

## The Legal Aspects of Philanthropic & Nonprofit Advocacy in the Trump Era

### Advocacy

Organizational leaders should consider whether advocacy would be a highly effective and efficient strategy in advancing their organization's mission. And if they decide it would, they may have a duty to lead the organization in engaging in advocacy activities. A change in policy, behavior, or law catalyzed by an advocacy effort may represent the difference between putting a bandage on the problem and solving the problem.

Advocacy may take on many forms. Lobbying is one such form and is subject to certain restrictions and limitations. Political campaign intervention is another form of advocacy and 501(c)(3) organizations are absolutely prohibited from engaging in such activities. But many other advocacy-related activities can be carried on without limitation in a nonpartisan manner so long as they advance the organization's mission. For example:

- Researching and analyzing policy issues
- Educating the public on issues
- Encouraging voting and registering voters
- Changing corporate behavior (e.g., through organizing boycotts)
- Engaging in impact litigation
- Communicating with an administrative agency advocating a view on an existing or proposed regulation or ruling
- Communicating with legislators advocating a view on nonlegislative matters (e.g., conducting an investigative hearing, intervening with a government agency)
- Praising/criticizing incumbent legislators or executive branch officials on their votes and actions.

### Lobbying and Public Charities

IRC §501(c)(3) provides that no substantial part of the activities of an otherwise qualified organization may be the carrying on of propaganda or otherwise attempting to influence legislation (i.e., lobbying). While violation of this prohibition may result in, among other consequences, loss of the organization's tax-exempt status, it is important not to rule out engaging in any or all advocacy activities. Instead, it is better to understand what is (and what is not) *lobbying* and what amount of lobbying is considered *substantial*. These terms may have different meanings depending on the charity's decision on the standard by which it chooses to measure its compliance:

**Substantial Part Test.** Under this test, little guidance is offered with respect to what activities are considered lobbying and how much lobbying is substantial. In one early case, devotion of less than 5% of an organization's time and effort was found to be insubstantial. However, the test appears to have evolved with later cases and it generally is thought to consider all the facts and circumstances of an organization's lobbying activities (including cash expenditures, volunteer efforts and donated resources). Accordingly, charities must document all of their lobbying activities and expenses. If a charity engages in substantial lobbying in any one year, it may have its tax-exempt status revoked. In addition to revocation, violation of the substantial part test may result in the imposition of (i) a 5% tax on the organization on all lobbying expenditures, and (ii) a 5% tax on organizational managers (e.g., directors and officers) who permitted such expenditures knowing that it would jeopardize the organization's tax-exempt status.

**501(h) Expenditure Test.** Under this test, which is available to most public charities (churches being a significant exception) that make the §501(h) election (*electing charities*) by filing Form 5768 (<http://www.irs.gov/pub/irs-pdf/f5768.pdf>), an otherwise qualified public charity will not be denied exempt status as a §501(c)(3) organization because of substantial lobbying so long as its total lobbying expenditures and grass roots expenditures do not normally exceed certain defined limits. Accordingly, an electing charity is not subject to limits on lobbying activities that do not require expenditures (e.g., unreimbursed lobbying by volunteers).

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Expenditure Limits Under §501(h):

Total Lobbying Expenditures (direct and grassroots):

- 20% of the first \$500,000 of Exempt Purpose Expenditures (defined on the next page), plus
- 15% of the next \$500,000 of Exempt Purpose Expenditures, plus
- 10% of the next \$500,000 Exempt Purpose Expenditures, plus
- 5% of the remaining Exempt Purpose Expenditures up to a total cap of \$1 million.

Grass Roots Expenditures:

- 25% of the Total Lobbying Expenditures Limits.

If an electing charity exceeds either the total lobbying or grass roots expenditures limit in any one year, it must pay an excess lobbying expenditures tax equal to 25% of the excess. If an electing charity exceeds both limits in any one year, it must pay 25% of whichever excess is greater. An electing charity will be subject to revocation of its tax-exempt status if, over a four-year period, either its total lobbying or grassroots expenditures exceed the appropriate aggregated annual limit over the period by more than 50%.

For purposes of §501(h), the following definitions apply:

(1) A Direct Lobbying Communication is any attempt to influence legislation through communication with (A) any member or employee of a legislative body or (B) any other government official or employee who may participate in the formulation of legislation, but only if its principal purpose is to influence legislation, and it reflects a view on *specific legislation* (proposed or pending law or bill).

(2) A Grassroots Lobbying Communication is any attempt to influence legislation through an attempt to affect the opinion of the general public (or any segment), but only if it reflects a view on specific legislation and encourages the recipient to *take action* (contact legislators) with respect to such legislation.

(3) Legislation includes action by a legislative body (e.g., Congress, county board of supervisors) or by the public in a referendum, ballot initiative, constitutional amendment or similar procedure.

(4) Exempt Purpose Expenditures include all amounts a charity expends to accomplish its exempt purpose (e.g., program expenses, administrative overhead expenses, lobbying expenses, and straight-line depreciation of assets used for an exempt purpose). They do not include fundraising expenses of a charity's *separate fundraising unit* or an outside fundraiser, capital expenditures, unrelated business income expenses, or investment management expenses.

For purposes of §501(h), the following activities are not considered lobbying:

(1) Nonpartisan analysis, study or research, which may advocate a particular position or viewpoint so long as: (a) there is a sufficiently full and fair exposition of the pertinent facts (and not just unsupported opinions) to enable the public or an individual to form an independent opinion or conclusion; (b) the distribution of the results is not limited to, or directed toward, persons who are interested solely in one side of a particular issue; and (c) subsequent use does not cause it to be treated as a grass roots lobbying communication (e.g., direct encouragement for recipients to take action within 6 months).

(2) Examinations and discussions of broad social, economic, and similar problems; provided, that: (a) they do not address themselves to the merits of a specific legislative proposal, and (b) they do not directly encourage recipients to take action with respect to legislation.

(3) Technical advice or assistance provided to a governmental body or committee in response to a written request from such body or committee.

(4) Communications pertaining to "self-defense" by the organization, to a legislative body or its representatives, and with respect to a possible action by such legislative body that might affect the existence of the organization (or an affiliate), its powers and duties, its tax-exempt status, or the deductibility of contributions to the organization. Under this exception, a charity may similarly make expenditure in order to initiate legislation if such legislation concerns the matters listed above.

**Special Rules:**

Referendum, Ballot Initiative or Similar Procedure. In such procedures, the general public in the state or locality where the vote will take place constitutes the legislative body. Accordingly, a communication to one or more members of the general public in that state or locality referring to and reflecting a view on a measure that is the subject of such procedure is direct lobbying.

Communication with Members with Respect to Specific Legislation. Not lobbying if it does not encourage members to take action. Direct lobbying if it encourages members to engage in direct lobbying. Grassroots lobbying if it encourages members to engage in grassroots lobbying.

Paid Mass Media Advertisement about Highly Publicized Legislation. Presumed to be grass roots lobbying if it: (i) is made within 2 weeks before a vote by a legislative body/committee; (ii) reflects a view on the general subject of the legislation; and (iii) either refers to the legislation or encourages the public to communicate with legislators on the general subject of the legislation. Rebuttable by demonstrating that the timing of the advertisement was unrelated to the upcoming legislative action.

### **Lobbying, Advocacy, and Private Foundations**

Private foundations that spend money on lobbying activities must pay a penalty tax on those expenditures. Foundation managers may also be charged with a penalty tax for knowingly approving such expenditures. Consequently, private foundations consider these penalties to reflect a general prohibition against lobbying. As is the case with public charities, private foundations are absolutely prohibited from engaging in political campaign intervention.

**Exceptions to lobbying** (similar to those described above for 501(h)-electing charities):

- (1) Nonpartisan analysis, study or research.
- (2) Examinations and discussions of broad social, economic, and similar problems.
- (3) Technical advice or assistance.
- (4) Communications pertaining to “self-defense” by the private foundation.

#### **Grantmaking:**

- Private foundations may not make grants earmarked for lobbying.
- Private foundations may not make grants for activities that are undertaken in preparation for lobbying.
- Private foundations may make *general support grants* to a public charity, even if the charity uses the grant funds for lobbying. TIP: In their grant agreements, private foundations need not prohibit the use of grant funds for lobbying.
- Private foundations may make *specific project grants* (i) that are not earmarked for lobbying and (ii) that are generally not in excess of the grantee’s budget (helpful if it’s signed by an officer of grantee) for nonlobbying expenditures, even if the specific project involves lobbying and the charity uses the grant funds for lobbying.
- Private foundations may make grants to support communications that provide objective facts about pending legislation and its likely impacts so long as the communications do not reflect a view on the legislation itself.
- Private foundation may make grants for capacity building, leadership development, collaboration explorations, coalition building, and study and research of key policy areas so long as such activities are not undertaken in preparation for lobbying, even if the grantee’s capacity to engage in lobbying is substantially heightened.
- Private foundations may make grants to organizations that are not exempt under 501(c)(3), including to 501(c)(4) social welfare organizations, so long as the grants are for exclusively 501(c)(3) exempt purposes and not for lobbying or voter registration. For such grants, the private foundations must exercise *expenditure responsibility*.

**Expenditure responsibility** means that the foundation exerts all reasonable efforts and establishes adequate procedures:

1. To see that the grant is spent only for the purpose for which it is made,
2. To obtain full and complete reports from the grantee organization on how the funds are spent, and
3. To make full and detailed reports on the expenditures to the IRS.

If expenditure responsibility must be exercised, the foundation should conduct a limited inquiry concerning the potential grantee before the grant is made (pre-grant inquiry). The inquiry should deal with matters such as the identity, past history and experience, management, activities, and practices of the grantee organization, and should be complete enough to give reasonable assurance that the grantee will use the

grant for the purposes for which it is made. The scope of the inquiry might be expected to vary from case to case depending on the size and purpose of the grant, the period over which it is to be paid, and the prior experience which the grantor has had with respect to the grantee.

Each grant must also be made subject to a written commitment signed by an appropriate officer, director or trustee of the grantee organization. This commitment must include the following agreements by the grantee:

1. To repay any amount not used for the purposes of the grant,
2. To submit full and complete annual reports to the grantor foundation on the manner in which the funds are spent and the progress made in accomplishing the purposes of the grant,
3. To keep records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and
4. Not to use any of the funds to influence legislation, to influence the outcome of elections, to carry on voter registration drives, to make grants to individuals or other organizations or to undertake any nonexempt activity, when such use of the funds would be a taxable expenditure if made directly by the foundation.

**Program-Related Investments.** Generally, a program-related investment (PRI) is an investment in which (1) the primary purpose is to accomplish one or more charitable purposes; (2) the production of income or the appreciation of property is not a significant purpose; and (3) lobbying or electioneering is not a purpose. While PRIs are not used widely by the vast majority of private foundations, PRIs can be an effective alternative or complementary strategy to grantmaking in advancing the foundation's charitable purpose and meeting its minimum distribution requirements. A PRI might take the form of a loan to a charity or a loan to, or equity investment in, a business entity for a charitable purpose, such as, to develop or distribute a lifesaving drug that would not otherwise be commercially viable.

**Mission-Related Investments.** While a mission-related investment (MRI) is not currently defined by the Internal Revenue Code or Treasury Regulations, it is generally considered to be an investment for both a financial return and a social impact return (more specifically, one that advances the particular mission of the investor). In some cases, there may be no need to balance those potentially competing concerns. But in many cases, the investor will need to balance at least short-term financial return with the social impact return. Some simple examples of MRIs include a purchase of equity in a company creating jobs in economically disadvantaged communities, a loan to an organization distributing essential resources in developing countries, and an investment in an alternative energy company.

In Notice 2015-62, the IRS "confirms that under section 4944 of the Internal Revenue Code, private foundation managers may consider the relationship between a particular investment and the foundation's charitable purpose when exercising ordinary business care and prudence in deciding whether to make the investment." In other words, it's not a lack of reasonable business care and prudence (and therefore not a *jeopardizing investment*) merely because the private foundation managers consider the social impact return related to the foundation's mission as well as the financial return the investment may produce in selecting an investment. Prior to this guidance, it was uncertain whether private foundation manager could select an investment whose primary purpose was to accomplish one or more charitable purposes where the production of income or the appreciation of property was also a significant purpose, making the investment fall outside of the definition of a PRI. The Notice specifically states: "Foundation managers are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business care and prudence under the facts and circumstances prevailing at the time of the investment in making investment decisions that support, and do not jeopardize, the furtherance of the private foundation's charitable purposes."

Notably, this conforms the standard under federal tax laws with the state prudent investment laws under the Uniform Prudent Management of Institutional Funds Act (UPMIFA), "which generally provide for the consideration of the charitable purposes of an organization or certain factors, including an asset's special relationship or special value, if any, to the charitable purposes of the organization, in properly managing and investing the organization's investment assets."

## Political Campaign Intervention

IRC §501(c)(3) describes an organization exempt under that Section as one that “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.” The general idea is that an organization is not operated exclusively for one or more exempt purposes within the meaning of Section 501(c)(3) if it engages in activities intended to impact the outcome of an election.

In simple terms, a 501(c)(3) organization may not directly or indirectly engage in or sponsor any activity that supports or opposes any candidate for public office. A “candidate” for purposes of this prohibition includes “an individual who offers himself or herself, or is proposed by others, as a contestant for an elective public office...”. The prohibition applies not only to declared candidates, but also to third-party movements and efforts to encourage or discourage someone from running for office. “Public office” for these purposes refers to any position that is filled by a vote of the people. This includes elected offices at the local, state, and federal level, as well as party nominations, and is not limited only to partisan positions. However, it does not extend to appointed public official positions, such as some judges and executive nominees (although note that activities related to such appointments may constitute lobbying if the appointments are subject to legislative confirmation).

The prohibition on election intervention includes publishing or distributing written statements or making oral statements on behalf of or in opposition to a candidate, including on social media. It also includes using any of the organization’s resources to support or oppose a candidate, such as by making a contribution to a campaign, preparing a research report for the use of only one campaign or certain campaigns, or sharing the organization’s mailing list with a specific campaign for free. However, it generally also includes less obvious activities, such as coordinating activities with a campaign, distributing campaign materials at an organizational event, or using code words in a communication to refer to a candidate other than by name.

In determining whether a particular action constitutes impermissible electioneering, the IRS will look at all of the relevant facts and circumstances. The IRS has indicated that the following factors may be considered in determining whether a particular communication constitutes prohibited electioneering:

- Whether it identifies a candidate for public office or a candidate’s position on an issue that is the subject of the communication
- Whether it expresses approval or disapproval for a candidate’s position or actions
- The timing of the message and its proximity to an election
- Whether it makes reference to an election or voting
- The targeted audience, including whether it targets voters in an election
- How the message relates to candidates’ and political parties’ communications, and whether it discusses an issue that has been raised as distinguishing candidates for a given office
- Whether it is part of an ongoing series of communications by the organization on the same issue that are made independent of the timing of any election
- Whether the timing of the communication and identification of a candidate are related to a specified event other than an election (such as a scheduled vote on legislation)

If a 501(c)(3) organization engages in any amount of prohibited electioneering, it runs the risk of having its tax-exempt status revoked by the IRS, either permanently or for a specified period during which the activities occurred. The IRS also has the authority, under §4955, to impose a tax of 10 percent of the expenditure associated with the electioneering activities on the organization and a tax of 2.5 percent on organizational managers who knowingly and willfully approved a prohibited expenditure, up to a total of \$5,000. If the IRS does impose either tax and the expenditure is not corrected within the appropriate period, an additional tax of 100 percent of the prohibited expenditure may be imposed on the organization and an additional tax of 50 percent may be imposed on the individual managers, up to a total of \$10,000. The IRS will not, for the same transaction, impose a tax under both §4955 and either §4945 (taxable expenditure) or §4958 (excess benefit transaction).

Not all election-related activities are completely prohibited for 501(c)(3) organizations. On the Nonprofit Law Blog, we have discussed the following topics: **Employee Endorsements & Election Activities**, **Candidate Appearances & Debates**, and **Voter Guides & Candidate Questionnaires**.