” test (“Substantial Part Test”). Rather, organizations electing under §501(h) can engage in certain lobbying activity to the extent of specified limits, which are expressed solely in terms of dollar amounts. Section §501(h) permits eligible organizations to elect the “expenditure test” (“Expenditure Test”) as a substitute for the Substantial Part Test. In fact, charities that make the §501(h) election can engage in extensive legislative activities, almost without limitation, if the lobbying is properly structured. Confusion over the lobbying limitations imposed by both the Substantial Part Test and the Expenditure Test, rather than any real and substantive limits on lobbying by public charities, actually limits legislative activity by charities. This, in turn, limits the unique benefits that public charities can provide to society.

This Article first explores the Substantial Part Test and the Expenditure Test, focusing on their basic structures and the legislative history surrounding the enactment of each test. The next Part examines the policy reasons for permitting public charities to lobby without restriction and notes the lack of convincing policy explanations for the restrictions contained in the Code.

The Article concludes that the restrictions on lobbying under §501(c)(3) are ambiguous, confusing, and ineffective. Indeed, most

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which 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.

I.R.C. § 170(c).

4 See I.R.C. § 501(c)(3) (noting that the Substantial Part Test applies except as otherwise provided in subsection (h)).

5 I.R.C. § 501(h)(1), (2).


7 Permitting private foundations to engage in legislative speech would not achieve the same goals. Accordingly, legislative activity is and should remain a taxable expenditure for private foundations under section 4945 but subject to the liberal rules of Treasury Regulation § 53.4945. See discussion regarding private foundations infra Part IV.A.1.
Charities electing the Expenditure Test under section 501(h) can lobby extensively, provided that the charity properly structures its lobbying to take advantage of the liberal rules and definitions under section 501(h) and utilizes "cheap" methods of lobbying. Given the benefits of increased and improved legislative discourse through lobbying by charities and the inefficacy and innate complexity of the restrictions on lobbying, section 501(c)(3) should be amended to permit unlimited legislative activities by all public charities. As a distant second choice, this Article suggests improving and simplifying the Expenditure Test and making it the default test for legislative activities by public charities.

I. THE SUBSTANTIAL PART TEST

The Substantial Part Test, derived from the language of section 501(c)(3), is the standard used to measure the lobbying activity of most public charities. Section 501(c)(3) provides that organizations organized and operated for certain specified purposes will be entitled to exemption from federal income tax if, inter alia, "no substantial part of the [organization's] activities...is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h))...." Accordingly, the Substantial Part Test causes an organization to lose its exemption (and incur an excise tax) if a "substantial part" of the organization's activities consist of carrying on propaganda or otherwise attempting to influence legislation. An organization that fails the Substantial Part Test becomes an action organization, and is deemed not to be operated exclusively for exempt purposes. Organizations that forfeit exemption for flunking the Substantial Part Test also are subject to an excise or penalty tax in an amount equal to 5 percent of lobbying expenditures incurred in the year that exemption is lost. Managers also may be subject to penalty taxes. A 501(c)(3) organization is subject to the Substantial Part Test unless it affirmatively elects the...

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8 More than 90 percent of public charities remain subject to the Substantial Part Test. CLPI Public Policy Positions: IRS Rules Governing Charitable Lobbying, CENTER FOR LOBBYING IN THE PUB. INT., www.clpi.org/protect-advocacy-rights/clpipublicpolicy (last visited Apr. 9, 2012). But see infra notes 142, 147–148 and accompanying discussion, which suggests that less than 2 percent of eligible organizations have actually made the § 501(h) election.
9 I.R.C. § 501(c)(3).
10 These rules do not apply to organizations that have made an election under section 501(h). Id.
12 I.R.C. § 4912(a). Organizations that make the election under section 501(h), churches and their affiliates, and private foundations are not subject to the excise tax. I.R.C. § 4912(c)(2).
13 I.R.C. § 4912(b).
Expenditure Test. In other words, the Substantial Part Test is the default test for determining whether an organization has engaged in excessive lobbying.

The Substantial Part Test is an entirely subjective test. No one, including the Internal Revenue Service (“Service” or “IRS”), knows when lobbying becomes “substantial.” Courts (and presumably the IRS as well) generally make the determination of substantiality by applying a balancing, or facts-and-circumstances, test. The results are both imprecise and inconsistent. Although a few early cases attempted to devise a quantitative test, more recently, courts have opted for a more subjective balancing test under which all of the facts and circumstances are weighed “in the context of the objectives and circumstances of the organization.” This balancing test is no more than a “smell test”; it is quite vague and provides almost no guidance to an organization wishing to influence legislation in furtherance of its exempt purposes without jeopardizing its exempt status.

In addition to absence of clarity on the concept of substantiality, critical concepts and terms are undefined under the Substantial Part Test. Even the term “lobbying” is not well defined. The Substantial Part Test fails even to address consistently the fundamental question of what activities lobbying is to be measured against.

The most significant danger of the vagueness in the Substantial Part Test is its propensity to scare charities into non-activity on the legislative front with its lack of direction and guidance and the

14 See infra Part II (discussing Expenditure Test); I.R.C. § 501(h) (providing the Expenditure Test).
15 Melaney Partner, acting director of the IRS’ Exempt Organizations Customer Education and Outreach office, concludes that the Substantial Part Test option is a “more subjective method compared to the more mathematical, objective expenditure test.” How to Lose Your 501(c)(3) Tax Exempt Status (Without Really Trying), INTERNAL REVENUE SERVICE, www.irs.gov/pub/irs-tege/how_to_lose_your_tax_exempt_status.pdf (last visited Apr. 9, 2012). Under this test, whether an organization’s activities are “substantial part” of its overall activities is determined by taking into account “all of the pertinent facts and circumstances.” Id.
16 See, e.g., Christian Echoes Nat’l Ministry, Inc. v. United States, 470 F.2d 849, 855 (10th Cir. 1972) (noting that the “political activities of an organization must be balanced . . . to determine whether a substantial part of its activities” consisted of lobbying).
18 One court held that devoting less than 5 percent of an organization’s “time and effort” to lobbying is insubstantial. Seasonood v. Comm’r, 227 F.2d 907, 912 (6th Cir. 1955).
19 Haswell v. United States, 500 F.2d 1133, 1142 (Ct. Cl. 1974).
20 See Chisolm, supra note 17, at 16–17 (noting various approaches to measuring the substantiality of an organization’s lobbying).
severity of its penalty.21 Furthermore, the lack of clarity in the Substantial Part Test may actually provide flexibility for charities not interested in compliance to circumvent limitations on lobbying. The Subcommittee on Oversight suggested in 1987 that “the opportunities for some exempt organizations to circumvent the law today are too numerous.”22 It said of the Substantial Part Test:

[T]he penalty that generally exists for violation of these rules and restrictions by a tax-exempt organization, i.e., revocation of an organization’s tax-exempt status, is often inappropriate and ineffective and can have little deterrent effect. For those organizations deeply concerned about being in complete compliance of the law, the lack of clear guidelines coupled with the threat of the revocation sanction may inhibit many organizations from engaging in even permissible activities.23

As the two men with primary responsibility for drafting and reviewing the 1988 Treasury regulations promulgated under section 501(h) surmised, “the Subcommittee found that the statutory and regulatory provisions governing lobbying by charities fail to deter abusers, but do deter nonabusers.”24 Both Congress and Treasury evidently were aware of the shortcomings of the Substantial Part Test and its negative impact on the voice of the charitable sector.

A. What We Can Surmise from the Legislative History

The Substantial Part Test was added to the Code in 1934.25 The rationale for its introduction is unclear, and the legislative history is

21 See Laura B. Chisolm, Exempt Organization Advocacy: Matching the Rules to the Rationales, 63 Ind. L.J. 201, 244–246 (1987) (arguing that the level of under-guided IRS discretion to impose sanctions is inappropriate and creates the potential for abuse as a political tool); see generally Richard L. Haight, Lobbying for the Public Good: Limitations on Legislative Activities by Section 501(c)(3) Organizations, 23 Gonz. L. Rev. 77 (1987) (analyzing the limitations on lobbying, their imprecisions, and the resulting penalties, and suggesting a cautious approach to lobbying activities); see also S. REP. No. 91–552, at 47 (1969) (noting that “the standards as to the permissible level of [lobbying] activities under present law are so vague as to encourage subjective application of the sanction”).
23 Id.
24 Paul G. Accettura et al., The Revised Lobbying Regulations—A Difficult Balance, 41 TAX NOTES 1425, 1434 (1988). The authors of this paper are James J. McGovern, the Assistant Chief Counsel (Employee Benefits and Exempt Organizations), Office of Chief Counsel, Internal Revenue Service, Paul G. Accettura, an Assistant Branch Chief, and Jerome P. Walsh Skelly, a senior attorney, in 1987. Id. at 1425.
sparse.\textsuperscript{26} Both the available legislative history and its sparseness, however, may be instructive as to congressional intent.\textsuperscript{27}

There appears to have been little initial controversy among Senate Finance Committee members when the idea of limiting the ability of charities to lobby was first introduced at a committee meeting on March 21, 1934. In contrast to many of the other motions passed that day, Committee Chairman Pat Harrison’s motion that, “no deductions from gross income should be allowed in the case of contributions made to organizations carrying on propaganda, attempting to influence legislation or participating in partisan politics” passed without requiring even a “record vote” and was not debated.\textsuperscript{28} This apparent ease of passage is particularly noteworthy because the motion appears far broader than the eventual codified language.\textsuperscript{29} Harrison’s motion seems to imply that there would be no deduction for an organization “carrying on” any lobbying activities.\textsuperscript{30}

The gap in the legislative history between introduction and vote is somewhat surprising. By the time the amendment had been submitted to the entire House of Representatives on April 2, 1934, language specifying that disqualification would occur only where a “substantial part” of an organization’s activities were lobbying-related had been added to the amendment.\textsuperscript{31} Senator Harrison may not, however, have considered this language significant to his motion in committee, as he introduced a large group of the Finance Committee’s amendments on the floor (including the new “no substantial part” language) by stating that “there are many amendments which it seems to me we can dispose of this afternoon as to which there is no controversy.”\textsuperscript{32} Senator David Reed, another member of the Senate Finance Committee,\textsuperscript{33} however, either had registered some dissent in committee that is not noted in the minutes or had a change of heart between the committee’s vote and the amendment’s introduction on the floor, as he created the controversy that Harrison did not

\textsuperscript{26} See Lloyd Hitoshi Mayer, What Is This “Lobbying” That We Are So Worried About?, 26 YALE L. & POL’Y REV. 485, 500 (2008) (noting the “very limited” legislative history).

\textsuperscript{27} Much of the legislative history summary derives from an excellent memorandum on the topic prepared by research assistant Daniel Schumeister in the summer of 2010.

\textsuperscript{28} STAFF OF S. COMM. ON FINANCE, 73RD CONG., MINUTES ON REVENUE ACT OF 1934 110, 112 (March 21, 1934).

\textsuperscript{29} See Revenue Act of 1934 § 23(o) (prohibiting lobbying only when it becomes a substantial part of an organization’s activities).

\textsuperscript{30} See MINUTES ON REVENUE ACT OF 1934, supra note 28, at 112.

\textsuperscript{31} See 78 CONG. REC. S861 (1934) (showing the introduction of the amendment).

\textsuperscript{32} Id. at S860 (statement of Sen. Harrison).

\textsuperscript{33} See Mayer, supra note 26, at 500 (noting that Senator Reed was the “ranking member of the Senate Finance Committee”).
anticipate. According to Harrison’s initial explanation on the floor, the amendment was to “apply to any organization that is receiving contributions, the proceeds of which are to be used for propaganda purposes or to try to influence legislation.” Senator Reed agreed with Harrison’s assessment of the bill’s purpose and claimed that the amendment fought against “selfish” donations to organizations that were advancing the “personal interests” of the donor. Yet, even at this early stage—during the initial floor debates—the difficulty in adequately defining “substantial part” became clear, as Reed noted that the amendment’s language was too broad, going “much further than the committee intended to go.”

Upon reconsideration of the amendment two days later, the congressmen and draftsmen were unable to formulate any more accurate language to accomplish the “impossible task” of wording the amendment. Reed again expressed his dismay at the amendment’s language, claiming that neither the Senate Finance Committee nor the “drafting counsel” was satisfied with the end product. Both Couzens and Reed agreed that the language could be changed in the Conference Committee. In the end, however, the “substantial part” language of the amendment did not change in conference aside from removing “participation in partisan politics” as a category of restricted action. Nor does any alternative to the “substantial part” language appear in the conference report.

Analysis of the limited legislative history can lead us to some concrete conclusions. Given that some legislative activity is permitted under the Substantial Part Test, Congress must have concluded that

34 His vacillations may have had to do with a personal feud with the National Economy League, a non-profit. See Oliver A. Houck, On the Limits of Charity: Lobbying, Litigation, and Electoral Politics by Charitable Organizations Under the Internal Revenue Code and Related Laws, 69 BROOK. L. REV. 1, 16–23 (2003) (chronicling Senator Reed’s feud with the National Economy League).
36 Id. (statement of Sen. Reed).
37 Id. Foreshadowing the decades of uncertainty to follow, Senator Couzens asked whether various types of organizations would pass the test. Id. Reed simply responded that he was “not so sure.” Id. The amendment was then passed over for later discussion. Id.
38 Id. (statement of Sen. Reed).
39 See 78 CONG. REC. 5989 (1934) (acknowledging the remaining imprecision and potential and the likely need for further revision).
40 Id.
41 Id.
lobbying by charities can produce public benefit. A journey deeper into the scarce legislative history confirms that Congress did not believe that legislative activity could not co-exist with charitable purpose, since Congress did not ban lobbying by charities altogether.\textsuperscript{44} The “no substantial part” language was added to the Code in the Revenue Act of 1934, without congressional hearings on the topic.\textsuperscript{45}

According to floor statements by one Senator, the intent in adding the “substantial part” language to section 501(c)(3) was to deny a deduction for contributions that were used to influence legislation because such contributions were “selfish” and “made to advance the personal interests of the giver of the money.”\textsuperscript{46} No additional illumination of the Substantial Part Test can be derived from the legislative history to the Revenue Act of 1934, leading us to deduce only that Congress concluded (1) some legislative activity can co-exist with and further the exempt purposes of a public charity,\textsuperscript{47} (2) “selfish” lobbying (i.e., lobbying that promotes the individual interests of its leaders rather than the interests of the public it serves) could not further the exempt purposes of a public charity, and (3) charities should be permitted to engage in non-selfish legislative activity to further their charitable purposes. There is no indication, however, as to why that non-selfish legislative activity should be restricted or limited in any way. Congress’s goals might have been better achieved by proscribing “selfish” lobbying but allowing unlimited non-selfish legislative activity by charities.\textsuperscript{48}

The history of the 1934 legislation does not support any sort of limitation on non-selfish lobbying by public charities. Furthermore, there are other sorts of checks on the activities of public charities that make selfish lobbying unlikely. For example, the inurement and private benefit restrictions would provide sufficient penalty to quell lobbying that might benefit personally those in charge of the

\textsuperscript{44} See Mayer, supra note 26, at 500 (concluding that Congress believed lobbying by charities should be restricted to prevent abuses, not prohibited outright).
\textsuperscript{46} 78 Cong. Rec. 5861 (1934) (statement of Sen. Reed). Senator Byron P. Harrison noted that “there are certain organizations which are receiving contributions in order to influence legislation and carry out propaganda. The committee thought there ought to be an amendment which would stop that, so that is why we have put this amendment in the bill.” Id. at 5959 (statement of Sen. Harrison).
\textsuperscript{47} See also Revenue Act of 1934: Hearings Before the S. Comm. on Finance, 73d Cong., 2d Sess. (1934).
\textsuperscript{48} Arguably Congress did this in 1969 when it enacted section 4945, which effectively prohibits private foundations from lobbying, although some would argue that they have gone too far. See discussion regarding private foundations infra Part IV.A.1.
organization. In addition, the requirement that charities be “organized and operated exclusively” for certain charitable purposes precludes substantial lobbying that does not support those purposes. More effective, perhaps, are the strictures imposed by the public accountability of the charities. In other words, public charities are dependent on the public and government for funding and support. If their legislative activities do not further the public purposes supported by their funders and the purchasers of their goods and services, they will lose support and suffer economic, reputational, and other consequences.

This reliance on the public decreases the risk that public charities will engage in selfish lobbying, further indicating that

the restrictions on lobbying for public charities are unnecessary and ill-advised.

B. IRS and Treasury Illumination

Given the vagueness of the Substantial Part Test and the severity of the penalty for failing it, one would expect Treasury or the IRS to provide some helpful direction. IRS and Treasury guidance, however, has been relatively ineffective in providing a roadmap for compliance with the Substantial Part Test.

According to the IRS, the Substantial Part Test is one “determined on the basis of all the pertinent facts and circumstances in each case.” The IRS has held that an organization whose “primary objective” can only be accomplished through lobbying would not be eligible for 501(c)(3) status. Nonetheless, this statement provides no guidance in determining what part of an organization’s activities would constitute a “substantial part” or which factors to weigh in making the determination. The line remains blurry and perplexing.

Treasury regulations defining “action organizations” for purposes of the operational test lead us to a similarly mystifying place. An “action organization” is not “operated exclusively” for exempt purposes, but the definition of “action organization” is anything but clear. “Action organization” is defined in two, equally unhelpful ways, both of which require line drawing without a legislative or regulatory ruler. To determine whether an organization falls within the definition we must determine either (1) that a “substantial part of its activities is attempting to influence legislation by propaganda or


[There is no simple rule as to what amount of activities is substantial . . . . Most cases have tended to avoid any attempt at percentage measurement of activities . . . . The central problem is more often one of characterizing the various attempts to influence legislation. Once this determination is made, substantiality is frequently self-evident.


54 See Rev. Rul. 62–71, 1962–1 C.B. 85 (holding that an organization primarily engaged in teaching and advocating the adoption of a particular real estate taxation theory did not qualify for 501(c)(3) exemption because it was an action organization, i.e., its primary objective could only be accomplished by the enactment of legislation); see also Treas. Reg. § 1.501(c)(3)–1(c)(3) (as amended in 2008) (defining “action” organizations, which are by definition not operated exclusively for exempt purposes).

55 Treas. Reg. § 1.501(c)(3)–1(c)(3). This regulation states, in part, that “An organization is not operated exclusively for one or more exempt purposes if it is an action organization . . . .” Id. § 1.501(c)(3)–1(c)(3)(i).

56 Id. § 1.501(c)(3)–1(c)(3)(i).
otherwise,”57 or (2) “its main or primary objective or objectives . . . may be attained only by legislation or a defeat of proposed legislation.”58 For the second test, the regulations suggest considering “all the surrounding facts and circumstances, including the articles and all activities of the organization . . . .”59 Nowhere in these two tests does Treasury provide guidance on which measurements to use or which factors to weigh in making a determination. As one commentator explains, “it is unclear whether this determination is based on the level of activity measured, for example, by time spent, or expenditures, or both. In addition, there is no guidance as to how much activity, however computed, constitutes a substantial part of the organization’s activities.”60

The lack of effective guidance from IRS and Treasury, combined with the threat of loss of exemption for crossing an invisible line, inevitably scares many charities into inactivity in the realm of legislative matters. It is hard to imagine, from available legislative history, that Congress ever intended this result.

C. Hints from the Courts

Just as there is little in the way of guidance from the legislative history, the IRS, and Treasury, the judicial record in interpreting the “substantial part” test is remarkably vague.61 Indeed, only four or five cases generally are cited in interpreting the test.62 Furthermore, as has been widely noted, the existing case law reveals anything but a clear, predictable doctrine surrounding the Substantial Part Test; just the opposite is true. In 1955, the Sixth Circuit held, in Seasongood v. Commissioner,63 that 5 percent of an organization’s expenditures did not reach the level of “substantial” and reversed the IRS’s revocation of an organization’s 501(c)(3) status.64 In Christian Echoes National

57 Treas. Reg. § 1.501(c)(3)–1(c)(3)(ii).
59 Id.
61 See id. (observing that the limited judicial precedents “do not resolve most of the significant issues”).
62 See id. (analyzing the four commonly cited cases addressing the “substantial part” test); Brian Galle, The LDS Church, Proposition 8, and the Federal Law of Charities, 103 NW. U. L. REV. COLLOQUIY 370, 372 (2009), available at http://www.law.northwestern.edu/journals/lawreview/Colloquy/2009/10 (discussing the unclear case law in this area); Miriam Galston, Lobbying and the Public Interest: Rethinking the Internal Revenue Code’s Treatment of Legislative Activities, 71 TEX. L. REV. 1269, 1279 n.25 (1993) (same); see generally Chisolm, supra note 17 (generally discussing the imprecision of the law and cases addressing this area of law).
63 227 F.2d 907 (6th Cir. 1955).
Ministry, Inc. v. United States, the Tenth Circuit declined to follow the developing certainty of the Sixth Circuit’s “percentage test,” and, instead, balanced “the political activities of the organization” within “the context of the objectives and circumstances of the organization,” upholding a revocation of exemption for this and other reasons. In League of Women Voters of United States v. United States, the Court of Claims focused only on the amount of time the organization’s staff spent on lobbying activities in reaching its conclusion. Finally, in 1975 in Haswell v. United States, the Court of Claims attempted to find a middle ground between the objective numbers of a percentage-based test and the subjectivity of a “significance of activities test,” noting both the organization’s percentage of expenditures spent on lobbying as well as the relative primacy of lobbying to the organization’s activities. Unfortunately, the court did not explain how it arrived at its determination of the significance of the organization’s lobbying activities, nor has that court, or any court, considered a “substantial part” test claim since then.

In essence, courts have applied a moving-target approach to both critical definitions and the measuring rods for substantiality of legislative activity. This judicial inconsistency leaves the charitable sector with no notion of either what constitutes substantial legislative activity or which factors to weigh in measuring substantiality. Given the severity of the penalty (loss of exemptions) for foot-faults over an invisible and unidentifiable line, the response of inaction in the realm of legislative activities is predictable.

II. THE EXPENDITURE TEST

In 1976, Congress enacted section 501(h), which established an elective standard for determining whether a public charity’s legislative activities qualify as insubstantial. Section 501(h) is an
elective safe harbor provision. Specifically, it provides an election for certain 501(c)(3) organizations\textsuperscript{73} that permits them to engage in legislative activity up to statutorily specified limits, which are expressed solely in terms of dollar amounts.\textsuperscript{74} Section 501(h) permits eligible organizations to elect the Expenditure Test as a substitute for the Substantial Part Test, making the Substantial Part Test, in effect, the default test for measuring lobbying activities.

Unlike the subjective Substantial Part Test, the Expenditure Test is quite objective. It draws vivid lines for charitable lobbying framed entirely in terms of dollar amounts.\textsuperscript{75} Charities electing the Expenditure Test to delineate their lobbying limitations are able to pinpoint precisely how much they can spend on various types of communications intended to impact legislation without incurring either an intermediate or the ultimate sanction. Furthermore, significant terms and concepts that remained undefined and inconsistently interpreted under the Substantial Part Test are now clearly defined by statute and in Treasury regulations.\textsuperscript{76}

A. Legislative History

The Expenditure Test is best viewed as a legislative fix to the vagueness of the Substantial Part Test. Legislative history to the 1976 Act, while not abundant, is more robust and clarifying than the discussion surrounding the addition of the “substantial part” language to the Code in 1934. The legislative history from 1976\textsuperscript{77} indicates five primary purposes for the enactment of the Expenditure Test. First, section 501(h) was intended to eliminate the vagueness of the Substantial Part Test by defining substantiality in objective terms.\textsuperscript{78} Second, the provision addressed the concern that large organizations would be less restricted than small organizations by the Substantial Part Test and thus able to lobby more extensively than smaller organizations because the larger organizations could afford to form

\textsuperscript{73} All public charities other than private foundations and churches may make the election. I.R.C. § 501(h)(3)–(5) (2006).
\textsuperscript{74} I.R.C. § 501(h)(1)–(2) (establishing dollar value ceilings on “lobbying expenditures” and “grass roots expenditures”); I.R.C. § 4911 (imposing tax on charities that make excessive expenditures to affect legislation).
\textsuperscript{75} I.R.C. § 501(h)(1)–(2).
\textsuperscript{76} The helpful terms and concepts adopted for the Expenditure Test explicitly do not apply to the Substantial Part Test. I.R.C. § 501(h)(7); Treas. Reg. § 1.501(h)–1(a)(4).
\textsuperscript{77} Special thanks to research assistant Daniel Schumeister for his thorough review of this legislative history. Much of the analysis is based on his description of this history in a memo dated August 20, 2010.
\textsuperscript{78} See H.R. REP. NO. 94–1210, pt. 1, at 8 (1976) (noting that the addition of 501(h) was “designed to set relatively specific expenditure limits to replace the uncertain standards of present law ”); S. REP. NO. 94–938, pt. 2, at 80 (1976) (same).
and fund organizations described in section 501(c)(4) that could lobby extensively or even exclusively.\textsuperscript{79} Third, Congress appeared to be concerned about the harshness of the ultimate sanction of loss of exemption as the penalty for violating the vague Substantial Part Test, particularly in light of the potentially greater risk of confronting that penalty for smaller organizations.\textsuperscript{80} Responding to this concern, section 4911 provides for an intermediate sanction in lieu of and in addition to an ultimate sanction for excessive lobbying expenditures under the Expenditure Test.\textsuperscript{81} Fourth, the House Report indicated that a more objective and clearly defined standard would enable the Service to more properly enforce the limitation on legislative activities imposed under section 501(c)(3).\textsuperscript{82} Fifth, Congress was interested in creating parity in the Code between the nonprofit sector and the for-profit sector in access to Congress.\textsuperscript{83} As made clear by an American Bar Association Report, legislators “need information” from the nonprofit lobby just as they need it from the business sector, and the Expenditure Test would tend to restore the balance between for-profit and non-profit lobbying influence.\textsuperscript{84}

The path to the addition of section 501(h) to the Code was a long and winding road through a stop-and-start maze. The bill that ultimately passed, H.R. 13500, was the product of a 1968 ABA report, nine different legislative proposals over a six year period, and attention by the Commission on Private Philanthropy and Public Needs, known as the Filer Commission, after its chair, John H. Filer.\textsuperscript{85}

\textsuperscript{79} See H.R. REP. No. 94–1210, pt. 1, at 8 (“Some organizations (particularly organizations which have already built up large endowments) can split up their activities between a lobbying organization and a charitable organization.”); S. REP. No. 94–938, pt. 2, at 80 (same). Organizations described in I.R.C. § 501(c)(4) are exempt from federal income tax under I.R.C. § 501(a) and are operated for the promotion of social welfare. I.R.C. § 501(a), (c)(4). A 501(c)(4) organization may further its purposes through lobbying as its primary or only activity without jeopardizing its exempt status but is not eligible to receive tax-deductible contributions under I.R.C. §§ 170(c), 501(c)(4).

\textsuperscript{80} See H.R. REP. No. 94–1210, pt. 1, at 8 (citing concern that smaller organizations incapable of splitting their activities between lobbying and charitable organizations, loss of 501(c)(3) status would constitute a “severe blow to the organization”); S. REP. No. 94–938, pt. 2, at 80 (same); see, e.g., Christian Echoes Nat’l Ministry, Inc. v. United States, 470 F.2d 849, 856 (1972) (revoking 501(c)(3) status of a religious organization engaged in lobbying activities under the substantial part test).

\textsuperscript{81} See I.R.C. § 4911 (imposing a tax on excess lobbying expenditures).

\textsuperscript{82} H.R. REP. No. 94–1210, at 8.

\textsuperscript{83} See Influencing Legislation by Public Charities: Hearing Before the H. Comm. on Ways and Means on H.R. 13500, 94th Cong. 65 (1976) [hereinafter Hearings on H.R. 13500] (statement of Sherwin P. Simmons, President, American Bar Association) (presenting the ABA view that charities “should be permitted to communicate directly with legislative bodies”).

\textsuperscript{84} Id.

\textsuperscript{85} See id. at 37–38 (discussing the history of H.R. 13,500 and referencing the findings of the Filer Commission). The Filer Commission ultimately recommended that the lobbying restrictions of section 501 should replicate those of section 162, stating that “nonprofit
H.R. 13500 clearly was not a bill that simply slipped through the halls of Congress and on to the President’s desk. Appropriately describing an earlier bill, the lawyers at Pepper, Hamilton & Sheetz characterized the effort as one that “represents a compromise on a compromise on a compromise . . . .” Considering that H.R. 13500 was the product of at least three more proposals and two more years of compromise and discussion after those compromises, the complexity of H.R. 13500’s passage is hard to overstate.

A review of the legislative history indicates that the 1976 changes in the Code were intended to encourage greater lobbying by the nonprofit sector. The evidence also strongly suggests that the interests of Congress and the independent sector were, in general, aligned in moving towards a new lobbying rule, although each group had distinct views on which reforms were necessary.

In 1969, Senator John Sherman Cooper made the first move in Congress, as he introduced an amendment to the Tax Reform Act of 1969 following up on the ABA Resolution from earlier that year. Senator Cooper argued that Congress needed to ensure that it received a “flow of information of the highest quality,” stating that “Senators and Representatives can act wisely only if all sides of the issue are aired before them.” Cooper, therefore, proposed to allow unlimited lobbying, explicitly attempting to keep the tax treatment of nonprofits in line with that of for-profit entities. He found it “disturbing” that while 501(c)(3)’s lobbying activities were heavily restricted, other Code sections provided a “tax stimulus” to for-profit businesses that lobby by permitting them to deduct lobbying expenses. Notably, however, Cooper would have forbidden all grassroots lobbying, or organizations, other than foundations, [should] be allowed the same freedoms to attempt to influence legislation as are business corporations and trade associations, that toward this end Congress remove the current limitation on such activity by charitable groups eligible to receive tax-deductible gifts.”

89 See Hearings on H.R. 13500, supra note 83, at 37 (noting the introduction of the ABA resolution).
91 Id. This is no longer the case under current law. I.R.C. § 162(e).
any attempts “to influence the general public or segments thereof with respect to legislative matters, elections, or referendums.”

Two years later, Senator Edmund Muskie and Congressman James Symington simultaneously introduced bills devoted to lobbying reform. Similar to Cooper’s amendment, the Muskie-Symington bill was designed to provide parity between the treatment of lobbying as provided by section 501(c)(3) and section 162. Introducing the bill, Muskie reiterated the desire for increased nonprofit participation in the legislative process, claiming that it “makes no sense to decide” that organizations operate in the public interest and thus “grant them tax-exempt status” yet still “silence them when they attempt to speak to those whom must decide public policy.” Indeed, Senator Muskie noted, “[i]t is fundamental to our constitutional system that they should have equal access along with business groups and others in presenting views to Congress.” Muskie’s proposal, however, was not intended to permit unlimited legislative activity by charities: only lobbying pertaining to “legislation of direct interest to the organization” would be permitted, and, as with Cooper’s proposal, grassroots lobbying would be disallowed. Although there was “broad support” for the bill, “there was some concern that it was too broad and that it might be interpreted” to allow charities to focus on lobbying rather than other “normal operations.” This attempt did not result in law.

Next, Senator Muskie and Senator Hugh Scott introduced a bill “which had the same fundamental purpose but somewhat limited the legislative activities in which charities might engage.” According to attorneys at Pepper, Hamilton & Scheetz, the Muskie-Scott bills limited legislative activities such that a 501(c)(3) organization had to “normally” devote “substantially more than one-half” of its budget to the function for which its exemption was granted. Though this language sounds perilously similar to the vague “substantial part”

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92 Id. at 29,427 (quotation omitted). Cooper would also have retained the prohibition on involvement in political campaigns. Id.
93 S. 1408, 92d Cong. (1971).
95 See Hearings on H.R. 13500, supra note 83, at 37 (observing that the Muskie-Symington bills followed the characteristics of section 162(e)).
96 117 CONG. REC. 8517 (1971).
97 Id.
98 Id. at 8518.
99 Hearings on H.R. 13500, supra note 83, at 37.
100 S. 3063, 92d Cong. (1972).
101 Hearings on H.R. 13500, supra note 83, at 37.
102 See Pepper, Hamilton Report, supra note 87, at 2926 (quoting S. 3063, 92d Cong. § 3(B) (1972)).
terminology, the Tax Reform Act of 1969 intended to define “normally” and “substantially more than one-half.”

Next up was the Ullman-Schneebeli bill of March 9, 1972, an effort that represented “[f]urther compromise and refinement.” The Ullman-Schneebeli bill marked the first time a reform proposal allowed for some amount of grassroots lobbying, and also held that communication between an organization and its members intended to spur those members to influence legislation would count towards the organization’s lobbying quota. The bill also presaged H.R. 13500’s use of an expenditure test that provided more stringent regulation of grassroots lobbying than direct lobbying; it provided that while a nonprofit could use 20 percent of its expenditures for general lobbying, only 5 percent of total expenditures could be used for grassroots lobbying. The Ullman-Schneebeli bill also for the first time excluded certain types of legislative activity from the definition of restricted lobbying, such as nonpartisan research, requested technical assistance, and appearances directly related to the viability of an organization’s tax-exempt status. This bill bears closer resemblance to the legislation ultimately passed than earlier versions, but a long road to passage still remained.

The Ullman-Schneebeli bill garnered “overwhelmingly favorable” testimony during May 1972 hearings, but Treasury remained unhappy with several of its provisions. Before the Ways and Means Committee, Edwin S. Cohen, Assistant Secretary of Treasury for Tax Policy, indicated Treasury’s interest in modeling the new legislation directly on section 162(e)’s allowable business deductions, and permitting charity lobbying for matters “of direct interest.” Among other hesitations, Cohen expressed concern that the limitations provided by the Ullman-Schneebeli bill would allow “at least $1.5 billion [to] be expended on ‘grassroots’ lobbying.”

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103 Id.
105 Hearings on H.R. 13500, supra note 83, at 37. See also Pepper, Hamilton Report, supra note 87, at 2926 (noting that the bill reflected “further compromise and considerable refinement”).
106 See Pepper, Hamilton Report, supra note 87, at 2926 (“This bill not only permitted direct lobbying; it also permitted charities to undertake a limited amount of ‘grassroots’ activity.”).
107 Id.
108 Id. at 2926–27.
109 Hearings on H.R. 13500, supra note 83, at 37.
111 Id. at 8.
believed organizations might develop large “slush funds.” The charities, however, favored the specificity of the Expenditure Test.

Next, competing bills were introduced in quick succession by Senators Muskie and Scott and by the Ullman-Schneebeli team. The latter bill garnered more attention and support, as reported in the Pepper, Hamilton & Sheetz report discussing the Ullman-Schneebeli bill:

This bill made some dramatic changes. It adopted a reverse graduation feature to limit expenditures for direct lobbying. This feature responded to the “slush fund” argument. The bill then grouped all other lobbying activities together, thereby including grass-roots activities with activities involving communication between the organization and its members. The bill proscribed all but an “insignificant” amount of such activities. The bill also contained a penalty clause that in effect fined charitable organizations which undertook proscribed legislative activities in addition to revoking their preferred status under section 501(c)(3). This provision was inserted to protect against the possibility of a public charity losing its section 501(c)(3) status with a large endowment fund, created with tax-deductible dollars, that could then be expended without limitation on lobbying activities.

The independent sector was not, however, satisfied with this latest bill: nonprofits initially objected to the penalty clause and believed that by allowing only an “insignificant” amount of communication between organizations and their members that was deemed lobbying,

112 See Pepper, Hamilton Report, supra note 87, at 2927 (citation and quotation omitted).
113 See id. (“The charitable organizations, on the other hand, supported the bill’s quantitative tests with its 20 percent – 5 percent feature. The tests were considerably more specific than the substantiality test and could be easily translated into dollars.”).
116 Pepper, Hamilton Report, supra note 87, at 2927 (footnotes omitted). The report continued:

Another feature of the Ullman-Schneebeli bill was a new provision relating to affiliated organizations. This provision required that if two or more organizations are effectively controlled, directly or indirectly, by the same person or persons, one of which was a section 501(c)(3) organization electing to have its lobbying activities regulated in accordance with the amendment, the two organizations would be treated as one and the same for purposes of the bill. Some such provision would appear to be required so long as a “reverse graduation” principle is used.

The bill also had a provision relating to section 501(c)(4) organizations and a self-terminating provision.

Id. (footnotes omitted).
“communication with their membership was effectively denied to them.” Representative Barber Conable, a member of the Ways and Means Committee, reacted to the charities’ concern about member communications by introducing his own bill in December of 1973. “The Conable bill retained most of the provisions of the second Ullman-Schneebeli bill, but excluded communications with members from the definition of influencing legislation, and deleted the penalty tax provision, the provision relating to section 501(c)(4) organizations, and the self-terminating provision.”

The Conable bill, upon its reintroduction in early 1974, was subject to significant discussion and amendment. The Ways and Means Committee adopted the bill, but changed three key provisions, including the penalty tax provision and the affiliation rules. By the time the Conable bill was ready to leave the committee, the changes led the Pepper, Hamilton & Sheetz report to describe the final product as “difficult to compare” with prior versions. Notably, however, the committee’s effort marked the first use of the phrases “qualified lobbying amounts” and “exempt purpose expenditures,” both significant terms in the final rules adopted in H.R. 13500. Congressman Conable was not, however, happy with all of these changes to his bill, and as the congressional session was drawing to a close, he asked that it be withdrawn in its entirety.

Finally, in the second half of 1975 an agreeable solution was reached. In June, Congressman Conable introduced a second bill, cosponsored by twenty-three members of the House Ways and Means Committee. In December, Senator Muskie, with eleven members—approximately half of the Senate Finance Committee—offered an “identical” bill.

117 Id.
119 Hearings on H.R. 13500, supra note 83, at 38.
120 Pepper, Hamilton Report, supra note 87, at 2927.
121 See id. at 2928 (noting that the bill was a compromise between the different proposals).
122 See id. (noting that “the proposed bill would accomplish a great deal. It would take care of the major concerns of the charities by allowing three things: 1. Definite provision with respect to direct lobbying, . . . 2. Freedom to communicate on proper subjects with bona fide members, . . . 3. Some residual protection for any combination of grass-roots lobbying and minor expenditures in any other area.”).
123 Id.; see also Hearings on H.R. 13500, supra note 83, at 38 (noting that “several changes of format and substance were made”).
124 Pepper, Hamilton Report, supra note 87, at 2928 (internal quotation marks omitted).
125 Id.
127 Hearings on H.R. 13500, supra note 83, at 38.
128 Compare Membership of the Committee (By Congress and Session): Select Committee on Finance and an Uniform National Currency, U.S. SENATE COMMITTEE ON FIN., http://finance.senate.gov/download/?id=e4b3f33b-d064-4ab0-8959-2d00f518a9f8 (last visited
H.R. 13500, therefore, did not simply slip through the halls of Congress and on to the President’s desk. Describing Barber Conable’s earlier H.R. 12037, the lawyers at Pepper, Hamilton & Sheetz characterized the effort as one that “represents a compromise on a compromise on a compromise.”

Considering, then, that H.R. 13500 was the product of at least three more proposals and two more years of compromise and discussion after the introduction of H.R. 12037, the complexity of the background to H.R. 13500’s passage is hard to overstate.

The detailed legislative history and the path of amendments over a six-year period and nine separate pieces of legislation sheds light on Congress’s intentions in providing an alternative for the Substantial Part Test. This history suggests that congressional action was significantly motivated by a desire to simplify and clarify the rules and definitions that restrict legislative activities by charities and to provide equal access to Congress for charities and business. Congress’s intent was not to prohibit lobbying by public charities, and the legislative history to the 1976 Act does not reflect concern that legislative activities are in some way incompatible with public purposes. Rather, Congress seemed to value and crave more rather than less input from the charitable sector on policy reform. Congress was concerned about the severity of the loss of exemption penalty for charities that crossed the undefined line of substantial lobbying. Reflecting this concern, Congress fashioned an intermediate sanction to make legislative activities less risky.

Although initially concerned about charities lobbying the public (so called “grassroots” lobbying), Congress ultimately opted not to prohibit that activity, but rather to limit it out of some unidentified fear. Finally, although a regressive sliding scale that prefers smaller organizations over those with large budgets and endowments arose from the legislative dust, those regressive limits seem to stem more from compromise than from any overriding intent to generally limit legislative activity by public charities. Even more perplexing, in light of the legislative history, is the source and policy behind the particular limits that appeared in the enacted legislation. Although reasons for the regressivity of the formula were hinted at, no clues

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Apr. 9, 2012) (showing the members of the 94th Senate Finance Committee as having eighteen members), with Hearings on H.R. 13500, supra note 83, at 38 (noting that eleven members of the Senate Finance Committee joined cosponsored the bill).

129 S. 2832, 94th Cong. (1975); see Hearings on H.R. 13500, supra note 83, at 38 (noting that the bills were identical).

130 Pepper, Hamilton Report, supra note 87, at 2928.
reflect a rationale for the limits selected or whether the limits were negotiated or well-vetted. The absence of any history regarding the selected limits, combined with clear history that demonstrates congressional intent to increase, rather than limit, legislative activity by public charities, suggests that the limits may not serve any identifiable policy purpose.

B. How it Works

As stated above, section 501(h) is essentially a safe harbor provision; it permits eligible organizations to elect the Expenditure Test as a substitute for the Substantial Part Test. The objective nature of the Expenditure Test makes it much more useful than the subjective Substantial Part Test for public charities wishing to impact public policy in a meaningful way.

Two distinct issues arise in connection with section 501(h). First is the issue of excise tax liability for excessive lobbying activities in any given year. This does not necessarily lead to loss of exemption. The second issue is loss of exemption that may result from excessive lobbying activities that continue over a period of time. Specifically, unlike a finding that a “substantial part” of an organization’s activities consist of lobbying, breaching the concrete ceilings provided by the Expenditure Test in one year will not result in a revocation of 501(c)(3) status. Rather, exceeding the limitations provided by section 4911 in any year will result in a 25 percent excise or penalty tax on excess expenditures, and only after an organization has been found to “normally” exceed the limits—that is, after it has exceeded the stated ceilings over a “four-year period”—will the organization risk loss of its exempt status.

The precise mechanics of sections 501(h) and 4911 are complex, and this Article does not intend to summarize the law, but a few points should be mentioned. A charity with a section 501(h) election in effect is permitted to spend a fixed amount on overall lobbying and a smaller fixed amount on grassroots lobbying. The amount that a

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131. See I.R.C § 501(h)(5) (2006) (providing that eligible organizations are electing public charities other than churches and certain affiliated entities and organizations of churches and private foundations, which are not eligible to make the § 501(h) election).

132. These ceilings are referred to as the “Lobbying Ceiling Amount” and the “Grass Roots Ceiling Amount.”

133. See Measuring Lobbying: Substantial Part Test, supra note 53.


charity may spend without penalty (i.e., the “Lobbying Nontaxable Amount” and the “Grassroots Nontaxable Amount”) is defined as a percentage of the charity’s exempt purpose expenditures.\textsuperscript{136} Exempt purpose expenditures, as the words suggest, are the amounts treated under the Code and regulations as being spent by an organization to further its exempt purpose.\textsuperscript{137} In effect, the exempt purpose expenditure of an organization is the “overall measuring rod against which an organization’s lobbying expenses are tested.”\textsuperscript{138} Lobbying expenditures are expenditures made in connection with influencing legislation, as that term is defined in section 4911(d), and are classified as either direct lobbying expenditures or grassroots expenditures.\textsuperscript{139} Grassroots expenditures, used to produce communications intended to influence the public, are subject to a stricter cap\textsuperscript{140} and therefore more limited than direct lobbying expenditures, for purposes of imposing both the intermediate sanction and the ultimate sanction of loss of exemption.

The Lobbying Nontaxable Amount and the Grassroots Nontaxable Amount, and, therefore, the Lobbying Ceiling Amount and the Grassroots Ceiling Amount, are determined based on regressive sliding scales. The maximum nontaxable and ceiling amounts kick in when an organization’s exempt purpose expenditures reach $17 million for a given year.\textsuperscript{141} As a result, organizations with large budgets and endowments are more restricted than their smaller counterparts, and larger organizations may be permitted to engage in

\textsuperscript{136}Id.; I.R.C. § 4911(c).
\textsuperscript{137}I.R.C. § 4911(c)(1); Treas. Reg. § 56.4911–4.
\textsuperscript{138}FISHERMAN & SCHWARZ, supra note 134, at 524.
\textsuperscript{139}“Influencing legislation” means any attempt to influence any legislation (A) “through an attempt to affect the opinions of the general public or any segment thereof” (i.e., grassroots lobbying), or (B) “through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation” (i.e., direct lobbying). I.R.C. § 4911(d)(1). There are some important exceptions to this definition, including (1) “making available the results to nonpartisan analysis, study, or research,” (2) “providing technical advice or assistance . . . to a governmental body . . . [at the request of] such body,” and (3) certain communications with members. I.R.C. § 4911(d)(2); see also Treas. Reg. § 56.4911–2(c) (providing a detailed explanation of the exceptions).
\textsuperscript{140}The grassroots nontaxable amount for any year is limited to 25 percent of the lobbying nontaxable amount for that year. I.R.C. § 4911(c)(4). See also Treas. Reg. § 56.4911–3 (providing further detail as to the definition of direct lobbying and grassroots communications).
\textsuperscript{141}I.R.C. § 4911(c)(2) (providing that the maximum lobbying nontaxable amount is the lesser of $1,000,000 or, where exempt purpose expenditures exceed $1,500,000, $225,000 plus 5 percent of the excess of exempt purpose expenditures over $1,500,000, which equates to a $17,000,000 cap for exempt purpose expenditures that can be used to increase an organization’s nontaxable amount ($15,500,000 multiplied by 5 percent equals $775,000, which added to the $225,000 from the initial $1,500,000 totals $1,000,000, i.e., the maximum lobbying nontaxable amount)); Treas. Reg. § 56.4911–1(c)(1)(ii).
more legislative activity under the Substantial Part Test than under the Expenditure Test.

C. Benefits of the Expenditure Test

The primary benefit of the Expenditure Test is clarity—both clarity as to what an organization can spend and as to what it can spend on. A safe harbor with bright line limitations should appeal to charities. It is therefore curious that less than 2 percent of eligible charities have actually made the election, and that the percentage of eligible organizations making the election has barely increased over the past two decades. As of 1989, only an estimated 1 percent of eligible organizations had taken advantage of the 501(h) election.142 In 1993, Miriam Galston intuitively argued that this minimal appeal could be attributed to the fact that final Treasury regulations were not codified until 1990 and that the certainty of the finalized regulations would lead to a greater proportion of eligible organizations making the election in the future.143 Similarly, Professor Laura Chisolm predicted in 1994, that:

it seems almost inevitable that the carefully crafted and highly workable standards of the 1990 regulations will, over time, become the measuring rod against which the activities of public charities that engage in issue advocacy will be evaluated. With detailed standards in place for electing organizations, it becomes harder to imagine Service or court decisions resting on an unmodified, know-it when-we-see-it approach, even if the organization at issue has not elected to come under section 501(h). Furthermore, it is likely that organizations with policy advocacy as a primary or secondary, as opposed to incidental, focus will choose to place themselves under the more predictable 501(h) framework.144

Commentators have overwhelmingly favored section 501(h) elections for public charities wishing to influence policy through legislative activity.145 The then-Assistant IRS Commissioner for

143Galston, supra note 62, at 1280 n.26.
144Chisolm, supra note 17, at 26 (citations omitted).
Employee Plans and Exempt Organizations predicted as much, but one commentator opined that there would be “no rush” to take up the new election in part because of the hassle of “additional paperwork.”\textsuperscript{146} Based on statistics from 2009, both Professor Galston and Professor Chisolm appear to have been surprisingly less than prophetic: according to the National Center for Charitable Statistics, 12,795 active 501(c)(3) organizations had made the election as of the fall of 2009.\textsuperscript{147} This number represents less than 1.3 percent of listed eligible charities at the time.\textsuperscript{148} The strange disinterest in this helpful safe harbor is hard to explain, except in light of the daunting complexity of the rules.

For an eligible charity wishing to participate in the legislative process, the Expenditure Test provides significant benefits. The objective nature of the test permits charity managers to know exactly how much of their funds can be spent on lobbying and legislative activity without jeopardizing the organization’s exempt status. Furthermore, the clearly defined relevant terms let charity managers know precisely what they can spend those dollars on. Since the spending limitations are based solely on dollars spent, an election is quite favorable to any charity that can engage in “cheap” lobbying, for example on the Web or using volunteers. In fact, organizations that can lobby effectively using their Web sites and emails can engage in virtually unlimited lobbying under the Expenditure Test. The ability to use the Internet to influence the public (and perhaps Congress as well) on legislative matters renders the dollar limitations imposed by the Expenditure Test useless in many cases. Furthermore, the liberal member communication rules provide a benefit to member organizations by permitting them to lobby without burning up any

\textsuperscript{146}Moriarty, supra note 142, at 150.
\textsuperscript{148}See Number of Public Charities in the United States, 2010, NAT’L CENTER FOR CHARITABLE STAT., http://nccsdataweb.urban.org/PubApps/profileDrillDown.php?state=US&rpt=PC (last visited Apr. 9, 2012) (displaying the number of public charities as of April 2010). Even assuming that the number of churches and related ineligible organizations falls halfway between the 222,145 501(c)(3) public charity organizations classified as “Religion Related, Spiritual Development” in IRS filings, id., and the 91,000 congregations (of any religion) that filed with the IRS as of 2007, only approximately 1.5% of eligible organizations elected would have elected as of 2009. Identifying Faith-based Organizations in NCCS Databases (Method Note), NAT’L CENTER FOR CHARITABLE STAT., http://nccsdataweb.urban.org/knowledgebase/detail.php?linkID=85&category=118&xrefID=3526&close=1 (last visited Apr. 9, 2012).
Lobbying Nontaxable Amount or Lobbying Ceiling Amount, or by treating grassroots lobbying expenditures as direct lobbying expenditures, subject to a higher monetary cap. Finally, the many exceptions to the definition of lobbying contained in section 4911(d)(2) permit “free” lobbying for charities engaging in lobbying that is not treated as lobbying for purposes of the Expenditure Test. A well-counselled organization can use many of these excepted communications to impact policy without expending Lobbying and Grassroots Nontaxable Amounts.

\[149\] See I.R.C. § 4911(d)(2)(D), 4911(d)(3); see also Treas. Reg. § 56.4911–3 (1990) (providing liberal allocation rules regarding what portion of a lobbying costs are direct lobbying expenditures and grassroots expenditures).

\[150\] I.R.C. § 4911(d)(2) states:

For purposes of this section, the term “influencing legislation”, with respect to an organization, does not include—

(A) making available the results of nonpartisan analysis, study, or research;

(B) providing of technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be;

(C) appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization;

(D) communications between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members, other than communications described in paragraph (3); and

(E) any communication with a governmental official or employee, other than—

(i) a communication with a member or employee of a legislative body (where such communication would otherwise constitute the influencing of legislation), or

(ii) a communication the principal purpose of which is to influence legislation.

Furthermore, in another example of generosity and leniency in the Expenditure Test definitions, “grass roots lobbying,” requires a reference to specific legislation, reflection of a view on that legislation, and encouragement of the recipient of the communication to take action with respect to the legislation, is easy to structure around by omitting any one of those factors. Treas. Reg. § 56.4911–2(b)(2).
III. PROPOSAL I: ABANDON RESTRICTIONS ON LEGISLATIVE
ACTIVITY BY PUBLIC CHARITIES

A. Policy Reasons For and Against Permitting Unlimited
Charitable Legislative Speech

1. Policy Arguments For Unlimited Lobbying

A plethora of sound policy reasons may be conjured to permit
public charities to lobby. First, debate is good for society regardless
of what is being debated and who is doing the debating, and lobbying
by public charities increases the number of voices in the discourse.
Moreover, public charities permit voices less often heard in the
discourse to participate. Second, charities can be effective and
efficient vehicles for the public’s participation in formulating public
policy and the laws embodying that policy. As the late Professor
Laura Brown Chisolm stated in her seminal article, Exempt
Organization Advocacy: Matching the Rules to the Rationales,
“[M]any believe that the roles of advocate and improver of social
systems, empowerer of citizens, and critic and monitor of government
policies and programs are among the most crucial functions of the
nonprofit sector.”151 Third, the rights of citizens to petition the
government is fundamental to our notion of democracy.152 Fourth,
organizations described in section 501(c)(4)153 that “promote social
welfare” can lobby without limitation, presumably because lobbying
is an activity that promotes social welfare.154 In fact, included in the
definition of “charitable” in the Treasury regulations defining that
term is the “promotion of social welfare.”155 If legislative activity
promotes social welfare, it is therefore charitable and charities are not
and should not be limited in the amount of charitable activity in
which they can engage. And finally, a public charity lobbying to
further the interests of its constituents just seems charitable,

151 Chisolm, supra note 21, at 205 (footnotes omitted).
152 U.S. CONST. amend. I; see generally Mayer, supra note 26, at 486 (“It is protected by
the First Amendment right to petition the government for redress and by similar provisions in
numerous state constitutions.”).
154 See Mayer, supra note 26, at 539 (observing the benefits of legislative activity,
including “supplying valuable information and advice for government decision makers,
informing citizens of proposed and current government actions and thus increasing the
transparency of government, and creating a mechanism through which citizens can both
participate in politics generally and influence specific government actions”).
particularly if the legislative activity furthers the charitable mission of the organization.\textsuperscript{156}

In sum, the charitable sector brings new perspectives to legislative discourse, and those perspectives serve to enlighten legislative discussion. In other words, “the voluntary sector [provides] ‘countervailing definitions of reality and morality—ideologies, perspectives and world views that frequently challenge the prevailing assumptions about what exists and what is good and what should be done in society; [and] is most likely to say that the emperor has no clothes.’”\textsuperscript{157} For these reasons, Congress should eliminate the restrictions on lobbying by public charities to encourage legislative activity by these organizations.

2. Policy Arguments Against Lobbying

Policy reasons are occasionally cited for limiting charitable legislative activity. These include (1) the negative perception that Americans have of lobbying and lobbyists,\textsuperscript{158} (2) the argument that government should remain neutral with regard to lobbying by its citizens,\textsuperscript{159} (3) the notion that unrestricted lobbying is antithetical to a majoritarian system of government, (4) the comparison with businesses, individuals, and other entities as opposed to veteran’s organizations,\textsuperscript{160} and (5) the availability of the 501(c)(4)\textsuperscript{161} alternative.

Given Americans’ negative perception of lobbying and lobbyists in general, unlimited lobbying by charities might precipitate suspicion and negativity from the public. As Miriam Galston reflects: “‘Lobbying’ is a dirty word. . . . [And] most people associate

\textsuperscript{156} For example, an organization formed to feed the hungry should be entitled to weigh in on food policy in furtherance of its mission, and an environmental group should join the discourse on environmental policy to further its mission. Even the IRS would agree with this conclusion. \textit{See} Rev. Rul. 80–279, 1980–2 C.B. 176 (holding that an organization engaged in legal research for and mediation of international environmental disputes, which included making its results known to the public by means of lectures, published articles, and interviews, qualified for 501(c)(3) exemption, because its activities constituted a long-recognized charitable purpose).


\textsuperscript{158} \textit{See infra} notes 162–63 and accompanying text (discussing this perception).

\textsuperscript{159} \textit{See infra} notes 164–67 and accompanying text (discussing the neutrality argument).

\textsuperscript{160} \textit{See infra} notes 168–73 and accompanying text (making these comparisons).

\textsuperscript{161} I.R.C. § 501(c)(4) (2006). Organizations described in section 501(c)(4) are exempt from federal income tax under section 501(a) and are operated for the promotion of social welfare. A 501(c)(4) organization may further its purposes through lobbying as its primary or only activity without jeopardizing its exempt status but is not eligible to receive tax-deductible contributions under I.R.C. § 170(c). \textit{Id}; I.R.C. § 170(c).
lobbying with pressure tactics at best, and with bribery or blackmail at worst.”162 Similarly, another commentator suggests that “[i]f one were to ask a friend, any friend, whether lobbying the legislature and campaigning for candidate X were charitable activities, four out of five answers would likely be quick, and negative.”163 While these statements ring true and may provide a convincing argument against requiring charities to lobby, they do not provide a similarly compelling case against permitting legislative activity by charities.

First, charities will never be required to engage in legislative activity. The risk that lobbying will engender a negative public reaction is a risk that charities can choose to take or avoid. Presumably, a thoughtful board would weigh the potential damage of public suspicion against the benefit to be achieved by the legislative engagement and make an informed and rigorous decision. Furthermore, as long as charities lobby responsibly and in furtherance of mission, there is no reason to believe that negative reaction among those who support that mission would ensue.

A second contention against permitting charities to lobby is the notion that governments should remain neutral with regard to lobbying by their citizens, refusing to take sides by “subsidizing” any particular lobbying effort. As Judge Learned Hand concluded in Slee v. Commissioner,164 “the Treasury stands aside” from political controversies (in that case, the provision of birth control).165 Learned Hand concluded that “[p]olitical agitation as such is outside the statute, however innocent the aim . . . .”166 Professor Chisolm perhaps said it best when she debunked the neutrality argument, concluding:

Even if the present system could be accurately characterized as neutral, maintaining that neutrality would be misguided. Neutrality is neither constitutionally required, nor necessarily supportable as a matter of good policy. Rules which have the effect of either limiting or encouraging advocacy activity should aim to protect the integrity of the processes to which the advocacy is directed. Where technical neutrality contributes to unequal access to governmental institutions and processes, reinforces rather than relieves the chronic voicelessness of some segments of society, and leads to social policy built on incomplete information, it no longer provides

162 Galston, supra note 62, at 1270.
163 Houck, supra note 34, at 85.
164 42 F.2d 184 (2d Cir. 1930).
165 Id. at 185.
166 Id.; see also Cammarano v. United States, 358 U.S. 498, 512 (1959) (agreeing with Hand).
an acceptable foundation upon which to rest a system of controls and incentives.\textsuperscript{167}

Restrictions on legislative speech of charities skew, rather than augment, the legislative process. That price for alleged (or even actual) neutrality is too costly for society to bear.

Some critics of lobbying by charities have asked, perhaps as an extension to the neutrality argument, Why permit charities to lobby with deductible contributions when businesses,\textsuperscript{168} individuals,\textsuperscript{169} and other entities\textsuperscript{170} cannot do so? In other words, Why should the government subsidize legislative activities of charities if legislative activities of other constituents are not similarly subsidized? First, this argument has several technical flaws, as businesses can deduct lobbying expenditures in many instances.\textsuperscript{171} Second, some organizations exempt under 501(a), specifically veterans’ organizations,\textsuperscript{172} can lobby without limitation with tax deductible, non-taxed dollars.\textsuperscript{173} This further erodes the “neutrality” argument, as well. Finally, as a policy matter comparing charities to businesses, individuals, and other noncharitable entities as an excuse for subjecting charities to the limits imposed elsewhere is unwise. Public charities likely to lobby generally represent a group of constituents traditionally less engaged in the legislative process.

Finally, because charities can, under current law, set up a 501(c)(4) organization and engage in unlimited legislative activity, albeit not with tax deductible contributions, many argue that release of the limits within the 501(c)(3) are unnecessary.\textsuperscript{174} Although charities can

\begin{itemize}
\item \textsuperscript{167}Chisolm, supra note 21, at 252 (footnotes omitted).
\item \textsuperscript{168}I.R.C. § 162(e)(1) (2006); Treas. Reg. § 1.162–20(c)(3) (as amended in 1995).
\item \textsuperscript{169}See I.R.C. § 170(c) (disallowing a charitable deduction for individuals who give to organizations that are disqualified for lobbying).
\item \textsuperscript{170}See, e.g., I.R.C. § 162(c)(3) (business leagues).
\item \textsuperscript{171}I.R.C. § 162(e); Treas. Reg. § 1.162–20(c)(3); see also Ronald S. Borod, Lobbying for the Public Interest—Federal Tax Policy and Administration, 42 N.Y.U. L. REV. 1087, 1112 (1967) (noting that “the business community can deduct their lobbying expenses, while all others cannot”).
\item \textsuperscript{172}I.R.C. § 501(c)(19); see Regan v. Taxation with Representation of Wash., 461 U.S. 540, 548–551 (1983) (rejecting an equal protection challenge to the preferential treatment afforded to veterans associations).
\item \textsuperscript{173}The dollars are often deductible under section 170(a) (assuming an itemizing donor) and generally are not taxed to the organization (assuming the funds are not subject to the unrelated business income tax). I.R.C. §§ 170(a); 501(c)(3); 511–514.
\item \textsuperscript{174}See Donald B. Tobin, Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy, 95 GEO. L.J. 1313, 1325 (2007) (arguing that charities receive “subsidies” for the nature of their work and the nature of their work does not include legislative activity, that if the charity engages in such activity, it should no longer receive their subsidy, and therefore, the organization should create a section 501(c)(4) affiliate if it wishes to engage in unlimited legislative activity); see also Chisolm, supra note 21, at 236 (explaining the 501(c)(4) organization option).
\end{itemize}
set up 501(c)(4) organizations to carry on unlimited legislative activity, setting up and operating one is a significant burden both administratively and as a matter of fundraising. Furthermore, 501(c)(4) organizations may represent different voices from affiliated 501(c)(3)s because their funders may be unique and have diverse interests. Additionally, as noted above, the comparison with social welfare organizations suggests that limitations on legislative activities by public charities should be released. If lobbying is a social welfare activity and charities may be formed to “promote social welfare,” no logical conclusion for restricting lobbying by charities can follow.

The policy arguments against charitable legislative speech are less compelling than the arguments for permitting the activity without limit. Unlimited legislative activity by charities should be encouraged in order to increase debate and the number of voices in the discourse. Both Congress and the public benefit from the increased and more diverse discourse. The benefits that would accrue to society from the additional debate would overwhelm any negative impact that may be feared.

B. Technical Reasons For and Against Permitting Unlimited Charitable Legislative Speech

I. Technical Reasons For Permitting Unlimited Charitable Legislative Speech

A second, more technical, set of rationales for permitting unlimited lobbying by public charities is that current restrictions are ambiguous, confusing, ineffective, and outdated. The boundaries drawn under current law are unworkable and far too easily avoidable by a well-lawyered organization. Moreover, both compliance with and enforcement of these rules is unnecessarily expensive.

As mentioned above, the Substantial Part Test is far too vague and subjective to provide proper guidance to organizations wanting to influence legislation to further exempt purposes. While the Expenditure Test contains bright lines and helpful definitions, none of these lines or definitions is available to non-electors. And even the
measuring rods for substantiality used in the Substantial Part Test are fuzzy. Various elements may be taken into account to determine how much lobbying is too much under the Substantial Part Test, including money spent, volunteer time employed, and the continuity and visibility (and perhaps the controversial nature) of the legislative activities, but no clear guidelines exist for identifying, much less weighing, these factors. Effectively, these nebulous boundaries restrict charities’ ability to lobby by failing to enlighten them as to how much legislative activity will jeopardize their exemption. In other words, charities tend to be so frightened of transversing this invisible line that they forego even “insubstantial” lobbying. In effect, ignorance paralyzes eligible charities and prohibits them from fulfilling their potential in impacting law and public policy.

While the Expenditure Test elective under 501(h) does not suffer from the same lack of clarity, it is ineffective, hypertechnical, and outdated in the twenty-first century. Unlike the subjective Substantial Part Test, the Expenditure Test is full of bright lines and crystal-clear definitions. As a legislative fix to the woes of the Substantial Part Test, it probably made terrific sense in 1976 when it was enacted.

As mentioned above, the primary benefit of the Expenditure Test is clarity—both clarity as to how much an organization can spend and as to what it can spend on. A safe harbor with bright-line limitations should appeal to charities. It is therefore curious that less than 2 percent of eligible charities have actually made the election.

The Expenditure Test’s primary difficulties are its over-complexity and that most of its restrictions are too easily avoided with the help of a knowledgeable lawyer. The test was enacted in 1976 and the world has changed quite a bit in the ensuing thirty-six years in many ways that impact the efficacy of the restrictions imposed under the 501(h) election. First, the World Wide Web was not around in 1976. Lobbying required drafting, printing, posting, stamping, and mailing letters, brochures, flyers, and pamphlets, and significant travel. In foundations have lobbied. Treas. Reg. § 53.4945–2 (as amended in 1990).

See Galston, supra note 62, at 1279–1280 (discussing the Substantial Part Test’s vagueness).


See CENTER FOR LOBBYING IN THE PUB. INT., supra note 8 (explaining that more than 90 percent of charities have continued to use the Substantial Part Test).
other words, lobbying required lots of money. Today, organizations can and do lobby virtually for free on the Internet and use email to correspond with legislators and constituents. New technology makes it possible to schedule “virtual meetings” with legislators at virtually no cost.\textsuperscript{181} Organizations that lobby through the Internet and other modes of digital communication can reach millions, maybe billions, of people without spending much of their section 501(h) permissible lobbying amounts other than costs of employee time (where volunteers are unavailable) and connectivity (a trivial number by most accounts). Future technological advances inevitably will continue the march toward free (or inexpensive) lobbying not contemplated in 1976. This makes and will continue to make the sections 501(h) and 4911 limitations useless for wisely crafted lobbying. Useless restrictions should be repealed because they confuse but do not restrict.

Second, the very liberal rules under section 4911 make it possible for many charities (particularly those with members) to engage in significant legislative activity that does not count as lobbying.\textsuperscript{182} The Internet multiplies the amount of “non-lobbying” lobbying a membership organization can accomplish. Again, properly structured lobbying can be practically limitless, so why impose limits?

Effectively, most charities electing the Expenditure Test can lobby almost without effective limit if they employ a crafty and knowledgeable lawyer. The benefits of increased discourse and the inefficacy of the restrictions on lobbying mandate unrestricted lobbying for public charities.

2. Technical Reasons Against Permitting Unlimited Charitable Legislative Speech

The most significant technical argument against permitting unlimited legislative activity by charities centers on the possibility that the elimination of the current restrictions might result in abuse. For example, twenty-seven donors could unite to form a charity, pass

\textsuperscript{181} Participants in this kind of lobbying use e-mails, phone calls, Skype, and social networking tools like Facebook and Twitter to “meet” with legislators. Some organizations have organized a “Virtual Lobbying Day” during which they encourage members themselves to engage in a communication blitz upon legislators. \textit{See, e.g., Be a Part of the Innovation Movement’s Virtual Lobby Day, THE INNOVATION MOVEMENT, http://www.declareinnovation.com/?issues/be-a-part-of-the-innovation-movements-first-ever-virtual-lobby-day (last visited Apr. 9, 2012) (inviting people to participate in a “Virtual Lobby Day”).}

the public support test, and engage in selfish lobbying in public charity form. Alternatively, the selfish donors might achieve the same goal by setting up a supporting organization as defined in section 509(a)(3), assuming that they could identify (or perhaps create) a cooperative public charity to support. But selfish lobbying was precisely what Congress intended to avoid when it added the “no substantial part” language to the Code in 1934. Therefore, this possibility presents a genuine threat to the integrity of the operational test for charities.

Most would agree that an organization that engages in selfish lobbying (i.e., lobbying that promotes the individual interests of its leaders rather than the interests of the public it serves) should not pass the operational test for classification as a charity. On the other hand, as argued earlier, lobbying that furthers a true charitable purpose should pass muster and should be encouraged by the law. The questions raised by this potential for technical abuse are: (a) how likely is this abuse to occur, and (b) how can the potential for abuse be mitigated?

As to the first question, Congress disposed of much of the potential for selfish lobbying in 1969 when it defined legislative activity by private foundations as a taxable expenditure, effectively prohibiting any direct lobbying by private foundations. The possibility of creative structuring remains, which would enable entities that are functionally private foundations to qualify as public charities either under the public support test of section 509(a)(1) or as supporting organizations under section 509(a)(3), as mentioned above. With respect to supporting organizations, the risk is minimal (although not nonexistent) because of the requisite control that must be exercised by the supported organization for it to maintain its exempt status. Moreover, as the eminent scholar Marion R. Fremont-Smith has convincingly argued, most charities operate for the public

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184 The group thus formed could avoid private foundation status under Code section 509(a)(1) and the restrictions on legislative activity by private foundations. I.R.C. § 509(a)(1).
185 See I.R.C. § 509(a)(3) (exempting organizations that are operated to support charities).
186 For a discussion of legislative history of Revenue Act of 1934, see supra notes 44–48 and accompanying text.
187 See Treas. Reg. § 1.501(c)(3)–1(c) (as amended in 2008) (stating the operational test for determining whether a substantial part of a charity’s activities are lobbying).
188 See supra note 156 for examples.
190 See discussion of private foundations infra Part IV.A.1.
191 See supra notes 181–85 and accompanying text (discussing ways to circumvent the taxes imposed on private foundations).
good and intentional malfeasance is rare. But some creative structuring for selfish lobbying purposes inevitably occurs under current law and arguably would increase if restrictions on legislative activities of public charities vanished, which would increase the value of public charity status to selfish donors.

This conclusion leads us to the second question, what to do about the abuse? Congressional and Treasury effort here should aim to reduce potential for abuse rather than to restrict legislative activity by well-intended charities. Abuse reduction might require heavy-handed anti-abuse laws that penalize only true culprits and deter only culpable charities and their managers but do not impact the innocent. Excise taxes and loss of exemption could be used to deter and penalize without quelling sincere legislative activity by charities. Arguably, these penalties are already in place for charities that serve selfish interests rather than public interests. Additional disclosure requirements might necessarily be implemented to help the IRS identify bad actors. Given the probability that the feared abuse will be minimal and the possibility of implementing additional disclosure and penalty provisions to identify and punish that abuse, the technical arguments raised against unlimited legislative activity by public charities do not outweigh the public good that charities can accomplish with unlimited lobbying.

IV. PROPOSAL II: FIX THE EXPENDITURE TEST

Although the elimination of restrictions on nonprofit legislative speech is the preferable outcome for the reasons discussed above, a distant second choice is to continue to impose lobbying restrictions through the Expenditure Test but to fix it, simplify it, and make it the default test for measuring permissible legislative activity by public charities. Specifically, this suggestion would require amending and expanding the Expenditure Test to make it more palatable for and accessible to a broader range of organizations by removing

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193 See I.R.C. §§ 501(c)(3), 4958 (excluding from the exemption organizations that participate or intervene in political campaigns and imposing excise tax sanctions on excess benefit transactions).
regressivity, increasing caps at least to keep pace with inflation, educating charities who fear it because they do not understand it, and making it the default test for all public charities.

A. Expand the List of Eligible Organizations

Not all organizations described in section 501(c)(3) are eligible to elect the Expenditure Test. Excluded organizations include private foundations and churches.194 As a first step, the law should be amended to permit churches and their affiliates to use the Expenditure Test.

1. Private Foundations

The rationale for disqualifying private foundations195 is fairly obvious, although not necessarily justifiable. Congress was concerned, and perhaps rightly so, about selfish lobbying by private charities, since they are not subject to the restraints imposed by public accountability discussed above.196 There is simply too much private, rather than public, control and too much risk that deductible contributions and exempt funds will be used to further the personal interests of those in control of the foundation.197 Accordingly, in 1969, Congress opted to significantly curtail legislative activity by private foundations by including amounts expended to influence legislation in the definition of “taxable expenditure,” subject to penalties under section 4945.198

The restrictions on lobbying by private foundations have engendered much discussion. Foundations themselves have argued that the restrictions tie their hands and make them less effective.199

195 Private foundations are defined in I.R.C. § 509(a).
196 See discussion of public accountability supra note 51 and accompanying text.
197 Most private foundations mean well. Very few people would be concerned about selfish advocacy by some of the larger and most well governed foundations. But the risk still exists. Congressional hearings on the abuses of private foundations influenced future legislation. Such abuses included “competitive advantage, self-dealing, delay in benefit to charity, distraction of management, maintenance of control, and imprudent investment.” Richard Schmalbeck, Reconsidering Private Foundation Investment Limitations, 58 TAX L. REV. 59, 73 (2004).
198 I.R.C. § 4945(d)(1); see generally Note, Regulating the Political Activity of Foundations, 83 HARV. L. REV. 1843 (1970) (detailing the restrictions and sanctions to be applied to private foundations under the Tax Reform Act of 1969).
199 Largely motivated by a desire to remove lobbying restrictions and to have a voice in national debate, Pew Charitable Trusts chose to become a public charity in 2004. See Stephanie Strom, Pew Charitable Trusts Will Become Public Charity, N.Y. TIMES, Nov. 7, 2003, at A20 (noting a statement by Rebecca W. Rimel, then president and chief executive of Pew, “It will give us greater flexibility in our operations, as well as economies of scale that we could not achieve as a private foundation,”) and identifying one advantages as the ability “to lobby on
The American Bar Association Tax Section Exempt Organizations Committee has suggested that “[t]he absolute prohibition against lobbying activity in section 4945(d)(1) does not serve an articulated policy goal and adds burdensome complexity to grantmaking compliance.” This position may overstate the problem and underestimate the ability of a well-advised foundation to advocate. The ABA’s statement also overlooks Congress’s fairly well articulated policy goal of avoiding selfish lobbying.

The strict constraints on private foundation lobbying and the concomitant exclusion of private foundations from the Expenditure Test naturally impose a burden on a private foundation wishing to influence legislation in furtherance of its charitable purpose. But not all of the news for private foundations is bad. First, private foundations can engage in activities that influence legislation that are not defined as “lobbying” for purposes of the Expenditure Test. The liberal definitions found in section 4911 give private foundations some wiggle room to influence legislation with rigorously structured “non-lobbying” lobbying.

Second, one could argue that private foundations are not subject to an “absolute prohibition on lobbying activity in section 4945(d)(1)” because of the lenient rules permitting grants to public charities that do lobby. Although private foundations cannot directly engage in lobbying activities, private foundations are not prohibited from making general support grants to charities that engage in lobbying provided that the grant is not earmarked for lobbying. Furthermore,
a private foundation special project grant to a public charity is not a taxable expenditure if none of the grant is earmarked for lobbying and provided that the total amount of the foundation’s special project grant does not exceed the amount budgeted by the charity for the non-lobbying aspects of the special project. These permissive rules apply even if the public charity ultimately uses some of the grant for legislative activity.

Third, private foundation creators, like all other humans, can use their wealth to create an organization described in section 501(c)(4) and use the organization exclusively for legislative purposes. It may feel politically awkward, and contributions to the 501(c)(4) entity would not be deductible, but many of the biggest donors get minimal tax benefits from charitable contributions, in any event.

Finally, if all else fails, private foundations can use the “Pew method” to erase most effective lobbying restrictions. By forming a public charity and converting a private foundation into a supporting organization, for that newly created public charity the former private foundation can effect an end run around the private foundation rules to advocate under the more lenient rules applicable to public charities.

The issue of lobbying by private foundations is difficult to resolve, with convincing arguments on both sides of the debate. The limitations on legislative activities by private foundations do place a burden on private foundations wishing to engage in lobbying to further their charitable purposes. But the limits do not completely prohibit private foundations from influencing the formation of public policy. The hoops through which private foundations must jump

206 “Earmarked” is defined in Treas. Reg. § 53.4945–2(a)(5)(i).
208 See, e.g., Treas. Reg. § 53.4945–2(a)(7) Ex. (8), (9) (providing examples of circumstances where grants to a public charity not earmarked for attempts to influence legislation do not constitute taxable expenditures). See also, FISHMAN & SCHWARZ, supra note 134.
210 I.R.C. § 170(c).
211 Warren Buffett, for example, donated stock worth over $1 billion to the Gates Foundation in 2010, but because of the 20 percent of AGI deduction cap for charitable contributions of stock to private foundations under section 170(b)(1)(D), and because Buffett has a rather low AGI compared to his total earnings (thanks to the long-term capital gains and qualified dividends tax rates), Buffet’s deduction was limited to the same amount he could have deducted had he donated $13 million, rather than over $1 billion. See Laura Saunders, What Did Warren Buffett Really Earn?, TOTAL RETURN BLOG, WALL ST. J. (October 19, 2011, 10:45 AM), http://blogs.wsj.com/totalreturn/2011/10/19/what-did-warren-buffett-really-earn.
212 See Strom, supra note 199 (reporting the conversion of the Pew Charitable Trust to a public charity); David Bank, Pew Casts Itself in Fresh Role as a Public Lobby, WALL ST. J., Nov. 6, 2003, at D5 (discussing Pew’s intent to influence public issues).
213 I.R.C. § 509(a)(3).
inevitably do quell some useful advocacy, but the dangers of selfish lobbying do present a real risk. This may be another situation where simplification, transparency, and education rather than a substantive change in the law offers the best solution.

2. Churches

The reason for excluding churches from the list of organizations eligible to elect the Expenditure Test under section 501(h) is somewhat less transparent and necessary from a policy perspective. Such ineligibility was noted in the Senate Finance Committee Report as a response to the “specific request” of “a number of churches,” and has been similarly described by commentators. Apparently, religious organizations lobbied to be excluded from 501(h) eligibility out of fear that some of their members would make the election and weaken their argument that the U.S. Constitution prohibits governmental restrictions on their legislative activity. The churches always lose this argument, and a body of law has developed through the courts confirming that churches and their affiliates are subject to the limitations on legislative activity imposed under the Code and elsewhere. Thus, excluding churches and their affiliates from making the section 501(h) election serves no purpose to the community that lobbied for the exclusion.

Barring churches from eligibility to elect under section 501(h) is helpful neither to the churches nor to society, as the former could more easily further their charitable purposes under the Expenditure Test and the latter could benefit from the increased legislative discourse that churches could provide under the Expenditure Test. To increase the voices impacting our nation’s public policy, Congress should repeal section 501(h)(5) to allow churches to elect the

214 The term “church” in this context includes an integrated auxiliary of a church or of a convention or association of churches and their affiliates. I.R.C. § 501(h)(5).


218 To make a First Amendment Free Exercise claim, a church would need to show that the restrictions unduly burden its free exercise rights. Courts have found that the sole effect of the loss of the tax exemption will be to decrease the amount of money available to the Church for its religious practices, and the Supreme Court has declared that such a burden “is not constitutionally significant.” Jimmy Swaggart Ministries v. Bd. of Equalization of Cal., 493 U.S. 378, 391 (1990) (citation omitted).
Expenditure Test. If, as suggested later, the Expenditure Test becomes the default test for legislative activity rather than the elective test, that might make the test more politically palatable for churches.

B. Eliminate the $1 Million Cap and Regressive Sliding Scale

If lobbying restrictions must continue to plague charities, the $1 million cap on lobbying expenditures and the regressive sliding scale should be vanquished. In 1976, when the caps were set, perhaps $1 million was a lot of money, but it is not so much money today. And though an organization with a $17 million budget might have been large and fairly rare in 1976, today a significant number of eligible charities’ budgets are at or surpass $17 million. While many charities can lobby well within the 501(h) dollar limits in the twenty-first century, some charities inevitably will want to take lobbying to the next level. The $1 million cap for the lobbying nontaxable amount and the $1.5 million cap for the lobbying ceiling amount are way too low to accommodate non-web lobbying activities by any sizable organization, and the regressivity of the sliding scale cuts out too many organizations that might be able to make a difference in the world with their legislative efforts. And since these larger organizations are likely to spend more on lobbying under either test, the IRS should appreciate the more specific data from these organizations that would be delivered under 501(h).

First, to the extent that Congress continues to restrict lobbying with an Expenditure Test, the caps should be increased at least to reflect inflation since 1976. This would increase the Lobbying Nontaxable Amount cap to approximately $4 million and the Lobbying Ceiling cap (the more important cap) to $6 million. Second, regressivity should be abandoned because there is no

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219 See infra Part IV.E.
222 See I.R.C. § 501(h)(1)(A), (2)(B) (2006) (providing that an exemption shall not be revoked unless an electing charity spends more than the “lobbying ceiling amount,” which is defined as 150 percent of the “lobbying nontaxable amount,” the maximum of which is $1 million).
223 This was one congressional goal in enacting I.R.C. § 501(h). See supra note 82 and accompanying text (noting this purpose).
particular reason to force charities with significant budgets into the fuzzy and unhelpful Substantial Part Test. The law should aim for a constant percentage of an organization’s exempt purpose expenditures that does not top out at a specified capped amount.

C. Eliminate the Distinction Between Direct and Grassroots Lobbying

The lower cap for grassroots lobbying as compared to direct lobbying is irrational and should be repealed. If caps survive, there should be one cap to cover all lobbying. If there is a rationale for any distinction in caps, grassroots lobbying should be subject to a higher, rather than lower, cap than direct lobbying. The lower cap on grassroots lobbying makes it more likely that charities will get into trouble by lobbying the public than by lobbying the government. This result makes little sense from either a practical perspective or a policy perspective. As a practical matter, grassroots lobbying may be more costly than direct lobbying, which suggests that a higher rather than lower cap should be available to make grassroots lobbying meaningful and effective. On the policy side, grassroots lobbying connects charities to the public, which seems more aligned with the purposes of a public charity, which also suggests that the lower cap on grassroots lobbying is unjustified. Furthermore, calculating two different limitations is unnecessarily burdensome and complex.

Legislative history to the 1976 legislation that implemented the distinct limitations on grassroots and overall lobbying expenditures did not elucidate any clear rationale for the distinction, other than some sort of nebulous fear that charities might create a “slush fund” for that purpose. Ill-fated legislation introduced in both the House and the Senate in 2003 would have eliminated the separate limitation on grassroots lobbying but the legislation did not pass. The elimination of the lobbying distinction, however, was not controversial, and the failure of the bills was unrelated to that provision. The Joint Committee on Taxation also has recommended eliminating the separate caps on overall and grassroots lobbying, stating that “there is no significant policy rationale for the separate limitations on grass-roots lobbying.” For both the practical and the

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225 I.R.C. § 4911(c)(4).
226 Exempt Orgs. Comm., ABA Tax Section, supra note 200 (discussing the complexity of the rules).
227 See supra notes 114–120 and accompanying text (discussing this legislative history).
230 STAFF OF JOINT COMM. ON TAXATION, 107TH CONG., STUDY ON THE OVERALL STATE
policy reasons mentioned above, the separate limitation on grassroots lobbying should be eliminated, and charities electing under 501(h) should be permitted to spend their entire nontaxable and ceiling amounts lobbying the public if they so choose.

D. Other Corrections

Two other changes to current law have been suggested by the American Bar Association Tax Section that would improve the operation of the Expenditure Test. First, section 4911(f), dealing with the application of the lobbying limits to affiliated organizations, should be deleted because the provision is “a complex and unnecessary trap for the unwary.” Second, the Code should be amended to remove section 501(h)(7) because “the IRS has not developed a separate set of rules for non-electing organizations and has no plans to do so.” These changes are sensible and will reduce complexity for charities wishing to engage in the legislative process.

E. Make the Expenditure Test the Default Test

If the above amendments are made to the Expenditure Test, the restrictive impact and complex implementation of the Expenditure Test would be reduced, and charities would be more willing and able to generate policy reform and improve legislative discourse. The benefits of the Expenditure Test over the Substantial Part Test would be more marked even than under current law. Accordingly, the final suggestion is to make the Expenditure Test the default provision, eliminating the Substantial Part Test or making it the opt-in provision. If public charities are subject to restrictions on lobbying activity, they deserve clarity and bright lines.

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232 Exempt Orgs. Comm., ABA Tax Section, supra note 200.
234 Exempt Orgs. Comm., ABA Tax Section, supra note 200.
CONCLUSION

The restrictions placed on the legislative activities of charities are overly complex and under affective. The policies for promoting rather than limiting legislative activity by charities are compelling, and neither the legislative history to the 1934 limits nor the legislative history to the 1976 limits shed light on any rationale for the restrictions imposed. Furthermore, thirty-five years after the Expenditure Test was enacted, most charities electing the Expenditure Test under section 501(h) can lobby extensively, provided that the organization is well-counseled to take advantage of lenient rules and definitions under the election and employs inexpensive and free methods of lobbying. In the twenty-first century, the Expenditure Test is outdated, hypertechnical, and ineffective. The vagueness of the Substantial Part Test and the unnecessary complexity of the Expenditure Test rather than any real limits imposed by the Code suppress legislative activity by public charities. This suppression, in turn, limits the unique benefits that public charities can provide to society by increasing debate and diversifying the voices in legislative discourse. In light of these potential but unrealized benefits of increased lobbying by the charitable sector, section 501(c)(3) should be amended to permit unlimited legislative activity by all public charities. If Congress will not enact that amendment, as a distant second choice, the Expenditure Test should be improved and simplified and should serve as the default test for legislative activities of public charities.