

March 16, 1987

Summary of Section of Taxation's Communication
Addressed to the Commissioner of Internal Revenue

The attached letter to the Commissioner of Internal Revenue makes the following points with respect to proposed lobbying regulations to implement section 1307 of the Tax Reform Act of 1976, in response to notices of proposed rule-making, November 5, 1986, 54 F.R. 40211 and January 9, 1987, 52 F.R. 802:

1. The proposed regulations generally inhibit accomplishment of the legislative purpose of the 1976 Act.

2. The applicability of the proposed regulations is not adequately described.

3. More precise definitional standards are needed in the proposed regulations to avoid inconsistency with the underlying statute.

4. The disparity in treatment of fund-raising expenditures should be eliminated.

5. Certain rules regarding affiliated organizations are an unwarranted extension of the underlying statute.

6. The section 501(h) election procedure under the proposed regulations conflicts with the Service's Form 1023 application and advance ruling procedure.

Attachment

Steering Committee:

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SECTION

Taxation

Committees:

Business Related Taxes
Employee Benefits
Estate Planning/Death
Related Taxes
Exempt Organizations
Legislation and Regulations
Tax Audits and Litigation

March 16, 1987

Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Proposed Regulations under § 1307, P.L. 94-455

Attention: CC:LR:T:EE-154-78
Room 4429

Dear Sir:

The purpose of this letter is to submit, on behalf of Section 16, Taxation, of the District of Columbia Bar, comments upon the proposed regulations relating to lobbying expenditures by certain tax-exempt public charities, in response to your notices of proposed rule-making published November 5, 1986, 54 F.R. 40211, and January 9, 1987, 52 F.R. 802.^{1/} The proposed regulations are to implement § 1307 of the Tax Reform Act of 1976, P.L. 94-455 ("the 1976 Act" and sometimes "the Act". Although the proposed regulations provide useful insights with respect to certain aspects of the Act, the proposals create several concerns which we believe should be addressed and resolved before final regulations are issued. Our comments are set forth below.

^{1/} The views expressed herein represent only those of the Taxation Section of the District of Columbia Bar and not those of the D.C. Bar or of its Board of Governors.

I. THE PROPOSED REGULATIONS GENERALLY INHIBIT ACCOMPLISHMENT OF THE LEGISLATIVE PURPOSE OF THE ACT.

Prior to the 1976 Act, an organization described in § 501(c)(3) of the Internal Revenue Code (hereinafter cited only by section number) was subject to loss of its tax exemption unless "no substantial part" of its activities consisted of lobbying. The 1976 Act provides an election in § 501(h) for eligible public charities, which is intended to free electing organizations from the application of the "no substantial part" test. To give effect to this intention, the Act establishes safeharbor guidelines which, if observed by an electing organization, will protect it from loss of exemption notwithstanding its lobbying activities.

Under the Act, a § 501(c)(3) organization that has made the § 501(h) election may spend on lobbying, up to a limited percentage of its exempt-purpose expenditures, not exceeding 1 million dollars annually. Separate limits are established for all lobbying expenditures (the "lobbying non-taxable amount") and for grass roots lobbying expenditures (the "grass roots non-taxable amount"). Lobbying expenditures exceeding the greater of these amounts are subject to a 25% excise tax. A separate ceiling amount is established with respect to lobbying expenditures and with respect to grass roots lobbying expenditures, and only if an electing organization's lobbying expenditures, or grass roots lobbying expenditures normally exceed the applicable ceiling amount, will the organization lose its § 501(c)(3) exemption.

Notwithstanding the avowed legislative intention to establish explicit standards regarding the quantum of permissible lobbying activities in which eligible electing public charities may engage, the breadth of concepts developed in the proposed regulations, described in more detail below, would unjustifiably limit the statutory guideline rules, thus interfering with an electing organization's right to conduct safeharbor lobbying activities without penalty.

II. THE APPLICABILITY OF THE PROPOSED REGULATIONS IS NOT ADEQUATELY DESCRIBED.

As already explained, §§ 501(h) and 4911 are designed solely to provide specific lobbying guidelines for organizations which have made the election under those provisions. Section 501(h)(7) itself, and its legislative history,^{2/} make it clear that these rules do not apply to (1) nonelecting public charities, (2) § 501(c)(3) organizations ineligible to elect, or (3) private foundations. Specific provisions should be added to proposed Reg.

^{2/} See, e.g., General Explanation of the Tax Reform Act of 1976, p. 415 (1976-3 C.B. (Vol. 2) 427).

§ 1.501(h)-1(a), reiterating the language in the statute and, thereby, emphasizing that these regulations have no application to such nonelecting organizations and will be given no interpretational weight in applying the § 501(c)(3) lobbying rules.

III. MORE PRECISE DEFINITIONAL STANDARDS ARE NEEDED IN THE PROPOSED REGULATIONS TO AVOID INCONSISTENCY WITH THE UNDERLYING STATUTE.

Sections 4911(c) and (d) speak of lobbying expenditures and grass roots lobbying expenditures as "expenditures for the purpose of influencing legislation". As to lobbying expenditures, "influencing legislation" includes an attempt to affect the opinions of the general public or a segment thereof and communications with a member or employee of a legislative body or with any government official or employee who may participate in formulation of the legislation.

A. Proposed Reg. § 56.4911-2(b)(2).

The rule in proposed Reg. § 56.4911-2(b)(2), regarding direct lobbying, is far broader, however, than the statutory framework. Under proposed Reg. § 56.4911-2(b)(2), an attempt to influence legislation through direct lobbying includes a communication which (i) pertains to legislation being considered by a legislative body, or seeks or opposes legislation; (ii) reflects a view with respect to the desirability of the legislation; and (iii) is with a member or employee of a legislative body or with a government official or employee.

The vague and open-ended scope of the direct lobbying concept, particularly with regard to the "pertains to" language and the reference to seeking legislation, lacks support in the statute and the legislative history. Many activities of public charities that are fundamentally non-legislative in character may be unjustifiably swept within this concept on the ground that the activities in question "pertain to" legislation, however remotely.

This language should be contrasted with the concept of lobbying in the private foundation context which is narrower in scope. The "pertains to" and "seeking of legislation" standards are particularly disturbing since, in light of indications of Congressional intent that there should be one overall definition of the term, "lobbying", there is danger that these vague and indefinite standards may be applied in other areas, such as to private foundations, in order to determine whether their activities constitute lobbying.

With respect to the "reflecting a view" concept, proposed Reg. § 56.4911-2(b)(2)(ii) provides that a communication

pertaining to legislation but expressing no explicit view on the legislation, nevertheless, would be deemed to reflect a view on the legislation if the communication is selectively disseminated to persons reasonably expected to share a common view of the legislation. There is no apparent statutory basis for this rule. This restriction would, in effect, arbitrarily handicap certain organizations that focus their program activities (such as position papers, seminars, and conferences) principally on the interests of their constituencies. The proposed regulations suggest that such an organization may avoid the application of this rule simply by disseminating communications to persons known, or reasonably believed, not to share the organization's views. Any such rule would indefensibly discriminate between well-financed organizations which can afford to reach out to those with opposing views, as well as their own constituents, and organizations with meager resources which are unable to mount such an effort.

B. Proposed Reg. § 56.4911-2(c)(1)(iii).

Proposed Reg. § 56.4911-2(c)(1)(iii) deserves further consideration so as to narrow its scope to comport with the underlying statute. Proposed Reg. § 56.4911-2(c)(1)(iii) states that a grass roots lobbying communication is one that is communicated in a form and distributed in a manner so as to reach individuals as members of the general public - that is, as voters or constituents. This definition means that a communication could be deemed to meet this test even if it reached the public only indirectly, (a standard without statutory basis) such as in a news release submitted to the media or via an interview initiated by the media.

C. Proposed Reg. § 56.4911-2(b)(1).

Proposed Reg. § 56.4911-2(b)(1) establishes a standard difficult to administer. That section defines direct lobbying expenditures as "amounts paid or incurred for, or "in connection with" lobbying. The term, "in connection with", is not a term used in the 1976 Act or a term of art established elsewhere. The proposed regulations provide no insights regarding the parameters of the quoted language. Nor are safeguards provided to prevent this open-ended concept from being transplanted, without statutory basis, to other areas such as to private foundations.

IV. DISPARITY IN TREATMENT OF FUND-RAISING EXPENDITURES SHOULD BE ELIMINATED.

The proposed regulations in § 56.4911-4(c) make clear that amounts paid to or incurred for a separate fund raising unit of an exempt organization, or to a nonemployee or a nonaffiliated organization for fund raising, are not exempt purpose or lobbying expenditures under §§ 501(h) and 4911. By contrast, under

§ 56.4911-2(d) of the proposed regulations, if regular employees of an organization make expenditures which have mixed lobbying and fund raising purposes, part or all of such expenditures are treated as lobbying expenses, even if the primary purpose is fund raising. Similarly, for purposes of determining whether a separate fund raising unit exists, proposed Reg. § 56.4911-4(f)(2) requires at least two persons who devote a substantial part of their time to fund raising. We believe that this provision needlessly discriminates against small organizations, and we suggest broadening the definition of a "separate fund raising unit" to include any employee who devotes 90 percent of his or her time to fund raising.

V. CERTAIN RULES REGARDING AFFILIATED ORGANIZATIONS ARE AN UNWARRANTED EXTENSION OF THE UNDERLYING STATUTE.

Special rules in the proposed regulations apply to an affiliated group of organizations, at least one of which has made the § 501(h) election. In such a situation, the affiliated group is treated as one organization.

Affiliation results if one organization has the ability to control the others as to legislative issues by reason of provisions in the governing instruments which expressly or by implication limit the independent action of the controlled organization on a legislative issue by requiring it to take into account the position of the controlling organization on that issue. This concept of affiliation by implication goes beyond the statute and should be re-examined to prevent inappropriate aggregation for § 4911 purposes of lobbying activities of organizations which are not "affiliated" within the specific language of § 4911(f)(2). Organizations are also members of an affiliated group if one organization is able to control action on legislative issues by the others by reason of interlocking directorates or by aggregating their votes.

These control rules take on greater significance in the light of another affiliation provision in the proposed regulations, namely proposed Reg. § 56.4911-7(a)(2). As provided in that section, two non-§ 501(c)(3) organizations may be affiliated if at least one § 501(c)(3) organization is affiliated with both non-§ 501(c)(3) organizations. Thus, under the proposed regulations, if any control test is met, lobbying activities, even of non-§ 501(c)(3) organizations, may become subject to § 4911 tax by attribution under the affiliated organizations rules to an electing § 501(c)(3) organization. This result should be reexamined because there is no basis for it in the statute.

VI. THE § 501(h) ELECTION PROCEDURE UNDER THE PROPOSED REGULATIONS CONFLICTS WITH THE FORM 1023 APPLICATION AND ADVANCE RULING PROCEDURE.

Proposed Reg. § 1.501(h)-2(c) provides that a newly created § 501(c)(3) organization may make the § 501(h) election before it is determined to be an eligible organization. In order to do so, it may submit Form 5768 (making the § 501(h) election) at the time it submits its Application (Form 1023) for recognition of exempt status under § 501(c)(3). To maintain § 501(h) treatment the organization must be a public charity eligible to make the election.

A newly created organization applying to the Internal Revenue Service for tax-exemption under § 501(c)(3) may also apply for an advance ruling under either § 509(a)(1) or (2) that it will be treated as a public charity during its advance ruling period. If, at the expiration of the advance ruling period the organization is deemed to be a private foundation, its characterization as such will be retroactive to the date of its organization, but only for purposes of § 507(d) (private foundation termination tax) and § 4940 (private foundation excise tax on net investment income). See Reg. §§ 1.170-A-9(e)(5)(iii)(b) and 1.509(a)-3(e)(2). In other words, if a newly created § 501(c)(3) organization receives an advance ruling of public charity status but is later determined to be a private foundation, the existing regulations provide that the organization will be deemed a public charity for all purposes other than §§ 507(d) and 4940. The organization, therefore, will not be subject to § 4945 excise tax with respect to taxable expenditures including lobbying expenditures (or the excise taxes imposed by §§ 4941-4944) during the advance ruling period plus 90 days thereafter, even if in fact it is later determined to be a private foundation and has attempted to influence legislation.

The proposed regulations, however, are to the contrary. Under Proposed Reg. § 1.501(h)-2(c), if a new organization is determined to be a private foundation (and hence ineligible to make the § 501(h) election), § 4945(d)(1) will apply and the organization will automatically be subject to excise taxes under § 4945 during the advance ruling period on amounts expended in attempts to influence legislation.

It is altogether evident that these procedural rules of the proposed regulations merit restructuring in order to make it clear that, in conformity with established principles, a newly created § 501(c)(3) organization which does not qualify for public charity status and is determined to be a private foundation after the expiration of its advance ruling period will be subject during that period only to § 507 and § 4940 tax and not to either the § 4945 tax or the "no substantial part" test.

VII. CONCLUSION.

On behalf of Section 16, Taxation, of the District of Columbia Bar, we respectfully urge that the proposed regulations be reconsidered in the light of the above comments. We are willing to work further with the Service in developing revisions to the proposed regulations.

Very truly yours,

Steering Committee
Section of Taxation (16)
District of Columbia Bar

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cc: J. Roger Mentz, Esq.
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