



713 - Tax Issues Confronting Nonprofits

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Faculty Biographies

Anita Drummond

Anita Drummond serves as senior attorney for corporate services at The Nature Conservancy, a 501(c)(3) public charity, located in Arlington, Virginia.

Prior to being counsel at the Conservancy, Ms. Drummond worked as director of legal affairs at Associated Builders and Contractors, a 501(c)(6) trade association, that had an affiliated charity, an insurance trust, a for-profit subsidiary, and more than 80 affiliated chapter organizations that were trade associations and educational nonprofits. She also served in private general practice for several years before going in-house. Ms. Drummond has also worked in the federal government and the private sector before becoming an attorney.

Cynthia Lewin

Cynthia Lewin is senior vice president and general counsel of the National Wildlife Federation, one of America's oldest and largest conservation organizations in Reston, Virginia. She is the chief legal officer of the organization and also has responsibility for the human resources, information technology, and administration functions.

Prior to joining the National Wildlife Federation, Ms. Lewin served as executive vice president and general counsel of Volunteers of America, Inc. Before that, she was in private practice focusing on nonprofit organizations. Ms. Lewin has broad-based experience in nonprofit tax and corporate matters, unrelated business income, charitable giving, personnel and employee benefits, contracts, and liability issues.

Ms. Lewin is the chair of ACC's Nonprofit Organizations Committee. She is past chair of the exempt organizations committee of the DC Bar tax section and has served on the DC Bar tax policy task force.

Ms. Lewin is a graduate of Yale Law School and Wellesley College.

Timothy Phillips

Timothy Phillips is associate corporate counsel with the national home office of the American Cancer Society, Inc. in Atlanta. He specializes in the areas of taxation, planned giving, nonprofit governance, risk management, compliance, employee benefits and executive compensation, grant reviews, vendor contracts, and collaborative efforts with foreign cancer fighting entities.

Prior to joining the American Cancer Society, Mr. Phillips was in private practice in the Atlanta office of Troutman Sanders LLP, where he was a member of the tax and trust and estates practice groups. In this capacity he served as counsel to multiple charitable, educational and religious organizations, trade associations, business leagues, and social welfare organizations in connection with their applications for recognition of exempt status

and joint ventures with for-profit entities. Mr. Phillips also served as counsel to high net worth individuals, private foundations and corporate fiduciaries in the areas of planning, probate, and wealth management.

Mr. Phillips is the immediate past president of the Atlanta Volunteer Lawyers Foundation. He also serves on the board of the Piedmont Park Conservancy, the Naval Academy Alumni Association, Atlanta chapter, the Atlanta Bar Association's section of taxation, and the Navy SEAL warrior fund.

Mr. Phillips received his B.S. from the U.S. Naval Academy after which he served as a commissioned officer in the U.S. Navy SEAL teams. He earned his J.D. from the University of Virginia.

Richard Thomas

Richard Thomas is associate general counsel of Volunteers of America in Alexandria, Virginia.

Mr. Thomas previously practiced law at Lichtman, Trister & Ross, PLLC where his practice focused exclusively on tax exempt organizations. He represented over 50 nonprofit clients, including the Chesapeake Bay Foundation, Sierra Club, and Human Rights Campaign, with an emphasis on tax, corporate, and election law matters.

Mr. Thomas is a member of the exempt organizations subcommittee of the tax section of the ABA and the author of "Playing the Percentages on Revenue Sharing – Private Inurement, Private Benefit and Intermediate Sanctions" Taxation of Exempts (2004) and "Amendments to Section 527 Bring Welcome Relief to Many Political Organizations," Taxation of Exempts (2003).

Mr. Thomas earned his B.A. from Haverford College and his J.D. from Northeastern University School of Law.



Basic terminology

- Nonprofit vs. tax-exempt status
- 501(c) status
 - 501(c)(3) charities
 - 501(c)(4) social welfare organizations
 - 501(c)(5) labor unions
 - 501(c)(6) trade and professional associations
 - All the way up to 501(c)(28)

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Private foundations vs. “public charities”

- Public charities are broadly publicly supported or are “supporting organizations” of other public charities
- Private foundations pay excise tax on net investment income, more difficult for other private foundations to contribute to them, historically more regulated

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Unrelated Business Income Tax

Anita Drummond
The Nature Conservancy



UBIT Paid for Certain Activities

-
- Trade or Business
- Regularly Carried On
- Not Substantially Related For Exempt Purpose



Exclusions from UBIT

- Royalties*
- Trade Show and Exhibits*
- Sponsorship Payments*
- Rent*
- Interest, Dividends and Annuities
- Contributed labor

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Royalties

- Strictly a license of trademark, name, photographs, copyrights
- Endorsements
- Mailing Lists
- Letters sent by vendor with facsimile signature of officer
- Affinity credit cards

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Royalties Asterisk *

- No Services Provided Under Royalty Contract
- No Marketing Provided Under Royalty Contract
- Solutions – Strong Separate Contracts

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Trade Shows and Exhibits

- Face-to-Face Trade Shows and Exhibits Exempt
- Virtual Trade Shows (Sometimes)

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Sponsorship Payments

- Acknowledgement with Sponsor's trademark
- No consideration
- No free advertisements or implied value

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Rent Asterisk *

- Personal property can be subject to it if more than 10% of total rent
- Debt-financed may be subject to UBIT

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Examples of Application of UBIT

- Convenient for members or patrons, such as hospital gift shops, museum cafeterias
- Museum space managed by third-party subject to UBIT
- Bingo (if its legal in the jurisdiction)
- Travel tours “substantially related” must be documented and demonstrated
- Associate members can’t be sham

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Filing on UBIT

- IRS Form 990-T
- Expenses/deductions that are directly connected
- File if Revenue over \$1,000
- 501(c)(3) Must Make Form Public

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Unrelated Business Income Tax

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Activities Subject to Unrelated Business Income Tax

Nonprofits are subject to UBIT when they engage in:

- trade or business;
- regularly carried on; and
- not substantially related to the organization's exempt purpose.

The tax return for UBIT activities is IRS Form 990-T.

Exclusions for UBIT

Some income is expressly excluded from UBIT, including:

- Royalties
- Trade Show and Exhibits
- Sponsorship Payments
- Rent
- Interest, Dividends and Annuities
- Contributed labor

See the 2006 Instructions for Form 990-T (page 3) for a more complete list.

Royalties

A royalty can be based on licensing the intangible property of the organization.

Examples of the licensed items:

- Trademarks
- Service marks
- Name of the organization
- Photographs
- Copyrights
- Signature Facsimile
- Endorsements

Examples of application:

- Endorsements
- Letters sent by vendor with facsimile signature of officer (as long as vendor pays for mailing)
- Affinity credit cards

Royalty contracts should:

- Be called "Royalty Agreement";
- Express that the two parties are solely independent and no agency exists;
- State consideration is solely for royalty of licensing the organization's intangible property;
- Provide for monitoring use, including approval of marketing material;
- Provide for royalties on gross income (not profits);
- State that the product or service is solely that of the vendor;
- Require solicitations to be clear about the source and follow solicitation laws, including those for faxes and emails; and
- Express that it is not a joint venture or partnering agreement.

Other tips on royalty arrangements:

- Create a separate agreement for any marketing, advertisements, or administration of sales of vendor's products and assure services are provided only at fair market value (no tradeshow discounts, free advertising, etc.);
- Assure to avoid inadvertent "promotions" and assure mention of it is made in member communications are part of list of benefits with minimal descriptions;
- Avoid special privileges or promotion in speeches or other organization events;
- Do not link to direct sales point on vendor's website; and
- Train staff and leadership about the importance to understand the agreement and accurately reflect it in official documents, such as board minutes or media announcements.

Trade Shows and Exhibits

While trade shows are exempt from UBIT under Section 512(d), the safe harbor is limited to face-to-face events. Under Revenue Ruling 2004-112, IRS provides a description of the use of virtual trade shows online where UBIT would not be applied. Specifically, a virtual trade show that is ancillary to a "live" show that augments the show is not subject to UBIT if it is available during essentially the same limited time period that the live trade show occurs. The IRS use an example where the virtual show precedes and follows the live show by only three days.

Sponsorship Payments

"Qualified sponsorship payments" are defined as any payment made by a person engaged in a trade or business that will receive no substantial return benefits other than the use or acknowledgement of the name or logo of the sponsor.

Advertising in a nonprofit organization's periodicals does not generally qualify as allowable "acknowledgement" but exhibits at an event are acceptable. (TAM 98-05-001)

Rent

Rent is exempt for UBIT except where personal property or debt-encumbered property is involved. There may be UBIT due depending on the circumstances.

Public Disclosure

Under section 6104(d), a section 501(c)(3) organization that has gross income from an unrelated business or trade of \$1,000 or more must make its annual tax return, including the Form 990-T, available for public inspection.

Anita Drummond
The Nature Conservancy



Advocacy Rules for Tax-Exempt Organizations

Richard L. Thomas
Volunteers of America



Roadmap

- Type of Tax-Exempt Organization
- IRS Lobbying Rules
- IRS Campaign Intervention Rules
- Reporting & Recordkeeping
- Other Advocacy Issues & Resources

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501(c)(3)

vs.

501(c)(4),(5) or (6)

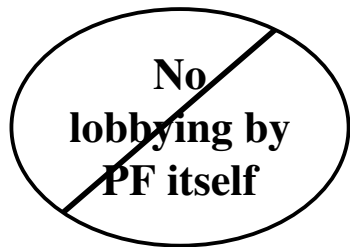
- | | |
|------------------------------------|---|
| • Exempt from federal income tax | • Exempt from federal income tax |
| • Contributions are tax-deductible | • Contributions NOT tax-deductible |
| • Insubstantial Lobbying | • Unlimited Lobbying |
| • NO campaign intervention | • Less-than-primary campaign intervention permitted |

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Lobby Limits for Two Types of 501(c)(3)s Private Foundation vs. Public Charity



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501(c)(3)s May Lobby – Just Not “Substantially”

Standard: No substantial part of a public charity’s activities can be “carrying on propaganda, or otherwise attempting, to influence legislation.”

Two tests to measure “substantial”

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Facts & Circumstances Insubstantial Test

Factors to be considered:

- Percentage of budget spent on lobbying
- Volunteer time devoted to lobbying
- Publicity organization assigns to the activity
- Continuous attention to the issue
- Supporting activity

Penalty for failure: Potential loss of tax exemption and/or excise tax on organization and managers

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Expenditure Test - 501(h) Election

- 1) Exempt purpose expenditures (\$ spent to achieve charitable purpose)
- 2) Overall lobbying expenditure limit is:
 - 20% of first \$500,000 exempt purpose expenditures
 - + 15% of next \$500,000
 - + 10% of next \$500,000
 - + 5% of the remaining amount
- 3) Grassroots lobbying limit is 25% of overall lobbying limit

Example: \$100,000 spending on exempt purpose =

Total Lobbying Limit: \$20,000

Grassroots Limit: \$5,000

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What Is Lobbying?

- Attempts to influence legislation by Congress, state legislature, or a local governing body (i.e. city council)
- Includes direct contact with legislators and their staff, as well as efforts to urge the public to contact their legislators (indirect or grassroots lobbying)
- Includes advocating passage of a ballot measure or initiative (the public = legislators)

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Direct and Grassroots Lobbying

(Distinction critical for 501(h) electors)

- (1) Reference to specific legislation
- (2) With a view on the legislation

+ (3) Addressed to a legislator or employee of legislative body = Direct Lobbying

OR

+ (3) Call to Action (encouraging public to contact legislators) = Grassroots lobbying

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Lobbying does NOT include:

Seeking to influence actions by executive, judicial or administrative bodies, such as school boards, zoning boards, and planning commissions.

EXAMPLE: Lobbying EPA for stricter curbs on mercury pollution from power plants



Other Non-lobbying Activities

- Nonpartisan study, analysis and research
- Examination and discussion of broad, social, economic or similar problems
- Written requests from a legislative body or full committee for technical advice



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Senate - 1 800 423 6900

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Grassroots Lobbying

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**Campaign Intervention
by 501(c)(3)s**

- Absolute prohibition on a 501(c)(3) participating or intervening in any political campaign on behalf of or in opposition to any candidate for public office
- Penalty: Taxes imposed on organization and managers and possible revocation of exempt status

Nonpartisan election-related activities are permissible

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Facts & Circumstances Test

- Timing close to an election
- Timing is outside of organization's control
- Breadth of Issues
- Identifies Candidates or Political Parties
- Candidate's position compared to organization
- Track record of doing the activity
- Questions / Answers printed reflect bias
- All candidates invited or included
- Targets voters

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Impermissible Campaign Intervention by a 501(c)(3)

- Contributing to candidates or political parties
- Endorsing candidates or political parties
- Establishing a PAC (Political Action Committee)

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Election-Related Activities

Subject to Facts & Circumstances Test

- Voting Records
- Candidate Questionnaires
- Public Surveys and Polling on Issues
- Public Forums / Candidate Debates
- Training & Issue Briefings for Candidates
- Party Platform
- Voter Registration & GOTV
- Issue Communications

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Example: Voting Records

- Include all legislators
- Do not identify candidates for reelection
- Discuss a broad range of issues
- May not coincide with election
- If records are compared to public charity's position, distribution may be restricted
- Avoid targeted distribution

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What may a person affiliated with a 501(c)(3) do in an individual capacity?

- Directors, officers, employees and volunteers are generally permitted to engage in partisan political activities in their individual capacity
- May not use facilities, equipment, personnel or other resources of the organization
- Activities must be outside of work hours or using available leave time
- Must make clear that one is not acting on behalf of organization (esp. important for organization's leaders)

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IRS Reporting

- Lobbying by 501(c)(3) on Form 990, Schedule A, Part VI
- Campaign Intervention by 501(c)(4), (c)(5) or (c)(6) on Line 81(a) of Form 990 – if taxable, must file Form 1120-POL
- New requirement to disclose expenditures for government officials' expenses and entertainment

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Recordkeeping

- Allocations must be reasonable
- Track direct costs, staff time and overhead

Activity	M	T	W	Th	F	Total Hours
Research	2	3	4	2	4	15
Education	3	0	2	4	3	12
Direct Lobby	2	2	2	2	0	8
Grassroots Lobby	1	1	2	0	1	5

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Other Advocacy Issues

- Federal, state and local election laws impose restrictions on corporations including nonprofit corporations.
- Even if activity is permitted under tax law, must make sure activity is permitted under election law
- Lobbyist Registration & Disclosure
- Funders restrictions on advocacy

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ADVOCACY RULES FOR TAX-EXEMPT ORGANIZATIONS**I. Overview**

Nonprofit organizations tend to err in two directions in conducting advocacy activities. Either they jump right in without fully understanding the restrictions placed on tax-exempt organizations in conducting advocacy. Or they suffer from the misconception that their tax-exempt status prohibits them from advocacy activities and remain on the sidelines.

Understanding the basic rules in this arena may be broken down to two key issues:

- 1) The type of tax-exempt organization seeking to conduct the advocacy activity; and
- 2) The type of advocacy activity involved

In the tax-exempt context, “advocacy” has two distinct parts: activities to advance the cause(s) of the organization through legislative changes (lobbying); and participation in the elections of individuals (campaign intervention). As discussed below, there are many advocacy activities that are neither lobbying nor campaign intervention even though they involve public policy or elections.

While the focus of this presentation is on the federal tax issues in this arena, nonprofit organizations must take into account additional legal issues in conducting advocacy activities. For example, federal law and many state election laws impose restrictions on certain political activities (i.e. giving contributions to candidates) on corporations, including nonprofit corporations. In addition, federal and state laws also have registration and reporting laws regarding lobbyists and the organizations on whose behalf they lobby.

II. Type of Tax-Exempt Organization

The restrictions governing lobbying and campaign intervention depend on the type of tax-exempt organization. One basic rule of thumb to keep in mind: the more benefits received under the tax code, the more restrictions in the advocacy arena.

501(c)(3) Organization

- Exempt from federal income tax
- Contributions are tax-deductible
- Insubstantial Lobbying
- NO campaign intervention

vs.

501(c)(4), (c)(5) OR (c)(6) Organization

- Exempt from federal income tax
- Contributions NOT tax-deductible
- Unlimited Lobbying
- Less-than-primary campaign intervention permitted

Given this framework, the focus is on 501(c)(3) organizations because they have to operate under far greater restrictions in terms of lobbying and campaign intervention. These concepts still apply when analyzing their application to 501(c)(4) (social welfare organizations), 501(c)(5) (unions) and 501(c)(6) (trade associations), even if different limits are in place.¹

¹ This presentation does not focus on organizations exempt under Section 527 of the Internal Revenue Code, including political action committees, political parties and candidate committees. Such organizations may engage in unlimited campaign intervention activities and are generally subject to election law (federal or state) regimes. Some 527 organizations, however, fall outside the jurisdiction of election law and are subject to IRS registration and reporting.

**Resources**

- Independent Sector: www.independentsector.org
- Alliance for Justice: www.afj.org
- Charity Lobbying in the Public Interest: www.clpi.org
- IRS Revenue Ruling 2007-41
- “Election Year Issues,” [for 501(c)(3)s] *IRS CPE Text* (2002)
- “Lobbying Issues” [for 501(c)(3)s], *IRS CPE Text* (1997)
- “IRS Political Campaign and Lobbying Activities by 501(c)(4), (c)(5) and (c)(6) Organizations,” *IRS CPE Text* (2003)

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Please be aware that the term 501(c)(3) is used here to mean a public charity 501(c)(3) – if the 501(c)(3) in question is instead a private foundation 501(c)(3), the private foundation may not conduct lobbying activity itself or it will be subject to excise taxes on such activity.

III. Lobbying

In order to be recognized and maintain 501(c)(3) status, an organization must ensure that “no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.” Internal Revenue Code § 501(c)(3). What constitutes lobbying and how much lobbying is permitted are therefore the key questions.

A. How much is more than insubstantial?

As stated above, 501(c)(3)s are permitted under the Internal Revenue Code to lobby within limits. There are two tests by which “more than insubstantial” is measured.

1. Facts & Circumstances Insubstantial Test

The default test applied to all 501(c)(3)s unless they elect (discussed below) is a facts & circumstances test. The factors to be considered:

- (a) Percentage of budget spent on lobbying
- (b) Volunteer time devoted to lobbying
- (c) Publicity organization assigns to the activity
- (d) Continuous attention to the issue
- (e) Supporting activity

Even though the test is not based on expenditures alone, one shorthand conservative rule of thumb is to ensure that expenditures for lobbying activities are less than five percent of the organization’s overall expenditures. The penalty for failure to stay within the limits includes the potential loss of tax exemption and/or excise tax on the organization and its managers.

2. Expenditure Test - 501(h) Election

Some 501(c)(3) organization are eligible to elect under IRC section 501(h) to be subject to a more concrete expenditure-based test as follows:

- (a) Calculate the exempt purpose expenditures (funds spent to achieve charitable purpose)
- (b) Overall lobbying expenditure limit is:
 - 20% of first \$500,000 exempt purpose expenditures
 - + 15% of next \$500,000
 - + 10% of next \$500,000
 - + 5% of the remaining amount
- (c) Grassroots lobbying limit is 25% of overall lobbying limit

Example: \$100,000 spending on exempt purpose = a) Total Lobbying Limit: \$20,000
b) Grassroots Lobbying Limit: \$5,000

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If an organization spends more on lobbying expenditures than is permitted under 501(h), a tax of 25% is imposed on the excess lobbying expenditures. An organization may lose its tax-exempt status if its lobbying expenditures exceed the permitted amount by more than 50% of a four-year period.

An organization elects by filing Form 5768 with the IRS. Certain 501(c)(3) organizations such as churches are ineligible to make the 501(h) election. Some eligible 501(c)(3) organizations that are extremely large may nonetheless choose not to elect because the lobbying expenditure caps under the sliding scale result in less permitted lobbying than under the default facts & circumstances test.

B. What is lobbying?

1. The following activities constitute efforts or attempts to influence legislation:

- a) Attempts to influence legislation by Congress, state legislature, or a local governing body (i.e. city council)
- b) Includes direct contact with legislators and their staff, as well as efforts to urge the public to contact their legislators (indirect or grassroots lobbying)
- c) Includes advocating passage of a ballot measure or initiative (the public = legislators)

2. In 501(h) context, distinguishing between Direct and Grassroots Lobbying is critical.

- (a) Reference to specific legislation;
- (b) With a view on the legislation;
- + (c) Addressed to a legislator or employee of legislative body = Direct Lobbying
- or
- + (c) Call to Action (encouraging public to contact legislators) = Grassroots lobbying

3. Lobbying does NOT include:

- (a) Seeking to influence actions by executive, judicial or administrative bodies, such as school boards, zoning boards, and planning commissions.
EXAMPLE: Lobbying EPA for stricter curbs on mercury pollution from power plants.
- (b) Nonpartisan study, analysis and research
- (c) Examination and discussion of broad, social, economic or similar problems
- (d) Written requests from a legislative body or full committee for technical advice

B. Lobbying by 501(c)(4), 501(c)(5) and 501(c)(6) organizations

Organizations exempt under sections 501(c)(4), 501(c)(5) and 501(c)(6) of the Code may conduct unlimited lobbying activity.

To the extent that individuals are deducting their dues to such organizations as ordinary and necessary business expenses, such deductions are not permitted for the portion of their dues that fund lobbying and political expenditures. Unless an exception applies, such organizations are

3

required to provide notice to their members of the percentage of dues, if any, they have allocated to lobbying and political expenditures.

IV. Campaign Intervention

There is an absolute prohibition on a 501(c)(3) participating or intervening in any political campaign on behalf of or in opposition to any candidate for public office. This rule applies to federal, state, and local elections. There is no *de minimis* amount permitted and the penalties may include taxes imposed on the organization and its managers and possible revocation of exempt status. Nonpartisan election-related activities, however, are permissible. The key thus becomes determining impermissible campaign intervention versus permissible election-related activity. What makes this difficult to provide clear guidance to one's organization is that the IRS uses a facts & circumstances test to determine whether an activity has crossed the campaign intervention line. A recently released ruling, IRS Revenue Ruling 2007-41, is a helpful starting point to see how the IRS currently applies the facts & circumstances test to different activities.

In the past two election cycles, the IRS has made a more concerted effort to address the perceived problem of 501(c)(3)s violating the campaign intervention prohibition. According to the IRS, they received 237 referrals in the 2006 election cycle and selected 100 (44 churches, 56 nonchurches) for examination. More than half of these cases are still under investigation. However, the IRS did substantiate improper political activity in 26 cases and issued written advisories. So far, there have been no revocation recommendations. In 2004, the IRS selected 110 cases for examination, issued 69 written advisories, revoked the tax-exempt status of five organizations and proposed revocation for two others.

A. IRS facts & circumstances test

1. Timing close to an election
2. Timing is outside of organization's control
3. Breadth of issues
4. Identifies Candidates or Political Parties
5. Candidate's position compared to organization
6. Track record of doing the activity
7. Questions / Answers printed reflect bias
8. All candidates invited or included
9. Targets voters

The following are activities that clearly constitute prohibited campaign intervention:

- (1) Contributing to candidates or political parties;
- (2) Endorsing candidates or political parties;
- (3) Establishing a PAC (Political Action Committee).

B. Key factors for certain election-related activities to be deemed permissible

1. *Voting Records*
 - (a) Include all legislators
 - (b) Do not identify candidates for reelection
 - (c) Discuss a broad range of issues
 - (d) May not coincide with election

- (e) If records are compared to public charity's position, distribution may be restricted
- (f) Avoid targeted distribution

2. Candidate Questionnaires

- (a) Must be sent to all candidates running for a particular office
- (b) All responses must be published verbatim
- (c) Questions should be framed without bias
- (d) Organization may not coordinate or cooperate with the candidates

3. Public Forums / Candidate Debates

- (a) May not promote one candidate
- (b) All qualified candidates must be invited; may exclude "non-viable"
- (c) At least two candidates must appear
- (d) Questions should be prepared by nonpartisan panel
- (e) Moderator should not exhibit bias

4. Voter Registration & Get-Out-the-Vote

- (a) Materials and activities must be made available to all individuals without regard to political views
- (b) May target areas but must not be based on the political or ideological interests of any group
- (c) May be directed to commonly underrepresented groups

5. Issue Communications / Education

- (a) May include radio, television, newspaper or Internet communications to educate the public on issues
- (b) All communications must be nonpartisan
- (c) Additional safeguards may be required if issue is contested or controversial

C. May a person affiliated with a 501(c)(3) organization engage in campaign intervention activities in an individual capacity?

Directors, officers, employees and volunteers are generally permitted to engage in partisan political activities in their individual capacity. However, they may not use facilities, equipment, personnel or other resources of the organization, and such activities must be done outside of work hours or using available leave time. Particularly when a tax-exempt organization's leaders are involved, they must make clear that one is not acting on behalf of the organization.

D. Campaign intervention by 501(c)(4), 501(c)(5) and 501(c)(6) organizations

Unlike 501(c)(3) organizations, 501(c)(4), 501(c)(5) and 501(c)(6) organizations may engage in campaign intervention, provided such activities are less than primary. There is no clear test for determining when campaign intervention becomes an organization's primary purpose. The IRS looks at expenditures, volunteer involvement, and focus of the organization on such activities. As

with determining lobby limits in the non-501(h) context for 501(c)(3), a quick approach is to analyze expenditures – erring on the side of caution, an organization should not spend more than one-third on campaign intervention activities. As described above, however, many election-related activities do not constitute campaign intervention, so the first question asked should be whether the activity in question even counts against the limits.

501(c)(4), 501(c)(5) and 501(c)(6) organizations may be subject to tax on their expenditures for campaign intervention. Under IRC section 527(f), the tax is imposed at the highest corporate rate on the lesser of the organization's annual net investment income or the aggregate amount spent on political activities. There are some campaign intervention expenditures that are not subject to this tax, including membership communications regarding endorsements of candidates.

Finally, just because campaign intervention activities are permitted under the Internal Revenue Code for certain types of tax-exempt organizations does not mean that they are permitted under the relevant election law (see Part VI-A below). To give the most obvious example, a 501(c)(6) nonprofit corporation is permitted under the tax code to make a contribution to a federal candidate, but is prohibited under federal election law from doing so as a corporation.

V. IRS Reporting & Recordkeeping

Tax-exempt organizations may be required to report lobbying and campaign intervention expenditures to the IRS. As usual, the type of tax-exempt organization impacts the type of reporting. The organization may have separate reporting required under applicable election or lobbying disclosure laws (see Part VI-A & B below).

A. Reporting lobbying & campaign intervention by 501(c)(3) organizations

A 501(c)(3) public charity reports its lobbying activities on Schedule A of Form 990, Part VI-A. The part to be filled out depends on whether the 501(c)(3) has elected under 501(h) or not. There is also a yes/no question on Schedule A, Part III, Question 1 that asks whether the organization has engaged in lobbying activities.

A 501(c)(3) is also supposed to report any campaign intervention expenditures (Form 990, Part VI, Question 81a) – if the organization does, it should fully expect to hear back from the IRS, since such expenditures are prohibited.

B. Reporting lobbying & campaign intervention by 501(c)(4), (c)(5) and (c)(6) organizations

Since 501(c)(4), (c)(5) and (c)(6) organizations do not complete Schedule A of Form 990, they get off light in terms of reporting any lobbying. They are required to complete questions 85a-h of Form 990, Part VI, relating to the restrictions on tax-deductibility of dues by members to the extent they were used for lobbying and political expenditures.

501(c)(4), (c)(5) and (c)(6) organizations report any campaign intervention expenditures (Form 990, Part VI, Question 81a). To the extent they incur taxes as a result (discussed above), they are required to file Form 1120-POL. Please note that Form 1120-POL is due three-and-a-half months after the tax year is complete, meaning the form is due prior to the normal due date for Form 990.

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C. Reporting travel reimbursement for elected officials

There is a new requirement for the reporting year 2006 for tax-exempt organizations to disclose travel reimbursement for government officials on line 43 of Form 990. Please be aware that this requirement is separate and apart from whether the organization conducted any lobbying activity. A tax-exempt organization that provides a round-trip flight to an elected official in order to give an award to the official would be required to disclose the expenses involved.

D. Recordkeeping

The ability to accurately report expenditures for lobbying, campaign intervention, and travel for government officials is entirely based on implementing an effective tracking and recordkeeping system. For 501(c)(3) organizations, employees involved in lobbying must track their time and expenses spent on lobbying activities. Other indirect expenses and overhead may be allocated on a reasonable basis.

As noted above, some issues in lobbying or campaign intervention fall into a grey area, with the IRS far more likely to raise questions on audit if it determines that the organization has not implemented a tracking system. Thus, in addition to training employees to distinguish between lobbying versus non-lobbying, organizations need to ensure that their tracking system is being followed.

VI. Other Legal Considerations in Advocacy Realm

The following are a few additional legal issues that tax-exempt organizations must be mindful of in the advocacy realm. It is not intended to be an exhaustive list.

A. Election law

Certain election-related activities are governed by federal, state or local election law. Even if an activity is permitted under tax law, an organization must make sure the same activity is permitted under the relevant election law. This is particularly true for 501(c)(4), (c)(5) and (c)(6) organizations, who are permitted to engage in campaign intervention under the tax code.

To give a quick sense, the basic rules under *federal* election law for nonprofit corporations are as follows:

- (1) General prohibition on corporate (and labor) contributions and expenditures;
- (2) "Contributions" and "Expenditures" include anything of value made to influence an election for Federal office;
- (3) Exceptions to the general prohibition include: (a) Membership communications; (b) Non-partisan voter registration and Get-Out-the-Vote (GOTV) drives; and (c) Electioneering Communications/ Issues Ads.

B. Lobbyist registration and disclosure

Separate from the IRS lobbying rules described above, the federal government and most states have laws requiring registration and reporting for lobbyists and organizations that lobby. There are frequently threshold requirements (i.e. based on time spent and expenditures) that must be

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met before registration/reporting is triggered, so it is important to understand your own particular state law. These state laws do not impose restrictions on how much lobbying may be conducted – they are strictly about registration and disclosure.

C. Funders' restrictions

Sometimes funding sources (i.e. private foundations or government) include restrictions on the use of their funds for lobbying or election-related activity. Paying close attention to the language found in grant agreements or contracts combined with appropriate accounting/documentation is necessary for compliance in this area.

VII. Resources

Organizations

- Independent Sector: www.independentsector.org
- Alliance for Justice: www.afi.org/nonprofit
- Charity Lobbying in the Public Interest: www.clpi.org
- U.S. Conference on Catholic Bishops -- 2007 Political Activity Guidelines for Catholic Organizations: <http://www.usccb.org/ogc/guidelines.shtml>

IRS

- IRS Revenue Ruling 2007-41: <http://www.irs.gov/pub/irs-drop/r-07-41.pdf>
- "Election Year Issues" [for 501(c)(3)s], IRS *CPE Text* (2002): <http://www.irs.gov/pub/irs-tege/eotopicl02.pdf>
- "Lobbying Issues" [for 501(c)(3)s], IRS *CPE Text* (1997): <http://www.irs.gov/pub/irs-tege/eotopicp97.pdf>
- "IRS Political Campaign and Lobbying Activities on 501(c)(4), (c)(5) and (c)(6) Organizations," IRS *CPE Text* (2003): <http://www.irs.gov/pub/irs-tege/eotopicl03.pdf>
- The IRS has also created a resource center on its website for 501(c)(3) organizations engaging in the political process: http://www.irs.gov/newsroom/article/0_id=161131_00.html

Attachments

- Form 5768 for making 501(h) election
- Part VI-A of Schedule A of Form 990 (and instructions) related to IRS disclosure of lobbying

Richard L. Thomas
Associate General Counsel
Volunteers of America

Form	5768	Election/Revocation of Election by an Eligible Section 501(c)(3) Organization To Make Expenditures To Influence Legislation	
<small>(Rev. December 2004)</small>		<small>(Under Section 501(h) of the Internal Revenue Code)</small>	For IRS Use Only ►
<small>Department of the Treasury Internal Revenue Service</small>			
Name of organization		Employer identification number	
Number and street (or P.O. box no., if mail is not delivered to street address)		Room/suite	
City, town or post office, and state		ZIP + 4	
<p>1 Election—As an eligible organization, we hereby elect to have the provisions of section 501(h) of the Code, relating to expenditures to influence legislation, apply to our tax year ending.....and all subsequent tax years until revoked. (Month, day, and year)</p> <p>Note: This election must be signed and postmarked within the first taxable year to which it applies.</p> <p>2 Revocation—As an eligible organization, we hereby revoke our election to have the provisions of section 501(h) of the Code, relating to expenditures to influence legislation, apply to our tax year ending..... (Month, day, and year)</p> <p>Note: This revocation must be signed and postmarked before the first day of the tax year to which it applies.</p> <p>Under penalties of perjury, I declare that I am authorized to make this (check applicable box) <input type="checkbox"/> election <input type="checkbox"/> revocation on behalf of the above named organization.</p> <p>..... (Signature of officer or trustee) (Type or print name and title) (Date)</p>			

General Instructions

Section references are to the Internal Revenue Code.

Section 501(c)(3) states that an organization exempt under that section will lose its tax-exempt status and its qualification to receive deductible charitable contributions if a substantial part of its activities are carried on to influence legislation. Section 501(h), however, permits certain eligible 501(c)(3) organizations to elect to make limited expenditures to influence legislation. An organization making the election will, however, be subject to an excise tax under section 4911 if it spends more than the amounts permitted by that section. Also, the organization may lose its exempt status if its lobbying expenditures exceed the permitted amounts by more than 50% over a 4-year period. For any tax year in which an election under section 501(h) is in effect, an electing organization must report the actual and permitted amounts of its lobbying expenditures and grass roots expenditures (as defined in section 4911(c)) on its annual return required under section 6033. See Schedule A (Form 990 or Form 990-EZ). Each electing member of an affiliated group must report these amounts for both itself and the affiliated group as a whole.

- To make or revoke the election, enter the ending date of the tax year to which the election or revocation applies in item **1** or **2**, as applicable, and sign and date the form in the spaces provided.
- Eligible Organizations.**—A section 501(c)(3) organization is permitted to make the election if it is not a disqualified organization (see below) and is described in:
1. Section 170(b)(1)(A)(ii) (relating to educational institutions),
 2. Section 170(b)(1)(A)(iii) (relating to hospitals and medical research organizations),
 3. Section 170(b)(1)(A)(iv) (relating to organizations supporting government schools),
 4. Section 170(b)(1)(A)(vi) (relating to organizations publicly supported by charitable contributions),
 5. Section 509(a)(2) (relating to organizations publicly supported by admissions, sales, etc.), or
 6. Section 509(a)(3) (relating to organizations supporting certain types of public charities other than those section 509(a)(3) organizations that support section 501(c)(4), (5), or (6) organizations).
- Disqualified Organizations.**—The following types of organizations are not permitted to make the election:
- a. Section 170(b)(1)(A)(i) organizations (relating to churches),

- b. An integrated auxiliary of a church or of a convention or association of churches, or
 - c. A member of an affiliated group of organizations if one or more members of such group is described in **a** or **b** of this paragraph.
- Affiliated Organizations.**—Organizations are members of an affiliated group of organizations only if (1) the governing instrument of one such organization requires it to be bound by the decisions of the other organization on legislative issues, or (2) the governing board of one such organization includes persons (i) who are specifically designated representatives of another such organization or are members of the governing board, officers, or paid executive staff members of such other organization, and (ii) who, by aggregating their votes, have sufficient voting power to cause or prevent action on legislative issues by the first such organization.
- For more details, see section 4911 and section 501(h).
- Note:** A private foundation (including a private operating foundation) is not an eligible organization.
- Where To File.**—Mail Form 5768 to the Internal Revenue Service Center, Ogden, UT 84201-0027.

Part VI-A Lobbying Expenditures by Electing Public Charities (See page 10 of the instructions.)
(To be completed **ONLY** by an eligible organization that filed Form 5768)

Check **a** if the organization belongs to an affiliated group. Check **b** if you checked "a" and "limited control" provisions apply.

Limits on Lobbying Expenditures		(a) Affiliated group totals	(b) To be completed for all electing organizations
(The term "expenditures" means amounts paid or incurred.)			
36	Total lobbying expenditures to influence public opinion (grassroots lobbying)	36	
37	Total lobbying expenditures to influence a legislative body (direct lobbying)	37	
38	Total lobbying expenditures (add lines 36 and 37)	38	
39	Other exempt purpose expenditures	39	
40	Total exempt purpose expenditures (add lines 38 and 39)	40	
41	Lobbying nontaxable amount. Enter the amount from the following table— If the amount on line 40 is— The lobbying nontaxable amount is— Not over \$500,000 20% of the amount on line 40 Over \$500,000 but not over \$1,000,000 \$100,000 plus 15% of the excess over \$500,000 Over \$1,000,000 but not over \$1,500,000 \$175,000 plus 10% of the excess over \$1,000,000 Over \$1,500,000 but not over \$17,000,000 \$225,000 plus 5% of the excess over \$1,500,000 Over \$17,000,000 \$1,000,000	41	
42	Grassroots nontaxable amount (enter 25% of line 41)	42	
43	Subtract line 42 from line 36. Enter -0- if line 42 is more than line 36	43	
44	Subtract line 41 from line 38. Enter -0- if line 41 is more than line 38	44	

Caution: If there is an amount on either line 43 or line 44, you must file Form 4720.

4-Year Averaging Period Under Section 501(h)

(Some organizations that made a section 501(h) election do not have to complete all of the five columns below. See the instructions for lines 45 through 50 on page 13 of the instructions.)

Calendar year (or fiscal year beginning in) ▶	Lobbying Expenditures During 4-Year Averaging Period				
	(a) 2006	(b) 2005	(c) 2004	(d) 2003	(e) Total
45 Lobbying nontaxable amount					
46 Lobbying ceiling amount (150% of line 45(e))					
47 Total lobbying expenditures					
48 Grassroots nontaxable amount					
49 Grassroots ceiling amount (150% of line 48(e))					
50 Grassroots lobbying expenditures					

Part VI-B Lobbying Activity by Nonelecting Public Charities (For reporting only by organizations that did not complete Part VI-A) (See page 13 of the instructions.)

During the year, did the organization attempt to influence national, state or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, through the use of:

	Yes	No	Amount
a Volunteers			
b Paid staff or management (Include compensation in expenses reported on lines c through h)			
c Media advertisements			
d Mailings to members, legislators, or the public			
e Publications, or published or broadcast statements			
f Grants to other organizations for lobbying purposes			
g Direct contact with legislators, their staffs, government officials, or a legislative body			
h Rallies, demonstrations, seminars, conventions, speeches, lectures, or any other means			
i Total lobbying expenditures (Add lines c through h)			

If "Yes" to any of the above, also attach a statement giving a detailed description of the lobbying activities.

enrolled in meaningful numbers, that its promotional activities and recruiting efforts in each geographic area were reasonably designed to inform students of all racial segments in the general communities within the area of the availability of the school. The question whether a school satisfies the preceding sentence will be determined on the basis of the facts and circumstances of each case.

(c) If a school customarily draws its students from local communities and follows a racially nondiscriminatory policy as to students, the publicity requirement may be satisfied by complying with section 4.02. *supra*. Such a school may demonstrate that it follows a racially nondiscriminatory policy within the meaning of the preceding sentence by showing that it currently enrolls students of racial minority groups in meaningful numbers. The question whether a school satisfies the preceding sentence will be determined on the basis of the facts and circumstances of each case. One of the facts and circumstances that the Service will consider is whether the school's promotional activities and recruiting efforts in each area were reasonably designed to inform students of all racial segments in the general communities within the area of the availability of the school. The Service recognizes that the failure by a school drawing its students from local communities to enroll racial minority group students may not necessarily indicate the absence of a racially nondiscriminatory policy as to students when there are relatively few or no such students in these communities. Actual enrollment is, however, a meaningful indication of a racially nondiscriminatory policy in a community in which a public school or schools became subject to a desegregation order of a Federal court or otherwise expressly became obligated to implement a desegregation plan under the terms of any written contract or other commitment to which any Federal agency was a party.

The Service encourages schools to satisfy the publicity requirement by the methods described in subsection 1 of this section, regardless of whether a school considers itself within subsection 2, because it believes these methods to be the most effective to make known a school's racially nondiscriminatory policy. In this regard it is each school's responsibility to determine whether paragraph (a), (b), or (c) of subsection 2 applies to it. On audit, a school must be prepared to demonstrate that the failure to publish its racially nondiscriminatory policy in accordance with subsection 1 of this section was justified by the application to it of paragraph (a), (b), or (c) of subsection 2. Further, a school must be prepared to demonstrate that it has publicly disavowed or repudiated any statements purported to have been made on its behalf (after November 6, 1975) that are contrary to its publicity of a

racially nondiscriminatory policy as to students, to the extent that the school or its principal official were aware of such statements.

4.04 Facilities and programs. A school must be able to show that all of its programs and facilities are operated in a racially nondiscriminatory manner.

4.05 Scholarship and loan programs. As a general rule, all scholarship or other comparable benefits procurable for use at any given school must be offered on a racially nondiscriminatory basis. Their availability on this basis must be known throughout the general community being served by the school and should be referred to in the publicity required by this section in order for that school to be considered racially nondiscriminatory as to students. . . . [S]cholarships and loans that are made pursuant to financial assistance programs favoring members of one or more racial minority groups that are designed to promote a school's racially nondiscriminatory policy will not adversely affect the school's exempt status. Financial assistance programs favoring members of one or more racial groups that do not significantly derogate from the school's racially nondiscriminatory policy similarly will not adversely affect the school's exempt status.

4.06 Certification. An individual authorized to take official action on behalf of a school that claims to be racially nondiscriminatory as to students is required to certify annually, under penalties of perjury, that to the best of his or her knowledge and belief the school has satisfied the applicable requirements of sections 4.01 through 4.05 of the Rev. Proc. *This certification is line 35 in Part V.*

4.07 Faculty and staff. The existence of a racially discriminatory policy with respect to employment of faculty and administrative staff is indicative of a racially discriminatory policy as to students. Conversely, the absence of racial discrimination in employment of faculty and administrative staff is indicative of a racially nondiscriminatory policy as to students.

7.01 Specific records. Except as provided in section 7.03, each exempt private school must maintain for a minimum period of three years, beginning with the year after the year of compilation or acquisition, the following records for the use of the Service on proper request:

- Records indicating the racial composition of the student body, faculty, and administrative staff for each academic year.
- Records sufficient to document that scholarship and other financial assistance is awarded on a racially nondiscriminatory basis.
- Copies of all brochures, catalogues, and advertising dealing with student admissions, programs, and scholarships. Schools advertising nationally or in a large geographic

segment or segments of the United States need only maintain a record sufficient to indicate when and in what publications their advertisements were placed.

4. Copies of all materials used by or on behalf of the school to solicit contributions.

7.02 Limitation.
1. For purposes of section 7.01, the racial composition of the student body, faculty, and administrative staff may be an estimate based on the best information readily available to the school, without requiring student applicants, students, faculty, or administrative staff to submit information to the school that the school otherwise does not require. For each academic year, however, a record of the method by which racial composition is determined must be maintained. . . .

2. The Service does not require that a school release personally identifiable records or personal information contained therein except in accordance with the requirements of the "Family Educational Rights and Privacy Act of 1974," 20 U.S.C. section 1232g (1974). Similarly, the Service does not require a school to keep records the maintenance of which is prohibited under state or federal law.

7.03 Exceptions. The records described in section 7.01 need not be independently maintained for Internal Revenue Service use if:

- Substantially the same information that each of these records would provide has been included in a report or reports filed in accordance with law with an agency or agencies of Federal, state, or local government, and this information is current within one year, and
- The school maintains copies of these reports from which this information is readily obtainable. Records described in section 7.01 providing information not included in reports filed with an agency or agencies must be maintained by the school for Service use.

7.04 Failure to maintain records. Failure to maintain or to produce upon the proper request the required records and information will create a presumption that the organization has failed to comply with these guidelines.

Part VI-A. Lobbying Expenditures by Electing Public Charities

Complete Part VI-A only for an eligible organization that elected to be subject to the lobbying expenditure limitations of section 501(h) by filing Form 5768 and for which the election was valid and in effect for its tax year beginning in the year 2006.

A public charity that makes a valid section 501(h) election may spend up to a certain percentage of its exempt purpose expenditures to influence legislation

without incurring tax or losing its tax-exempt status.

Expenditure test. Under the expenditure test, there are limits both upon the amount of the organization's grassroots lobbying expenditures and upon the total amount of its direct lobbying and grassroots lobbying expenditures. If the electing public charity does not meet this expenditure test, it will owe a section 4911 excise tax on its excess lobbying expenditures. Moreover, if over a 4-year averaging period the organization's average annual total lobbying or grassroots lobbying expenditures are more than 150% of its dollar limits, the organization will lose its exempt status.

The following terms are used in Part VI-A. See Regulations section 56.4911 for details.

Exempt purpose expenditures. The amount an electing public charity may spend on lobbying (without incurring tax) is a scaled percentage of the organization's exempt purpose expenditures. In general, an expenditure is an exempt purpose expenditure if it is paid or incurred by an electing public charity to accomplish the organization's exempt purpose.

In general, exempt purpose expenditures are:

1. The total amount paid or incurred for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or to foster national or international amateur sports competition (not including providing athletic facilities or equipment, other than by qualified amateur sports organizations described in section 501(j)(2)).
2. The allocable portion of administrative expenses paid or incurred for the above purposes.
3. Amounts paid or incurred to try to influence legislation, whether or not for the purposes described in 1 above.
4. Allowance for depreciation or amortization, and
5. Fundraising expenditures, except that exempt purpose expenditures do not include amounts paid to or incurred for either the organization's separate fundraising unit or other organizations, if the amounts are primarily for fundraising.

See also Regulations section 56.4911-4(c) for a discussion of excluded expenditures.

Lobbying expenditures. The term *lobbying expenditures* is expenditures paid or incurred for the purpose of attempting to influence legislation:

- 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, and
- By attempting to affect the opinions of the general public.

To determine if an organization has spent excessive amounts on lobbying, the organization must know which expenditures are lobbying expenditures and which are not lobbying expenditures. An electing public charity's lobbying expenditures for a year are the sum of its expenditures during that year for (1) direct lobbying communications (direct lobbying expenditures) plus (2) grassroots lobbying communications (grassroots expenditures).

Direct lobbying communications (direct lobbying expenditures). A direct lobbying communication is any attempt to influence any legislation through communication with any:

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

A communication with a legislator or government official will be treated as a direct lobbying communication, if, but only if, the communication:

- Refers to specific legislation, and
- Reflects a view on such legislation.

Grassroots lobbying communications (grassroots expenditures). A grassroots lobbying communication is any attempt to influence any legislation through an attempt to affect the opinions of the general public or any part of the general public.

A communication is generally not a grassroots lobbying communication unless (in addition to referring to specific legislation and reflecting a view on that legislation) it encourages recipients to take action about the specific legislation.

A communication encourages a recipient to take action when it:

1. States that the recipient should contact legislators;
2. States a legislator's address, phone number, etc.;
3. Provides a petition, tear-off postcard, or similar material for the recipient to send to a legislator; or
4. Specifically identifies one or more legislators who:
 - a. Will vote on legislation;
 - b. Opposes the communication's view on the legislation;
 - c. Is undecided about the legislation;
 - d. Is the recipient's representative in the legislature; or
 - e. Is a member of the legislative committee that will consider the legislation.

A communication described in (4) above generally is grassroots lobbying only if, in addition to referring to and reflecting a view on specific legislation, it is a communication that cannot meet the full and fair exposition test as nonpartisan analysis, study, or research.

Communication with members. For purposes of section 4911, expenditures for certain communications between an organization and its members are treated more leniently than are communications to nonmembers. Expenditures for a communication that refers to, and reflects a view on, specific legislation are not lobbying expenditures if the communication satisfies the following requirements:

1. The communication is directed only to members of the organization,
2. The specific legislation the communication refers to, and reflects a view on, is of direct interest to the organization and its members.
3. The communication does not directly encourage the member to engage in direct lobbying (whether individually or through the organization), and
4. The communication does not directly encourage the member to engage in grassroots lobbying (whether individually or through the organization).

Expenditures for a communication directed only to members that refers to, and reflects a view on, specific legislation and that satisfies the requirements of paragraphs 1, 2, and 4, but does not satisfy the requirements of paragraph 3, are treated as expenditures for direct lobbying.

Expenditures for a communication directed only to members that refers to, and reflects a view on, specific legislation and satisfies the requirements of paragraphs 1 and 2, but does not satisfy the requirements of paragraph 4, are treated as grassroots expenditures, whether or not the communication satisfies the requirements of paragraph 3.

See Regulations section 56.4911-5 for details.

There are special rules regarding certain paid mass media advertisements about highly publicized legislation; allocation of mixed purpose expenditures; certain transfers treated as lobbying expenditures and special rules regarding lobbying on referenda, ballot initiatives, and similar procedures (see Regulations sections 56.4911-2 and -3).

Legislation. In general, the term *legislation* includes Acts, bills, resolutions, or similar items. *Specific legislation* includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes.

Exceptions to the definitions of direct lobbying communication and/or grassroots lobbying communication. In general, engaging in nonpartisan analysis, study, or research and making its results available to the general public or segment or members thereof, or to governmental bodies, officials, or employees is not considered either a direct lobbying communication or a grassroots lobbying communication. Nonpartisan analysis, study, or research may advocate a particular position or

viewpoint as long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion.

A communication that responds to a governmental body's or committee's written request for technical advice is not a direct lobbying communication.

A communication is not a direct lobbying communication if the communication is an appearance before, or communication with, any legislative body whose action might affect the organization's existence, its powers and duties, its tax-exempt status, or the deductibility of contributions to the organization, as opposed to affecting merely the scope of the organization's future activities.

Affiliated groups. Treat members of an affiliated group as a single organization to measure lobbying expenditures and permitted lobbying expenditures.

Two organizations are affiliated if one is bound by the other organization's decisions on legislative issues (control) or if enough representatives of one belong to the other organization's governing board to cause or prevent action on legislative issues (interlocking directorate).

If the organization is not sure whether its group is affiliated, it may ask the IRS for a ruling letter. There is a fee for this ruling.

For information on requesting rulings, see Rev. Proc. 2007-4, 2007-1 I.R.B. 118.

Members of an affiliated group measure both lobbying expenditures and permitted lobbying expenditures on the basis of the affiliated group's tax year. If all members of the affiliated group have the same tax year, that year is the tax year of the affiliated group.

However, if the affiliated group's members have different tax years, the tax year of the affiliated group is the calendar year, unless all the members of the group elect otherwise. See Regulations section 56.4911-7(e)(3).

If the electing organization belongs to an affiliated group, complete in Part VI-A, lines 36 through 44:

- Column (a) for the affiliated group as a whole, and
- Column (b) for the electing member of the group.

If there are no excess lobbying expenditures on either line 43 or 44 of column (a), treat each electing member as having no excess lobbying expenditures.

However, if there are excess lobbying expenditures on either line 43 or 44 of column (a), treat each electing member as having excess lobbying expenditures. In such case, each electing member must file Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code, and must pay the tax on its proportionate share of the

affiliated group's excess lobbying expenditures.

To find a member's proportionate share, see Regulations section 56.4911-8(d). Enter the proportionate share in column (b) on line 43 or line 44, or on both lines.

Attached schedule. Attach a schedule showing each affiliated group member's name, address, EIN, and expenses. Use the format of Part VI-A for this schedule. Show which members elected and which did not.

Include each electing member's share of the excess lobbying expenditures on the attached schedule. Nonelecting members do not owe tax, but remain subject to the general rule, which provides that no substantial part of their activities may consist of carrying on propaganda or otherwise trying to influence legislation.

Limited control. If two organizations are affiliated because their governing instruments provide that the decisions of one will control the other only on national legislation, apply expenditures as follows:

- Charge the controlling organization with its own lobbying expenditures and the national legislation expenditures of the affiliated organizations.
- Do not charge the controlling organization with other lobbying expenditures (or other exempt-purpose expenditures) of the affiliated organizations, and
- Treat each local organization as though it were not a member of an affiliated group; for example, the local organization should account for its own expenditures only and not any of the national legislation expenditures deemed as incurred by the controlling organization.

If a central or parent organization files a group return on behalf of two or more members of the group, complete column (a), Part VI-A, for the affiliated group as a whole. Include the central, electing, and nonelecting members.

In column (b), except on lines 43 and 44, include the amounts that apply to all electing members of the group if they are included in the group return.

Attach the schedule described above under *Affiliated groups*. Show what amounts apply to each group member.

If the group return includes organizations that belong to more than one affiliated group, show in column (a) the totals for all such groups. On the

attached schedule, show the amounts that apply to each affiliated group and to each group member.

If the parent organization has made the lobbying expenditure election, its separate return must also show in column (a) the amounts that apply to the affiliated group as a whole and, in column (b), the amounts that apply to the parent organization only.

A subordinate organization not included in the group return would also complete column (a) for the affiliated group as a whole and column (b) for itself only.

However, if limited control (defined above) exists, complete only column (b) in Part VI-A of the group return for the electing members in the group.

Attach a schedule to show the amounts that apply to each electing member.

In the separate returns filed by the parent and by any subordinate organizations not included in the group return, complete only column (b).

Lines 36 through 44. Complete column (b) for any organization using Part VI-A but complete column (a) only for affiliated groups.

Use lines 36 through 44 to determine whether any of the organization's current year lobbying expenditures are subject to tax. File Form 4720 if the organization needs to report and pay the excise tax.

Lines 45 through 50. Lines 45 through 50 are used to determine if the organization exceeded lobbying expenditure limits during the 4-year averaging period.

An organization for which a lobbying expenditure election under section 501(h) was in effect for its tax year beginning in 2006 must complete columns (a) through (e) of lines 45 through 50 except in the following situations.

1. An organization first treated as a section 501(c)(3) organization in its tax year beginning in 2006 does not have to complete any part of lines 45 through 50.
2. An organization does not have to complete lines 45 through 50 for any period before it is first treated as a section 501(c)(3) organization.
3. If 2006 is the first year for which an organization's first section 501(h) election is effective, that organization must complete line 45, columns (a) and (e).

The organization must then complete all of column (e) to determine whether the amount on line 47, column (e), is equal to or less than the lobbying ceiling amount calculated on line 46 and whether the amount on line 50 is equal to or less than the grassroots ceiling amount calculated on line 49.

The organization does not satisfy both tests if either its total lobbying expenditures or grassroots lobbying expenditures exceed the applicable ceiling amounts. When this occurs, all five columns must be completed and a

recomputation made unless exception 1 or 2 above applies.

4. If 2006 is the second or third tax year for which the organization's first section 501(h) election is in effect, that organization is required to complete only the columns for the years in which the election has been in effect, entering the totals for those years in column (e).

The organization must determine, for those 2 or 3 years, whether the amount entered in column (e), line 47, is equal to or less than the lobbying ceiling amount reported on line 46, and whether the amount entered in column (e), line 50, is equal to or less than the grassroots ceiling amount calculated on line 49.

The organization does not satisfy both tests if either its total lobbying expenditures or grassroots lobbying expenditures exceed applicable ceiling amounts. When that occurs, all five columns must be completed and a recomputation made, unless exception 1 or 2 above applies.

If the organization is not required to complete all five columns, attach a statement explaining why. In the statement, show the ending date of the tax year in which the organization made its first section 501(h) election and state whether or not that first election was revoked before the start of the organization's tax year that began in 2006.

Note. If the organization belongs to an affiliated group, enter the appropriate affiliated group totals from column (a), lines 36 through 44, when completing lines 45, 47, 48, and 50.

Line 45. Lobbying nontaxable amount. For 2003 through 2006, enter the amount from line 41 of the Schedule A (Form 990 or 990-EZ) filed for each year.

Line 47. Total lobbying expenditures. For 2003 through 2006, enter the amount from line 38 of the Schedule A (Form 990 or 990-EZ) filed for each year.

Line 48. Grassroots nontaxable amount. For 2003 through 2006, enter the amount from line 42 of the Schedule A (Form 990 or 990-EZ) filed for each year.

Line 50. Grassroots lobbying expenditures. For 2003 through 2006, enter the amount from line 36 of the Schedule A (Form 990 or 990-EZ) filed for each year.

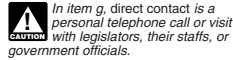
Part VI-B. Lobbying Activity by Nonelecting Public Charities

The Part VI-A instructions defining direct and grassroots lobbying activities by organizations that made the section 501(h) election do not apply to nonelecting organizations that complete Part VI-B.

Part VI-B provides a reporting format for any organization that engaged in lobbying activities in its 2006 tax year but did not make a section 501(h) lobbying expenditure election for that year by filing Form 5768.

A nonelecting public charity will generally be regarded as lobbying if the organization either: (1) contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation or the government's budget process; or (2) advocates the adoption or rejection of legislation.

Nonelecting organizations must complete Part VI-B to show lobbying expenditures paid or incurred.



In item g, direct contact is a personal telephone call or visit with legislators, their staffs, or government officials.

These nonelecting organizations must also attach a statement giving a detailed description of their lobbying activities. The detailed description of lobbying activities should include all lobbying activities, whether expenses are incurred or not (for example, even lobbying activities carried out by unreimbursed volunteers).

For example, the activities should be included in the attached statement if an organization (either through its employees or volunteers) attempts to influence legislation in any of the following ways:

- Sending letters or publications to government officials or legislators,
- Meeting with or calling government officials or legislators,
- Sending or distributing letters or publications (including newsletters, brochures, etc.) to members or to the general public, or
- Using direct mail, placing advertisements, issuing press releases, holding news conferences, or holding rallies or demonstrations.

Part VII. Information Regarding Transfers To and Relationships With Noncharitable Exempt Organizations

Part VII is used to report direct and indirect transfers to (line 51a), direct and indirect transactions with (line 51b), and relationships with (line 52) any other noncharitable exempt organization (section 6033(b)(9)).

A *noncharitable exempt organization* is an organization exempt under section 501(c) (that is not exempt under section 501(c)(3)), or a political organization described in section 527.

For purposes of these instructions, the section 501(c)(3) organization completing this Schedule A (Form 990 or 990-EZ) is referred to as the *reporting organization*.

A noncharitable exempt organization is related to or affiliated with the reporting organization if:

1. The two organizations share some element of common control, or
2. A historic and continuing relationship exists between the two organizations.

A noncharitable exempt organization is unrelated to the reporting organization if:

1. The two organizations share no element of common control, and
2. A historic and continuing relationship does not exist between the two organizations.

An *element of common control* is present when one or more of the officers, directors, or trustees of one organization are elected or appointed by the officers, directors, trustees, or members of the other. An element of common control is also present when more than 25% of the officers, directors, or trustees of one organization serve as officers, directors, or trustees of the other organization.

A historic and continuing relationship exists when two organizations participate in a joint effort to work in concert toward the attainment of one or more common purposes on a continuous or recurring basis rather than on the basis of one or several isolated transactions or activities. Such a relationship also exists when two organizations share facilities, equipment, or paid personnel during the year, regardless of the length of time the arrangement is in effect.

Line 51. Reporting of certain transfers and transactions. Except as provided below, report on line 51 any transfer to or transaction with a noncharitable exempt organization even if the transfer or transaction constitutes the only connection with the noncharitable exempt organization.

Related organizations. If the noncharitable exempt organization is related to or affiliated with the reporting organization, report all direct and indirect transfers and transactions except for contributions and grants received by the reporting organization.

Unrelated organizations. All transfers from the reporting organization to an unrelated noncharitable exempt organization must be reported on line 51a. All transactions between the reporting organization and an unrelated noncharitable exempt organization must be shown on line 51b unless they meet the *Exception* in the specific instructions for that line.

Line 51a. Transfers. Answer "Yes" to lines 51a(i) and 51a(ii) if the reporting organization made any direct or indirect transfers of any value to a noncharitable exempt organization.

A *transfer* is any transaction or arrangement whereby one organization transfers something of value (cash, other



Commercial Ventures Involving Tax Exempt Organizations

Timothy B. Phillips

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Common Purposes

- Further mission by engaging in commercial activity
- Generate revenue streams from non-traditional sources
- Protect assets from risk of unrelated enterprises

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The Means – Traditional Legal Structures

- The Partnership
 - Definition – “A separate legal business entity, which includes a system, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on and which is not a trust, estate or corporation.”

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The Means - Partnerships

- Types of Partners in Partnerships
 - General Partners
 - ⊖ The liability for the consequences of a partnership's operations or obligations rests with the general partners
 - ⊖ General partners can be called on to make additional contributions
 - ⊖ All partnerships must have at least one general partner
 - ⊖ Partnerships with only general partners are "general partnerships"
 - Limited Partners
 - ⊖ The liability is limited to the amount of partner's contribution
 - ⊖ There is limited ability to manage business and affairs
 - ⊖ There is limited authority/ability to bind the partnership
 - ⊖ Partnerships with general and limited partners are "limited partnerships"

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The Means - Other Joint Ventures

- Limited Liability Company
 - Tax attributes of the partnership
 - Limited liability features of the corporation
- Joint Venture Created by Contract
 - Created by agreement
 - Not a distinct legal entity
 - Ex: Priv. Ltr. Rul. 200610022 ruled that a "Sale and Joint Publication Agreement" between an educational organization and a publisher was a joint venture

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Chief IRS Concerns

- Significant private benefit (i.e. more than incidental) to for-profit partners (usually the limited) or associates
- Disproportionate risks borne by exempt general partners or managing members
 - Examples:
 - Exempt hospital partnerships with private physician groups
 - Joint ventures between charitable organizations that supply low income housing and investors

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History: The “per se rule”

- IRS originally took the position that any participation by a charitable organization in a partnership, where the organization was the general partner and private investors were limited partners, was contrary to the organization’s tax exempt status
 - Called the “per se rule”
 - Result: automatic revocation of tax-exempt status
 - Furthering or advancing a charitable objective was not a factor to be considered

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History: The “per se rule”

- Challenged in 1980
 - Plumstead Theatre Soc’y, Inc. v. Comm’r, 74 T.C. 1324 (1980)
 - Exempt theatre company formed limited partnership with investors to fund production. IRS challenged and lost. Court found venture furthered exempt purposes and exempt org sufficiently controlled venture’s activities.
- Abandoned in 1983
 - Gen. Couns. Mem. 39005
 - IRS stated that it was possible for a charitable organization to participate as a general partner in a limited partnership without jeopardizing its tax exemption

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Current State of the Law

- Three Part Test¹
 1. Whether the charitable organization’s participation in the partnership is serving a charitable purpose
 - Must be satisfied for the remainder of test to apply
 - Met only if the partnership agreement contains express provisions

¹ Rev. Rul. 98-15, 1998-1 C.B. 718

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Current State of the Law

- Three Part Test
 2. Whether the charity, under the particular facts and circumstances, is insulated from the day-to-day responsibilities as general partner
 - Sufficient control
 - Limited contractual liability
 - No apparent conflicts of interest

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Current State of the Law

- Three Part Test
 3. Whether or not the limited partners are receiving an undue economic benefit from the partnership
 - Private interest being served must be **incidental** in both a qualitative and quantitative sense²
 - To be incidental in a qualitative sense, the interest served must be a necessary concomitant of the activity which benefits the public at large (i.e. activity can only be accomplished by benefiting certain individuals)
 - To be incidental in a quantitative sense, the private benefit must not be substantial after considering the overall public benefit conferred by the activity
- ² Priv. Ltr. Rul. 8541108

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Application of the Law

- Health Care Institutions
 - Legitimate Purposes for Commercial Ventures
 - The raising of needed capital
 - The bringing of new services to a community
 - The pooling of diverse areas of expertise
 - Illegitimate Purposes for Commercial Ventures
 - The selling of net revenue streams to limited partners to reward and retain members of the medical staff
 - Results in private inurement and lacks “charitable purposes”
 - Any venture where the sole priority is to generate profits

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Commercial Ventures Checklist

- Does the participation of the exempt organization in the commercial venture further its exempt purposes?
- Are the assets of the exempt partner adequately protected?
 - Contractual liability is limited
 - No unreasonable rate of return on invested capital
 - No obligation to return invested capital from the exempt organization's own funds
- Does the exempt partner have a right of refusal on the sale of the assets of the commercial venture?

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Commercial Ventures Checklist

- Has the exempt partner received an ownership interest in the venture commensurate with the value of the assets it contributed?
- Do the venture participants receive distributions of earnings and/or losses in proportion to their capital contributions?
- Does the exempt partner have a share of control over the entity that is more than fifty percent?
 - The IRS has not recognized exemption in any venture where the tax-exempt entity's share of control was less than fifty percent³

³ Lawrence M. Brauer, Mary Jo Salins & Robert Fontenrose, *Update on Health Care, in EXEMPT ORGANIZATIONS: CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FOR FY 2002*, 155 (2002)