Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5), and (c)(6) Organizations

By John Francis Reilly and Barbara A. Braig Allen

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Overview

Purpose

This article is intended to provide EO with information about the rules relating to the political campaign and lobbying activities of IRC 501(c)(4), (c)(5), and (c)(6) organizations.

An Appendix contains the Proxy Tax Check Sheet applicable for certain IRC 501(c)(4), (c)(5), and (c)(6) organizations used in Projects 206 and 207.

In This Article

This article contains the following topics:

A. General Rules Relating to Lobbying and Political Campaign Activities by IRC 501(c)(4), (c)(5), and (c)(6) Organizations

May IRC 501(c)(4), (c)(5), or (c)(6) Organizations Engage in Attempts to Influence Legislation (Lobbying)?

Yes. Organizations described in IRC 501(c)(4), (c)(5), and (c)(6) may engage in an unlimited amount of lobbying, provided that the lobbying is related to the organization's exempt purpose.

- This principle is enunciated in Rev. Rul. 61-177, 1961-1 C.B. 117, which holds that a corporation organized and operated primarily for the purpose of promoting a common business interest is exempt under IRC 501(c)(6) even though its sole activity is introducing legislation germane to such common business interest.
    - Rev. Rul 61-177 notes that there is no requirement, by statute or regulations, that a business league or chamber of commerce must refrain from lobbying activities to qualify for exemption.
    - The rule set forth in Rev. Rul. 61-177 applies to organizations described in IRC 501(c)(4) and (c)(5) as well. See Rev. Rul. 67-293, 1967-1 C.B. 185, and Rev. Rul. 71-530, 1971-2 C.B. 237.

May IRC 501(c)(4), (c)(5), or (c)(6) Organizations Engage in Political Campaign Activities?

IRC 501(c)(4), (c)(5), and (c)(6) organizations may engage in political campaigns on behalf of or in opposition to candidates for public office provided that such intervention does not constitute the organization's primary activity.

- The regulations under IRC 501(c)(4) provide that promotion of social welfare does not include participation or intervention in political campaigns. Reg. 1.501(c)(4)-1(a)(2)(ii).

G.C.M. 34233 (Dec. 3, 1969) reaches the same conclusion with respect to labor unions described in IRC 501(c)(5) and business leagues described in IRC 501(c)(6).

- The G.C.M. contrasts support of a candidate for office with lobbying activities.

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A. General Rules Relating to Lobbying and Political Campaign Activities by IRC 501(c)(4), (c)(5), and (c)(6) Organizations, Continued

May IRC 501(c)(4), (c)(5), or (c)(6) Organizations Engage in Political Campaign Activities?, continued

- The G.C.M. notes that the content of specific legislative proposals may be readily identified and related to the business or labor interests of the organizations. Therefore, business leagues and labor unions may engage in lobbying activities that are germane to their exempt purposes as their primary activity.

- However, "support of a candidate for public office necessarily involves the organization in the total political attitudes and positions of the candidate."

Because of this, the G.C.M. concluded that "this involvement transcends the narrower [exempt] interest" of the organization and could not be the primary activity of an organization described in either IRC 501(c)(5) or IRC 501(c)(6).

May IRC 501(c) Organizations Make Expenditures for IRC 527 "Exempt Function" Activities?

IRC 501(c) organizations may generally make expenditures for political campaign activities if such activities (and other activities not furthering its exempt purposes) do not constitute the organization's primary activity.

Examples:

- Social welfare organizations described in IRC 501(c)(4): (Rev. Rul. 81-95, 1981-1 C.B. 332 -- because organization's primary activities promote social welfare, its less than primary participation in political campaigns will not adversely affect its exempt status).

- Labor organizations described in IRC 501(c)(5): (Marker v. Schultz, 485 F.2d 1003 (D.C. Cir. 1973) and G.C.M. 36286 (May 22, 1975)).

- Business leagues described in IRC 501(c)(6): (G.C.M. 34233 (Dec. 3, 1969)).

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A. General Rules Relating to Lobbying and Political Campaign Activities by IRC 501(c)(4), (c)(5), and (c)(6) Organizations, Continued

Effect of Political Campaign Activity or Lobbying by an IRC 501(c) Organization on the Deductibility of Dues or Contributions to the Organization Under IRC 162

Dues or contributions to IRC 501(c)(4), (c)(5), and (c)(6) organizations may be deductible as business expenses under IRC 162.

Political campaign activity:

- Amounts paid for intervention or participation in any political campaign may not be deducted as a business expense. IRC 162(e)(2)(A).

Lobbying:

- Amounts paid for direct legislative lobbying expenses at the federal and state (but not the local) level may **not** be deducted as a business expense.
- Grass roots lobbying expenditures also are not deductible.
- Amounts paid for contact with certain federal officials would not be deductible under IRC 162(e).

Amounts paid to an IRC 501(c) organization that are specifically for political campaign activities or lobbying, would not be deductible under IRC 162.

If a substantial part of the activities of the IRC 501(c) organization consists of political campaign activities or lobbying, a deduction under IRC 162 is allowed only for the portion of dues or other payments to the organization that the taxpayer can clearly establish was not for political campaign or lobbying activities. Reg. 1.162-20(c)(3).

Until 1993, no mechanism existed at the association level to ensure notification to members of the disallowance.

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A. General Rules Relating to Lobbying and Political Campaign Activities by IRC 501(c)(4), (c)(5), and (c)(6) Organizations, Continued

OBRA 1993

In 1993, Congress enacted the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993).

- The Act disallowed the deduction for direct lobbying at the federal and state level as a business expense under IRC 162.

- Grassroots lobbying and political campaign activity continued to be nondeductible.

§13222 of OBRA 1993 amended IRC 6033, adding a new subsection to provide a system based on the disallowance of dues that builds in an incentive (or penalty) to ensure that associations notify their members.

The trigger is contained in IRC 6033(e), which imposes reporting and notice requirements on tax-exempt organizations incurring expenditures to which IRC 162(e) applies. IRC 162(e)(3) denies a deduction for the dues or other similar amounts paid to certain tax-exempt organizations to the extent that:

- The organization, at the time the dues are assessed or paid, notifies the dues payer that the dues are allocable to nondeductible lobbying and political expenditures of the type described in IRC 162(e)(1).

    - Payments that are similar to dues include voluntary payments or special assessments used to conduct political campaign activities.

The reporting and notice requirements and proxy tax under IRC 6033(e) are discussed under "**D. Disallowance and Notification - IRC 162(e) and 6033(e)**"

B. Tax on Political Expenditures - IRC 527(f)

What if an IRC 501(c) Organization Makes Expenditures for "Exempt Function" Activities as Defined in IRC 527(e)(2)?

IRC 527(e)(2) defines "exempt function" as "the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected or appointed." The term also includes payment of an incumbent's office expenses.

An IRC 501(c) organization that makes expenditures for such exempt function activities is subject to tax under IRC 527(b). IRC 527(f)(1) provides that the tax base is an amount equal to the lesser of:

(1) The organization's net investment income for the taxable year in which such expenditures are made, or

(2) The aggregate amount of expenditures for exempt function activities during the year.

This treatment applies whether the IRC 501(c) organization makes such expenditures

- Directly, or
- Through another organization.

Thus, an IRC 501(c) organization may not avoid taxation under IRC 527(f)(1) by establishing a separate organization to make expenditures for exempt function activities.

- However, under IRC 527(f)(3) expenditures may be made from a separate segregated fund.
    - Separate segregated funds are discussed in under "**C. Separate Segregated Fund Under IRC 527(f)**.

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B. Tax on Political Expenditures - IRC 527(f), Continued

What Is Included in Net Investment Income?

IRC 527(f)(2) defines net investment income as the excess of

(a) The gross amount of income from
- Interest,
- Dividends,
- Rents, and
- Royalties,
- Plus the excess (if any) of gains from the sale or exchange of assets over the losses from the sale or exchange of assets, over

(b) Allowable deductions, which are directly connected with producing such income.

Income and expenses taken into account for purposes of the unrelated business income tax under IRC 511 are not taken into account in calculating net investment income for purposes of IRC 527(f)(2).

Is Interest on State or Local Bonds Excluded in Determining Net Investment Income?

Interest on state or local bonds, within the meaning of IRC 103, should be excluded in determining net investment income under IRC 527(f)(2).

- In determining the gross amount of income from interest, etc., the definition of gross income under IRC 61 and the exclusions from gross income thus defined apply.
- Expenses directly connected with the production of interest on state or local bonds may not be deducted in determining net investment income.

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B. Tax on Political Expenditures - IRC 527(f), Continued

What Is Deductible in Determining Net Investment Income?

- Deductions allowed in determining net investment income under IRC 527(f)(2) must meet the same requirements as deductions allowed under IRC 527(c)(1).
- Expenses, depreciation, and similar items must qualify as deductions allowed under Chapter 1 and must be directly connected with the production of the gross amount of income which is subject to tax. Reg. 1.527-4(c)(1).
- Directly connected deductions have a proximate and primary relationship to the production of the taxable income and are incurred in the production of such income.
- The determination of whether a deduction was incurred in the production of taxable income is made on the basis of the relevant facts and circumstances.
- An item attributable solely to items of taxable income is proximately and primarily related to such income. Reg. 1.527-4(c)(2).

Example:

State income taxes paid on net investment income are attributed solely to items of taxable income and thus have a proximate and primary relationship with producing that income. IRC 164 allows a deduction for such taxes. They are deductible in computing net investment income under IRC 527(f). Rev. Rul. 85-115, 1985-2 C.B. 172.

The legislative history indicates that indirect expenses (such as general administrative expenses) are not allowed as deductions.

- These amounts were expected to be relatively small.
- Eliminating them would simplify the tax calculation. S. Rep. No. 93-1357, 93d Cong., 2d Sess. 29 (1974), reprinted in 1975-1 C.B. 527, 533.

The modifications under IRC 527(c)(2) also apply in computing the tax under IRC 527(f)(1). Reg. 1.527-6(d).

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B. Tax on Political Expenditures - IRC 527(f), Continued

Are All Expenditures That Are Considered Exempt Function Expenditures for Political Organizations Identically Treated When Carried on by an IRC 501(c) Organization?

Not all expenditures that are considered exempt function expenditures for political organizations are treated as taxable expenditures when carried on by an IRC 501(c) organization. Reg. 1.527-6(b)(4) and Reg. 1.527-6(b)(5) provide two specific exceptions.

(1) Under Reg. 1.527-6(b)(4), where an IRC 501(c) organization appears before any legislative body for the purpose of influencing the appointment or confirmation of an individual to a public office, any expenditure relating to such appearance is not treated as an exempt function expenditure.

- This exception is similar, but more limited than, the "furnishing technical advice or assistance" exception relating to lobbying by IRC 501(c)(3) organizations under IRC 4911 and 4945. The exception contained in Reg. 1.527-6(b)(4) only concerns certain requested appearances before legislative bodies, whereas, "technical advice or assistance" may be given otherwise than by appearance. Furthermore, the exception under Reg. 1.527-6(b)(4) only applies to appearances relating to appointments and confirmations, while the subject matter of the "technical advice or assistance" exception is unlimited.

(2) The exception provided by Reg. 1.527-6(b)(5) relates to expenditures for nonpartisan activities (including nonpartisan voter registration and "get-out-the-vote" campaigns).

- To come within the exception, nonpartisan voter registration and "get-out-the-vote" campaigns must not be specifically identified by the organization with any candidate or political party.

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B. Tax on Political Expenditures - IRC 527(f), Continued

Are an IRC 501(c) Organization's Expenditures Allowed by the FECA (2 U.S.C. § 441b(b)(2)(C)) and its Indirect Expenses Relating to Political Campaign Activity Considered Exempt Function Expenditures?

With respect to the FECA issue, the statute specifically permits labor unions and trade associations to spend money for:

(1) Internal communications with members, stockholders, and their families (but not to the general public) that might involve support of particular candidates;

(2) The conduct of nonpartisan registration and get-out-the-vote campaigns aimed at their members, stockholders, and families; and

(3) The establishment, administration, and solicitation of contributions to separate segregated funds to be used for political purposes.

As a result, when the regulations under IRC 527 were published in proposed form, several commentators suggested that these expenditures,

- Which are made routinely by some IRC 501(c) organizations, and
- Are regarded as appropriate under the FECA for such organizations, should be treated differently from identical expenditures made by political organizations.

In other words, the commentators suggested that such expenditures continue to be treated as "exempt function" activities for political organizations (including separate segregated funds of IRC 501(c) organizations) but not for IRC 501(c) organizations.

No final determination of the issue was made; therefore:

- The treatment of expenditures allowed by the FECA is reserved in the final regulations. Reg. 1.527-6(b)(3).
- The treatment of indirect expenses also is reserved in the final regulations. Reg. 1.527-6(b)(2).

Indirect expenses are defined in Reg. 1.527-2(c)(2) as expenses, overhead, and record keeping, necessary to support directly related exempt function activities.

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B. Tax on Political Expenditures - IRC 527(f), Continued

Are an IRC 501(c) Organization's Expenditures Allowed by the FECA (2 U.S.C. § 441b(b)(2)(C)) and its Indirect Expenses Relating to Political Campaign Activity Considered Exempt Function Expenditures?, continued

The Supplementary Information to the final regulations, T.D. 7744, 1981-1 C.B. 360, 361, explains that when these two subparagraphs (Reg. 1.527-6(b)(2) and (3)) are adopted as a final regulation, they will apply on a prospective basis.

- This means that an IRC 501(c) organization currently may engage in activities permitted by the FECA or may make any indirect exempt function expenditures and will not be subject to tax with respect to such expenditures under IRC 527.

- This situation may change when Reg. 1.527-6(b)(2) and (3) are promulgated, but there is no indication at present as to how or when the matters will be resolved.

- In summary, any decision with regard to the adverse treatment of such expenditures will be applied on a prospective basis from the date of any such decision.

As a result of these reserved provisions, an IRC 501(c) organization may pay for the indirect expenses of an IRC 527 organization without incurring tax under IRC 527(f).

- However, to take advantage of this situation, an IRC 501(c) organization must actually pay the indirect expenses.

Example:

In TAM 94-33-001 (Jan. 26, 1994), an IRC 501(c)(6) organization that made payments to the general treasury of its affiliated political action committee was determined to be subject to the tax under IRC 527(f).

The IRC 501(c)(6) organization stated:

- It intended the payments to be used to defray the administrative costs of the political action committee.

- It made the payment directly to the general treasury of the political action committee.

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B. Tax on Political Expenditures - IRC 527(f), Continued

Are an IRC 501(c) Organization's Expenditures Allowed by the FECA (2 U.S.C. § 441b(b)(2)(C)) and its Indirect Expenses Relating to Political Campaign Activity Considered Exempt Function Expenditures?, continued

- It took no steps to ensure that the funds were used solely for the indirect expenses of the political action committee.
- It based the amount paid on the number of its members rather than on any determination of actual indirect expenditures made by the political action committee.

Is an IRC 501(c) Organization Absolutely Liable for Amounts Transferred to an Individual or Organization That Are Used for Political Purposes?

An expenditure may be made for an exempt function

- Directly or
- Through another organization.

An IRC 501(c) organization will not be absolutely liable under IRC 527(f)(1) for amounts transferred to an individual or organization.

An IRC 501(c) organization is, however, required to take reasonable steps to ensure that the transferee does not use such amounts for an exempt function. Reg. 1.527-6(b)(1)(ii).

C. Separate Segregated Fund under IRC 527(f)

What is the Tax Treatment to an IRC 501(c) Organization of Expenditures for Political Activities Made by a Separate Segregated Fund Maintained by the Organization?

Expenditures for exempt function activities made by a separate segregated fund described in IRC 527(f)(3) are considered as made by an organization separate from the IRC 501(c) organization that maintains the fund. IRC 527(f)(3).

- Thus, an IRC 501(c) organization is not subject to tax under IRC 527 by reason of expenditures for exempt function activities made by a separate segregated fund that it maintains.

What is a Separate Segregated Fund?

A separate segregated fund is:

- A fund maintained by an IRC 501(c) organization
- That is a "separate segregated fund" within the meaning of 2 U.S.C. § 441b(b) (formerly 18 U.S.C. § 610), or of a similar state statute,
- Or within the meaning of a state statute that permits the segregation of dues money for expenditure for political campaign activities. IRC 527(f)(3).

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C. Separate Segregated Fund under IRC 527(f), Continued

How Is a Separate Segregated Fund Taxed?

If a separate segregated fund **meets** the requirements for a political organization under IRC 527(e)(1), it is treated for tax purposes as a political organization. Reg. 1.527-6(f).

- Expenditures by the separate segregated fund for non-exempt function activities would have the same result as expenditures made by any other political organization.

If a separate segregated fund **does not** meet the requirements for a political organization under IRC 527(e)(1), it is subject to tax, as a taxable organization, under general tax principles.

- IRC 527(f)(3) provides that a separate segregated fund "shall be treated as a separate organization."

What is the Tax Treatment of a Fund That Loses Its Status as a Separate Segregated Fund Under Applicable Federal or State Law?

If a fund loses its status as a separate segregated fund under applicable federal or state law:

- It is no longer treated as a separate organization for federal tax purposes. IRC 527(f)(3).
- Expenditures made from such a fund will subject the IRC 501(c) organization that maintains it to tax, pursuant to IRC 527(f)(1).

Example:

An IRC (c)(5) organization established an account as a separate segregated fund.

- The organization failed to meet the operational test.
- The account lost segregated fund status.
- The account was treated not as a separate entity, but as a bank account of the IRC 501(c)(5) organization. TAM 96-16-002 (Dec. 13, 1995).

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C. Separate Segregated Fund under IRC 527(f), Continued

Is a Transfer of Dues or Political Contributions by an IRC 501(c) Organization to a Separate Segregated Fund an Exempt Function Expenditure?

A transfer of dues or political contributions by an IRC 501(c) organization to a separate segregated fund is an exempt function expenditure of the IRC 501(c) organization unless:

- The transfer is made promptly after the receipt of such amounts by the IRC 501(c) organization and
- Is made directly to the separate segregated fund. Reg. 1.527-6(e)

Reg. 1.527-6(e) also provides that a transfer is considered promptly and directly made if the following conditions are met:

(A) The procedures followed satisfy applicable federal or state campaign law and regulations;

(B) The IRC 501(c) organization maintains adequate records to show that amounts transferred were political contributions and dues and not investment income; and

(C) The political contributions and dues were not used to earn investment income for the IRC 501(c) organization.

Example 1:

An IRC 501(c) organization collected political contributions and dues along with other receipts from its members.

- It deposited all amounts collected in an interest-bearing checking account.
- It subsequently transferred the political contributions and dues to the separate segregated fund.
- The IRC 501(c) organization maintained records showing the amount of political contributions and dues received.
- Once or twice a month, the organization transferred the amounts collected in the immediate preceding month or half-month period to the separate segregated fund.
- The organization retained the small amount of interest earned on these funds.
- The organization deposited the funds in the interest-bearing account primarily as an administrative convenience and not to earn investment income.

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C. Separate Segregated Fund under IRC 527(f), Continued

Is a Transfer of Dues or Political Contributions by an IRC 501(c) Organization to a Separate Segregated Fund an Exempt Function Expenditure?, continued

The organization did not make an exempt function expenditure. G.C.M. 39837 (May 22, 1990).

Example 2:

Alaska Public Service Employees Local 71 v. Commissioner, T.C.M. 1991-650.

FACTS:

- An IRC 501(c)(5) organization maintained a separate segregated fund.
- The primary source of funds for the separate segregated fund consisted of contributions from members of the IRC 501(c)(5) organization.
- Five percent of the general fund dues were allocated to the political fund unless discontinued by the member. Some additional contributions were withheld from the salary of the office staff of the IRC 501(c)(5) organization.
- These amounts were deposited in the general fund and promptly transferred (up to four times a month) to the separate segregated fund. It was agreed that these amounts did not constitute an exempt function expenditure by the IRC 501(c)(5) organization.
- However, in addition to these amounts, the organization authorized a transfer of $25,000 to the separate segregated fund from its general fund.
- During that year, the IRC 501(c)(5) organization had more than $25,000 of net investment income.

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C. Separate Segregated Fund under IRC 527(f), Continued

Is a Transfer of Dues or Political Contributions by an IRC 501(c) Organization to a Separate Segregated Fund an Exempt Function Expenditure?, continued

- Three years later, after the Service proposed to assess tax under IRC 527 on the amount transferred, the IRC 501(c)(5) organization attempted to reverse the transaction by transferring $25,000 from the separate segregated fund to the general fund.
- Prior to the transfer, the $25,000 transfer was an exempt function expenditure subject to tax under IRC 527(f)(1).

The court held that the IRC 501(c)(5) organization's attempt to reverse the transaction was not effective.

The court held that since the IRC 501(c)(5) organization failed to show that the transfer consisted of dues and not investment income and that the dues had not been used to earn investment income prior to the transfer, the $25,000 transfer was an exempt function expenditure subject to tax under IRC 527(f)(1).

May an IRC 501(c) Organization Whose Income Is Derived From Fees and Donations Establish a Separate Segregated Fund?

An IRC 501(c) organization that derives its income from fees and donations is not prohibited from establishing a separate segregated fund.

Amounts contributed by others directly to the separate segregated fund, and expenditures made by the fund will not be attributed to the IRC 501(c) organization for the purposes of the tax under IRC 527.

Whether transfers from the IRC 501(c) organization to the separate segregated fund will be considered exempt function expenditures of the IRC 501(c) organization is determined on the basis of the relevant facts and circumstances.

- Amounts transferred from the general fund of the IRC 501(c) organization will be considered exempt function expenditures causing the organization to be subject to tax under IRC 527.

- Amounts collected by the IRC 501(c) organization that are designated for the separate segregated fund and are promptly and directly transferred to the separate segregated fund in accordance with Reg. 1.527-6(e) will not be considered exempt function expenditures of the IRC 501(c) organization.

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C. Separate Segregated Fund under IRC 527(f), Continued

May an IRC 501(c)(4) Organization That Has a Related IRC 501(c)(3) Organization Also Have a Related PAC?

There is nothing that prohibits an IRC 501(c)(4) organization that has a related IRC 501(c)(3) organization from also having a related political action committee (PAC).

- The same concerns apply when an IRC 501(c)(4) organization with a related IRC 501(c)(3) organization conducts political activities through a PAC as when it conducts those activities itself.
- Like the situation with IRC 501(c)(4) organizations, contributions to a PAC are not tax-deductible.
- To ensure that no tax-deductible contributions are used to support the political campaign activity of the PAC, it must be separately organized and adequate records must be maintained.

As with political activities conducted directly by IRC 501(c)(4) organizations, a particular concern is the allocation of income and expenses when an IRC 501(c)(3) organization and a related PAC share

- Staff, S
- Facilities,
- Other expenses, or
- Conduct joint activities.

The determination of whether the allocation method used is appropriate and reasonable is based upon the relevant facts and circumstances.

D. Disallowance and Notification - IRC 162(e) and 6033(e)

1. In General

IRC 162(e)

IRC 162(e) disallows the deductibility of direct legislative lobbying expenses at the federal and state (but not the local) level.

- It also disallows deductions for contacts with certain federal officials.
- Grass roots lobbying and political campaign expenditures were also nondeductible.

In addition, IRC 162(e)(3) includes pass-through provisions affecting dues paid to exempt organizations, so organizations cannot indirectly do what is disallowed directly.

IRC 6033(e)

The regulations under IRC 162 have, since their adoption in 1965, provided for the disallowance of dues paid to an organization to the extent the organization is engaged in an activity prohibited under IRC 162(e). Reg. 1.162-20(c)(3).

However, no mechanism existed at the association level to ensure notification to members of the disallowance. Therefore, §13222 of OBRA 1993 also amended IRC 6033, adding a new subsection to provide a system based on the disallowance of dues that builds in an incentive (or penalty) to ensure that associations notify their members.

- The trigger is contained in IRC 6033(e), which imposes reporting and notice requirements on tax-exempt organizations incurring expenditures to which IRC 162(e) applies.

IRC 162(e)(3) denies a deduction for the dues (or other similar amounts) paid to certain tax-exempt organizations to the extent that the organization, at the time the dues are assessed or paid, notifies the dues payer that the dues are allocable to nondeductible lobbying and political campaign expenditures of the type described in IRC 162(e)(1).

- Payments that are similar amounts include voluntary payments or special assessments used to conduct lobbying and political campaigning.

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1. In General, Continued

IRC 6033(e) Options

An exempt organization subject to IRC 6033(e) has several options.

- It may provide a notice that contains a reasonable estimate of the amount allocable to lobbying and political campaign expenditures to its members when they pay dues.
- If it does not give notification, it must pay a proxy tax at the highest rate imposed by IRC 11 (currently 35 percent) on its lobbying and political campaign expenditures (up to the amount of dues and other similar payments received by the organization) during the taxable year.
- In addition, if the organization does provide notices to its members but underestimates the actual amount of lobbying and political campaign expenditures, it is subject to the proxy tax on the excess lobbying expenditures paid during the applicable year that were not included in the notices.
    - However, this tax may be waived if the organization agrees to include the excess lobbying and political campaign expenditures in the following year's notices.

Notice vs. Proxy Tax

This mechanism allows a membership organization to elect not to provide its members with a disallowance notice in which case the organization will be required to pay the tax.

If an organization elects the proxy tax option, no portion of any dues or other payments made by members of the organization will be deemed nondeductible as a result of the organization's lobbying and political campaign activities.

2. History of Regulations and Administrative Pronouncements

Reg. 1.162-20

Reg. 1.162-20 dealing with expenditures attributable to grass roots lobbying, political campaigns, and certain advertising, was published in 1965. (T.D. 6819, 30 FR 5581 (Apr. 20, 1965))

- The regulation, amended nearly four years later (T.D. 6996, 34 FR 835 (Jan. 18, 1969)), provides that if expenditures for lobbying purposes do not meet the requirements of IRC 162(e)(1), such expenditures are not deductible as ordinary and necessary business expenditures. Reg. 1.162-20(c)(1).

    - Proposed amendments to Reg. 1.162-20 were published in 1980 but have not been finalized. FR 78167 (Nov. 25, 1980).

Final Regulation

As a result of the OBRA 1993 legislation, the Service published final regulations providing allocation rules and rules concerning the definition of influencing legislation in 1995. T.D 8602, 60 FR 37568 (July 21, 1995).

- These new regulations also provide that to the extent the existing provisions of Reg. 1.162-20 are inconsistent with the new IRC 162, they are superseded. Reg. 1.162-20(c)(5).

At the same time, the Service published Rev. Proc. 95-35, 1995-2 C.B. 391, (superseded by Rev. Proc 98-19, 1998-1 C.B. 547) to provide procedures for organizations to determine whether they were excepted from the reporting and notice requirements of IRC 6033(e) in accordance with IRC 6033(e)(3).

3. Reporting and Notice Requirements and Proxy Tax IRC 6033(e)

a. Organizations Excepted from the Reporting and Notice Requirements

Are All IRC 501(c) Organizations Subject to the Requirements of IRC 6033(e)?

IRC 6033(e)(1)(B)(i) provides that the IRC 6033(e) notice requirements do not apply to IRC 501(c)(3) organizations.

- IRC 6033(e)(3) provides an exception for organizations that establish to the satisfaction of the Secretary that substantially all of the dues or similar amounts received by the organization are not deducted by its members as business expenses.

- Most IRC 501(c) organizations do not receive dues that are deducted by their members as business expenses under IRC 162.

The Service provides in Rev. Proc. 98-19, 1998-1 C.B. 547, § 4.01, that, pursuant to IRC 6033(e)(3), the requirements of IRC 6033(e) shall not apply to organizations recognized by the Service as exempt from taxation under IRC 501(a), other than:

(1) IRC 501(c)(4) social welfare organizations that are not veterans organizations,

(2) Agricultural and horticultural organizations described in IRC 501(c)(5), and

(3) IRC 501(c)(6) organizations.

Which IRC 501(c)(4) and IRC 501(c)(5) Organizations Does Rev. Proc. 98-19 Except?

The Service excepts from the IRC 6033(e) requirements in Rev. Proc. 98-19, § 4.01:

- IRC 501(c)(4) veterans' organizations and IRC 501(c)(5) labor organizations are excepted by other are excepted by the Service from the IRC 6033(e) requirements in Rev. Proc. 98-19, § 4.01.

- IRC 501(c)(4), social welfare organizations and IRC 501(c)(5) agricultural and horticultural organizations that meet a safe harbor set forth in Rev. Proc. 98-19, § 4.02, also will be excepted from IRC 6033(e).

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a. Organizations Excepted from the Reporting and Notice Requirements, Continued

Which IRC 501(c)(4) and IRC 501(c)(5) Organizations Does Rev. Proc. 98-19 except?, continued

The safe harbor provides that these organizations are not subject to IRC 6033(e) if more than 90 percent of their annual dues (or similar amounts) are received from members paying annual dues (or similar amounts) of $75 or less, or from

1. IRC 501(c)(3) organizations, state or local governments, entities whose income is exempt from tax under IRC 115, or

2. Organizations excepted by § 4.01 of Rev. Proc. 98-19 as noted above.

- The $75 amount will be increased for years after 1998 by a cost-of-living adjustment under IRC 1(f)(3), rounded to the next highest dollar. Rev. Proc. 98-19, § 5.05. For tax years beginning in 2002, this amount is $83. Rev. Proc. 2001-59, Rev. Proc. 2001-52, I.R.B. 623, § 3.23.

Organizations that do not meet the safe harbor may establish that they satisfy the requirements of IRC 6033(e)(3) by

- Maintaining records establishing that at least 90 percent of the annual dues received by the organization are not deductible by its members (without regard to IRC 162(e)) and

- Notifying the Service on its Form 990, *Return of Organization Exempt from Income Tax*, that it is described in IRC 6033(e)(3). Rev. Proc. 98-19, § 5.06.

  - The organization may also request a private letter ruling to this effect in accordance with the procedures set forth in Rev. Proc. 2001-4, 2001-1 I.R.B. 121. If an organization receives a favorable private letter ruling, the Service will not contest its entitlement to exemption under IRC 6033 (e)(3) for a subsequent year so long as the character of its membership is substantially similar to its membership at the time of the ruling.

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a. Organizations Excepted from the Reporting and Notice Requirements, Continued

What Organizations Described in IRC 501(c)(6) Are Excepted by Rev. Proc. 98-19?

Generally, IRC 501(c)(6) organizations are subject to the IRC 6033(e) requirements.

Rev. Proc. 98-19, § 4.03, provides an exception for IRC 501(c)(6) organizations if over 90 percent of their annual dues (or similar amounts) are received from

(1) IRC 501(c)(3) organizations,
(2) State or local governments,
(3) Entities whose income is exempt from tax under IRC 115, or
(4) Organizations excepted by § 4.01 of Rev. Proc. 98-19, as noted above.

IRC 501(c)(6) organizations that do not meet this test may also establish that they satisfy the requirements of IRC 6033(e)(3) by

- Maintaining records establishing that at least 90 percent of the annual dues received by the organization are not deductible by its members (without regard to IRC 162(e)) in the same manner as IRC 501(c)(4) and IRC 501(c)(5) organizations and

- Notifying the Service on its Form 990 that it is described in IRC 6033(e)(3). Rev. Proc. 98-19, § 5.06.

IRC 501(c)(6) organizations may also request a private letter ruling as discussed above.

What Are "Annual Dues" and "Similar Amounts"?

The terms:

- **Annual dues** means the amount an organization requires a person to pay to be recognized by the organization as a member for an annual period.

- **Similar amounts** includes, but is not limited to:

  - Voluntary payments made by persons,

  - Assessments made by the organization to cover basic operating costs, and

  - Special assessments imposed by the organization to conduct lobbying activities. Rev. Proc. 98-19, § 5.01.

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a. Organizations Excepted from the Reporting and Notice Requirements, Continued

What Are "Annual Dues" and "Similar Amounts"?, continued

- **Member** is used in its broadest sense and is not limited to persons with voting rights in the organization. Rev. Proc. 98-19, § 5.02.

  If payment for a "membership" is intended to provide more than one person with recognition by the organization as a member for an annual period, annual dues is the full amount of payment requested for that category of membership

How Does Rev. Proc. 98-19 Treat Affiliated Organizations?

Rev. Proc. 98-19 provides a special aggregation rule that treats affiliated organizations (a national trade association that has state and local chapters) as a single organization for purposes of IRC 6033(e).

- The rule provides that if more than one organization described in IRC 501(c)(4), (c)(5), or (c)(6) share a name, charter, historic affiliation, or similar characteristics, and coordinate their activities, organizations in the affiliate structure are treated as a single organization.

Applying the Tests in the Safe Harbor

In applying the tests in the safe harbor, only dues paid by the "ultimate members" whether paid to one level, which then remits the amounts to other levels in the structure, or paid separately to each level are considered.

Amounts paid by one organizational level to another are not considered, even if they are characterized as "dues." If the organization as a whole meets the requirements of IRC 6033(e)(3), (more than 90 percent of the dues are received from persons paying $75 or less) all organizations in the affiliated structure meet the requirements. Rev. Proc. 98-19, § 5.03.

- If organizations within the affiliated structure are on different taxable years, the organizations may base their calculations of annual dues received on any single reasonable taxable year.

Continued on next page

a. Organizations Excepted from the Reporting and Notice Requirements, Continued

Applying the Tests in the Safe Harbor, continued

Example:

Applying the affiliation rule.

- A group of national, state, and local IRC 501(c)(4) organizations share a common name and work jointly to promote their purpose.

- Individuals or families pay annual dues of $75 to the local organizations, entitling them to membership in the national and state organizations.

- The local organizations remit a portion of the dues to the state and national organizations. These remittances by the local organizations exceed $75. The total amount received by all local organizations is $950x. In addition, corporations pay dues of $500 to and become members of the national organization. The total amount received from these members is $50x. Since the $950x exceeds 90 percent of the $1000x received from all members, all of the national, state, and local organizations meet the requirements of IRC 6033(e)(3). The transfers from the local organization are not considered in this determination. Rev. Proc. 98-19, § 5.04.

b. Exempt Organization Requirements

How Are Exempt Organizations Taxed Under IRC 6033(e)?

Organizations may not avoid the disallowance of the deduction for political campaign activity by deducting dues paid to tax-exempt organizations that engage in political campaign activity.

- Thus, to prevent this avoidance, IRC 6033(e) provides that organizations subject to its provisions are required to provide a notice to its members indicating the nondeductible portion of dues paid due to political campaign activities.
    - If the exempt organization does not provide the notice or if its actual political campaign expenditures exceed the amount disclosed in the notice, the organization will be subject to a proxy tax on the amount that should have been included in the notice but was not.
    - The proxy tax is equal to this amount multiplied by the highest corporate rate imposed by IRC 11. IRC 6033(e)(2). Thus, the organization has the option of providing a notice to its members of the amount of dues that is not deductible due to political campaign activities or paying the proxy tax.

What Notices Must Be Provided to Members?

An organization subject to IRC 6033(e) is required to provide notice to each person paying dues of the portion of dues that the organization reasonably estimates will be allocable to the organization's political campaign expenditures during the year and, thus, is not deductible by the member.

- This estimate must be provided at the time of assessment or payment of the dues and must be reasonably calculated to provide the organization's members with adequate notice of the nondeductible amount. IRC 6033(e)(1)(A)(ii).
- The legislative history indicates that the notice should be provided in a conspicuous and easily recognizable format, referring to IRC 6113 and the regulations thereunder for guidance regarding the appropriate format of the disclosure statement.
    - For guidance regarding IRC 6113, see Notice 88-120, 1988-2 C.B. 454, discussed under **E. Disclosure Requirements – IRC 6113.** However, unlike IRC 6113, there is no penalty associated with failure to provide the disclosure notice in this format.

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b. Exempt Organization Requirements, Continued

What Information Must be Disclosed on the Form 990?

IRC 501(c)(4), IRC 501(c)(5), and IRC 501(c)(6) organizations are required to disclose information regarding their political campaign activities on Form 990, *Return of Organization Exempt from Income Tax*.

If an organization is excepted from the IRC 6033(e) requirements either because

- substantially all of its dues were not deductible by its members or
- because its direct lobbying expenditures consisted solely of in-house expenditures that did not exceed $2,000,

It must disclose this information on the Form 990.

- If the organization does not meet either of these exceptions, it must disclose the information necessary to determine if it is subject to the proxy tax.
- This information consists of the total dues received from members, the amount of its IRC 162(e) lobbying and political campaign expenditures, and the amount it disclosed to its members as the nondeductible portion of dues. IRC 6033(e)(1)(A)(i).

What Amount Is Disclosed on the Form 990 as IRC 162(e) Lobbying and Political Campaign Expenditures?

The amount disclosed begins with the organization's lobbying and political campaign expenses determined in accordance with IRC 162(e).

- Direct lobbying of local councils or similar governing bodies with respect to legislation of direct interest to the organization or its members and in-house direct lobbying expenses if the total of such expenditures is $2,000 or less (excluding allocable overhead expenses) should be excluded from the amount disclosed. IRC 162(e)(2) and IRC 162(e)(5)(B).
- Amounts carried over from prior years, either because the lobbying and political campaign expenditures exceeded the dues received in those years or because the organization received a waiver of the proxy tax imposed on that amount must be included. IRC 6033(e)(1)(C) and IRC 6033(e)(2)(B).
- The current year's lobbying and political campaign expenditures should be reduced, but not below zero, by costs allocated in a prior year to lobbying and political campaign activities that were cancelled after a return reporting these costs was filed in accordance with Reg. 1.162-29(e)(2).

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b. Exempt Organization Requirements, Continued

What Amount Is Disclosed for Nondeductible Dues Notices?

If the organization notified its members in accordance with IRC 6033(e)(1)(A)(ii) of its estimate of the portion of dues that would not be deductible under IRC 162(e), it must disclose on Form 990 the total amount of dues that its members were notified were nondeductible.

Example:

The organization timely notified its members that 25 percent of their dues would be nondeductible and the members paid a total of $100,000 of dues allocable to the year, the amount reported on Form 990 would be $25,000.

What If Lobbying and Political Campaign Expenditures Exceed the Estimated Amount?

If the actual lobbying and political campaign expenditures of an organization subject to IRC 6033(e) exceed the amount that it notified its members was not deductible (either because the expenses were higher than anticipated or the dues receipts were lower), the organization is liable for a proxy tax on the excess amount. IRC 6033(e)(2)(A). The organization may seek a waiver of the proxy tax.

- It is also possible that an organization could overstate the portion of the dues that are not deductible in the notice of disallowance. It could do so by overestimating the amount of the disallowed expenses or underestimating dues income.

    - The Conference Report indicates that guidance should be issued to cover this eventuality. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 608 n. 66 (1993), reprinted in 1993-3 C.B. 393, 486. Therefore, the legislative history clearly indicates that organizations that overstate the portion of dues that are not deductible may be able to take this excess into account. Until such time as guidance is issued, a reasonable method would be to treat an overstatement similarly to an understatement and take the excess amount into account in the following year by subtracting it from the estimate of lobbying and political campaign expenses for that year.

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b. Exempt Organization Requirements, Continued

How Does an Organization Request a Waiver?

An organization checks a box on Form 990 agreeing to add the amount it entered as its taxable amount of lobbying and political campaign expenditures to its dues estimate for the following year and to enter the amount on the next year's Form 990.

- An organization may use this waiver procedure only if it sent dues notices at the time of assessment or payment of dues that reasonably estimated the dues allocable to nondeductible lobbying and political campaign expenditures.

How Is the IRC 6033(e) Proxy Tax Determined?

An organization subject to IRC 6033(e) must report on the Form 990:

- The total dues it received from members,
- The amount of its IRC 162(e) lobbying and political campaign expenditures for the year, and
- The amount it disclosed to its members as the nondeductible portion of dues.

The amount subject to the IRC 6033(e)(2) proxy tax equals lobbying and political campaign expenditures under IRC 162 minus the amount disclosed to the members as nondeductible.

- However, if this amount is more than the amount by which the total dues received exceeds the amount disclosed to the members as nondeductible, then the tax is imposed on the lesser amount and the excess is carried over to the next year.

Examples:

1. An organization reports on the Form 990 that its lobbying and political campaign expenditures under IRC 162(e) for the taxable year were $600x and the aggregate amount of nondeductible dues notices is $100x. If the total amount of dues received was $800x, then the taxable amount would be $500x ($600x - $100x).

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b. Exempt Organization Requirements, Continued

How Is the IRC 6033(e) Proxy Tax Determined?, continued

2. If the total amount of dues received was $400x, the taxable amount would be limited to $300x ($400x - $100x) and the excess $200x ($500x - $300x) would be carried over and included in the next year's IRC 162 lobbying and political campaign expenditures.

The taxable amount is multiplied by the highest rate specified in IRC 11 to determine the IRC 6033(e) proxy tax. If the organization elects to pay the tax, it is reported on Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*.

- When an organization elects to pay the proxy tax rather than to provide its members with an estimate of dues allocable to IRC 162(e) lobbying and political campaign expenditures, all of the members' dues remain eligible for deduction to the extent otherwise deductible.

- The organization may also request a waiver of this tax if it made a reasonable estimate and agrees to adjust its notice of IRC 162(e) lobbying and political campaign expenditures to members in the following year.

- Thus, in the second example above, if the organization requested a waiver, both the excess amount and the taxable amount would be carried over and included in the next year's IRC 162 lobbying and political campaign expenditures.

Must Estimated Tax on the Proxy Tax Be Paid?

Organizations subject to IRC 6033(e) are not required to pay estimated tax on the IRC 6033(e) proxy tax, even if they do not provide notices to their members. The instructions for Form 990-T indicate that the proxy tax is not to be included when calculating estimated tax liability.

What if Political Campaign Expenditures Are Under-reported?

Under-reported political campaign expenditures are subject to the IRC 6033(e) proxy tax for the year at issue only to the extent that the same expenditures (if actually reported) would have resulted in a proxy tax liability for that year.

- A waiver of the proxy tax for the taxable year only applies to reported expenditures. Under-reporting political campaign expenditures may also subject the organization to a $10 per day penalty under IRC 6652 for filing an incomplete or inaccurate return.

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4. Definitional Issues Regarding Lobbying

What Is the Meaning of "Influencing Legislation?"

IRC 162(e)(4)(A) defines "influencing legislation" as "any attempt to influence any 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 legislation."

- This definition is essentially identical (as it relates to direct, as opposed to grass roots, lobbying) to IRC 4911.

Reg. 1.162-29(b)(1) provides that "influencing legislation " involves the following activities:

(A) Any attempt to influence any legislation through a lobbying communication; and

(B) All activities, such as research, preparation, planning and coordination, including deciding whether to make a lobbying communication, engaged in for a purpose of making or supporting a lobbying communication.

What Is a "Lobbying Communication?"

Pursuant to Reg. 1.162-29(b)(3), a "lobbying communication" is

- any communication (other than any communication compelled by subpoena, or otherwise compelled by federal or state law) with any member or employee of a legislative body or any other government official or employee who may participate in the formulation of the legislation that does either of the following:

  (A) The communication refers to specific legislation and reflects a view on that legislation; or

  (B) The communication clarifies, amplifies, modifies, or provides support for views reflected in a prior lobbying communication.

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4. Definitional Issues Regarding Lobbying, Continued

What Is a "Lobbying Communication?", continued

- The phrase "reflects a view" is of critical importance. After it appeared in the proposed regulations, several commentators suggested it should be defined to mean an explicit statement of support or opposition to the legislation.

- Some commentators also suggested that presenting a balanced analysis of the merits and defects of specific legislation should not constitute reflecting a view on legislation. Neither recommendation was adopted in the final regulations. T.D. 8602, 60 FR 37568 (July 21, 1995).

- Therefore, an organization can reflect a view on legislation without specifically stating it supports or opposes that legislation.

Example:

An organization writes a letter to a United States Senator discussing how a certain pesticide has benefited citrus fruit growers and disputing problems linked to its use. The letter discusses a bill pending in Congress and states in part:

> This bill would prohibit the use of pesticide O. If citrus growers are unable to use this pesticide, their crop yields will be severely reduced, leading to higher prices for consumers and lower profits, even bankruptcy, for growers.

- Despite the fact that the organization does not explicitly state that it opposes the bill, its views on the bill are reflected in the statement.

The communication is a lobbying communication, and the organization is attempting to influence legislation. Reg. 1.162-29(b)(7), Example 8.

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4. Definitional Issues Regarding Lobbying, Continued

Do the Exceptions Under IRC 4911(d)(2) Apply for Purposes of IRC 162(e)?

No. A significant difference between the two statutes is that while IRC 4911(d) contains specific exceptions to the term "influencing legislation," IRC 162(e) does not. An example of this difference is the "self defense" exception under IRC 4911(d)(2)(C). IRC 162(e) contains no counterpart, and the legislative history strongly suggests that no exception is to be inferred.

- Statements in footnote 49 of the Conference Report (H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 597 (1993), reprinted in 1993-3 C.B. 475), H.R. Rep. No. 1447 (87th Cong., 2d Sess. 16-18 (1962), reprinted in 1962-3 C.B. 405, 420-422) and S. Rep. No. 1881 (87th Cong., 2d Sess. 21-24 (1962), reprinted in 1962-3 C.B. 707, 727-730) indicate that the holding of Cammarano v. United States, 358 U.S. 498 (1959) (upholding the validity of regulations denying a deduction for lobbying even when the expenses related to proposed legislation that affected the survival of the taxpayer's business) remains good law unless specifically contradicted by statute.

- Similarly, IRC 162(e) draws no distinction between influencing legislation and educating legislators, unlike the IRC 4911(d)(2) exceptions for making available the results of nonpartisan analysis, study, or research and for providing technical advice or assistance to a governmental body.

    - See also, H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 607 (1993), reprinted in 1993-3 C.B. 485, where the Conference Report notes that exceptions contained in previous versions of the bill were not included in conference agreement.

    - Therefore, IRC 162(e) disallows a deduction for some activities that would not be considered direct lobbying under IRC 4911. Accordingly, Reg. 1.162-29(a) specifically provides that the rules enunciated in the regulation have no bearing on IRC 4911 or IRC 4945.

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4. Definitional Issues Regarding Lobbying, Continued

What Is Legislation?

IRC 162(e) disallows the deduction for amounts spent or incurred to influence "legislation" considered by a "legislative body."

- IRC 162(e)(4)(B) provides that, for this purpose, "legislation" has the same meaning as under IRC 4911(e)(2).

Reg. 1.162-29(b)(4) provides that "legislation" includes any action on Acts, bills, resolutions and similar items by a "legislative body." "Legislation" includes a proposed treaty required to be submitted by the President to the Senate for and consent from the time the President's representative begins to negotiate a position with the prospective parties to the treaty.

What Is "Specific Legislation?"

Under Reg. 1.162-29(b)(5), the term "specific legislation" includes a specific legislative proposal that has not been introduced. In a legislative body. Unlike "legislation" under Reg. 1.162-29(b)(4) it is not limited to action with respect to acts, bills, etc.

Example 1:

Taxpayer W, based in State A, notes in a letter to a legislator of State A that State X has passed a bill that accomplishes a stated purpose and then says that State A should pass such a bill. No such bill has been introduced into the State A Legislature. The communication is a lobbying communication because it refers to and reflects a view on a specific legislative proposal.
Reg. 1.162-29(b)(7), Example 7.

- However, merely identifying a problem and indicating that a legislative body should do something about the problem without specifying what the legislative body should do will not constitute a specific legislative proposal.

Example 2:

An organization provides to legislators a paper that it has prepared stating that the lack of new capital is hurting the economy. If the organization merely indicates that increased savings and local investment will assist the economy and includes a cover letter stating, "You must take action to improve the availability of new capital," the organization has not referred to a specific legislative proposal. Reg. 1.162-29(b)(7), Example 5.

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4. Definitional Issues Regarding Lobbying, Continued

What Is "Specific Legislation?", continued

But if the organization indicates that lowering the capital gains rate would increase the availability of new capital and includes a cover letter stating, "I urge you to support a reduction in the capital gains tax rate," then it has referred to a specific legislative proposal. Reg. 1.162-29(b)(7), Example 6.

What Are "Legislative Bodies? "

Reg. 1.162-29(b)(6) defines the term "legislative bodies" to include Congress, state legislatures, and other similar governing bodies.

- Local councils and similar governing bodies are not "legislative bodies" for purposes of IRC 162(e). Executive, judicial, and administrative bodies are also not included.

  - "Administrative bodies" includes
    - School boards,
    - Housing authorities,
    - Sewer and water districts,
    - Zoning boards, and
    - Other similar federal, state, or local special purpose bodies, whether elective or appointive.

Example 1:

State X enacts a statute that requires the licensing of all day-care providers.

- Agency B in State X is charged with writing rules to implement the statute.

- After the enactment of the statute, Taxpayer S sends a letter to Agency B providing detailed proposed rules that S recommends Agency B adopt to implement the statue on licensing of day-care providers.

- Because the letter to Agency B neither refers to nor reflects a view on any specific legislation, it is not lobbying communication.

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4. Definitional Issues Regarding Lobbying, Continued

What Are "Legislative Bodies? ", continued

Communications with the administrative agency charged with writing regulations implementing a statute regarding recommendations concerning those regulations are not considered lobbying communications because the regulations are not legislation considered by a "legislative body." Reg. 1.162-29(b)(7), Example 3.

Example 2:

Taxpayer R is invited to provide testimony at a congressional oversight hearing concerning the implementation of The Financial Institution Reform, Recovery, and Enforcement Act of 1989.

- Specifically, the hearing concerns a proposed regulation increasing the threshold value of commercial and residential real estate transactions for which an appraisal by a state licensed or certified appraiser is required.

- In its testimony, R states that it is in favor of the proposed regulation. Because R does not refer to any specific legislation or reflect a view on any such legislation, R has not made a lobbying communication.

The issue is the administrative action and not specific legislation considered by a "legislative body," even though the hearings are before a "legislative body." Reg. 1.162-29(b)(7), Example 2.

What Is the Exception for Local Councils and Similar Bodies?

IRC 162(e)(2) provides an exception to the general disallowance rule for certain lobbying expenditures related to local councils and similar governing bodies.

IRC 162(e)(2) provides that two types of lobbying expenses are deductible.

1. Ordinary and necessary expenses (including travel and preparation of testimony) in connection with appearances before, making statements to, or sending communications to the committees or individual members of a local council.

2. Expenses of communication with an organization of which the taxpayer is a member about local legislation or proposed legislation of direct interest to the taxpayer or the organization.

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4. Definitional Issues Regarding Lobbying, Continued

What Is the Exception for Local Councils and Similar Bodies?, continued

3. In addition, the portion of the dues paid to an organization that is attributable to either of these activities is not subject to the disallowance rule and therefore deductible.

    - Grass roots lobbying on local government legislative actions is not covered by the exception.

The legislative history indicates that the term "local councils or similar governing bodies" includes any legislative body of a political subdivision of a state, such as a county or city council. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 605 (1993), reprinted in 1993-3 C.B. 483.

For purposes of the IRC 162 lobbying rules, Indian tribal governments are treated as "local councils or similar governing bodies." IRC 162(e)(7).

What Is a "Covered Executive Branch Official?"

IRC 162(e)(1)(D) disallows a deduction for expenditures for any "direct communication with a covered executive branch official in an attempt to influence the official actions or positions of [the] official."

Pursuant to IRC 162(e)(6), a "covered executive branch employee" includes:

- The President,
- The Vice President,
- Any person serving in level I of the Executive Schedule (e.g., a Cabinet Officer) or
- Any other person designated by the President as having Cabinet-level status and their immediate deputies,
- The two most senior-level officers of each agency within the Executive Office of the President, and
- Any other official or employee of the White House Office of the Executive Office of the President.

The legislative history indicates that all written or oral communication with covered executive branch officials is included in this disallowance. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 605 n. 57 (1993), reprinted in 1993-3 C.B. 483. A communication with the covered executive branch official will be considered with that official if the official is intended as the primary recipient.

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4. Definitional Issues Regarding Lobbying, Continued

What Is the Exception for Minimal In-house Lobbying?

IRC 162(e)(5)(B)(ii) excepts from the general disallowance rule organizations that are involved in a minimal amount of in-house lobbying.

- When an organization's total amount of in-house lobbying expenses does not exceed $2,000 (computed without taking into account general overhead costs otherwise allocable to lobbying), this exception applies.
    - For purposes of this rule, in-house expenses include labor and material costs.
- Payments made to a third-party lobbyist and dues payments allocable to lobbying are subject to the disallowance rules, regardless of whether or not the organization's in-house expenses are exempted.
- In addition, the de minimis in-house rule does not apply to expenses incurred for political activity, grass roots lobbying or foreign lobbying which continue to be disallowed under current law rules.

5. Lobbying Purpose

When Is an Activity Engaged in for the Purpose of Making a Lobbying Communication?

As noted above, Reg. 1.162-29(b)(1) provides that an "attempt to influence legislation" includes:

- Not only a lobbying communication,
- But also all research and
- Other preparatory activities engaged in for a purpose of making or supporting a lobbying communication.

Reg. 1.162-29(c) sets forth a purpose test, which considers the original intent for engaging in a particular activity in order determine whether a lobbying activity, in whole or in part, has occurred.

- The general rule, set forth in Reg. 1.162-29(c)(1), provides that the purpose or purposes for engaging in an activity are determined on the basis of all the facts and circumstances, including (but not limited to) the following factors:

  (A) Whether the activity and the lobbying communication are proximate in time;

  (B) Whether the activity and the lobbying communication relate to similar subject matter;

  (C) Whether the activity is performed at the request of, under the direction of, or on behalf of a person making the lobbying communication;

  (D) Whether the results of the activity are also used for a non-lobbying purpose; and

  (E) Whether, at the time the organization engages in the activity, there is specific legislation to which the activity relates.

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5. Lobbying Purpose, Continued

When Is an Activity Engaged in for the Purpose of Making a Lobbying Communication? continued

The regulations provide several examples of how the facts and circumstances test is applied.

Example 1:

In 1997, Agency F issues proposed regulations relating to the business of Taxpayer W. There is no specific legislation during 1997 that is similar to the regulatory proposal. W undertakes a study of the impact of the proposed regulations on its business. W incorporates the results of that study in comments sent to Agency F in 1997. In 1998, legislation is introduced in Congress that is similar to the regulatory proposal. Also in 1998, W writes a letter to Senator P stating that it opposes the proposed legislation. W encloses with the letter a copy of the comments it sent to Agency F.

Although the communication with the legislator is a lobbying communication, the organization conducted the study and submitted comments to the administrative agency at a time when no similar legislative proposal was pending. Therefore, it engaged in the study for a non-lobbying purpose. Reg. 1.162-29(c)(4), Example 1.

Example 2:

An organization that has entered into a contract with a government agency conducts tests regarding the project, submits the test results to the government agency and revises the project specifications in compliance with the contract. It subsequently prepares a summary of the test results and revised specifications which it submits to legislators to encourage them to support appropriations for the contract. The summary was prepared specifically for, and close in time to, the lobbying communication and so was for a lobbying purpose. However, the tests were conducted and the specifications revised pursuant to contract requirements and, thus, were solely for a non-lobbying purpose. Reg. 1.162-29(c)(4), Example 4.

On the other hand, an organization that conducts a study at the request of its legislative affairs staff concerning the impact of proposed legislation on its business does so solely for a lobbying purpose, despite the fact that the organization subsequently used the study for labor negotiations with its employees. Reg. 1.162-29(c)(4), Example 2.

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5. Lobbying Purpose, Continued

What if an Activity Is Engaged in for Multiple Purposes?

Pursuant to Reg. 1.162-29(c)(2), if an organization engages in an activity both for a lobbying purpose and for some non-lobbying purpose, it must treat the activity as engaged in partially for the lobbying purpose and partially for the non-lobbying purpose.

- This division of the activity must result in a reasonable allocation of costs between nondeductible lobbying costs and other costs. (The allocation rules set forth in Reg. 1.162-28 are discussed at **D. 6. Cost Allocations**.)

Example 1:

A person travels to the state capital to attend a two-day conference. While there, he spends a third day meeting with state legislators to explain why his corporation opposes a pending bill unrelated to the subject of the conference. Although his trip is partially for a non-lobbying purpose, it also has a lobbying purpose since he refers to and reflects a view on the pending bill. Thus, his corporation must reasonably allocate his traveling expenses between these two purposes.
Reg. 1.162-29(c)(4), Example 5.

Example 2:

An organization's legislative affairs staff prepares a summary of legislation that would affect the organization's business at the time it is proposed and continues to confirm the procedural status of the bill periodically. Two months after the bill was introduced, the organization assigns one of its employees to prepare a position letter on the bill to be delivered to legislators. The preparation of the original summary and the procedural status checks on the bill for the first two months are not considered to be for a lobbying purpose. However, once the organization made the determination to make a lobbying communication, the procedural status checks on the bill after that time are for a lobbying purpose.
Reg. 1.162-29(c)(4), Example 6.

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5. Lobbying Purpose, Continued

May Certain Activities Be Treated as Having No Purpose To Influence Legislation?

Reg. 1.162-29(c)(3) provides that certain activities are not engaged in for the purpose of making or supporting lobbying communications.

These activities consist of:

- Those activities undertaken to comply with the requirements of any law (for example, satisfying state or federal securities law filing requirements),
- Reading any publications available to the general public, or
- Viewing or listening to other mass media communications, and
- Merely attending a widely attended speech.

In addition, if, prior to evidencing a purpose to influence particular legislation (or similar legislation), an organization

- Determines the existence or procedural status of that legislation,
- Determines the time, place, and subject of any hearing to be held by a legislative body with respect to that legislation, or
- Prepares or reviews routine, brief summaries of the provisions of that legislation,

the organization is treated as engaging in that activity with no purpose of making or supporting a lobbying communication.

What if Activities Support Lobbying Communications by Another Organization?

Reg. 1.162-29(d) provides that when an organization engages in activities for a purpose of supporting a lobbying communication to be made by another person, the organization's activities are treated as influencing legislation.

Example:

If an organization or its employee (as a volunteer or otherwise) engages in an activity to assist a trade association in preparing its lobbying communication, the organization's activities are influencing legislation even though the lobbying communication is made by the trade association. However, the personal activities an organization's employee outside the scope of employment will not be attributed to the organization.

Continued on next page

5. Lobbying Purpose, Continued

What Happens if a Lobbying Communication Is Not Made?

In some instances, organizations engage in activity to support lobbying communications that they never make.

- Under Reg. 1.162-29(e), if the organization determines before the filing date of its return that it does not expect, under any reasonably foreseeable circumstances, to make a lobbying communication, the activity is treated as if it had not been engaged in for a lobbying purpose. The organization need not treat any amount allocated to that activity for that year as an amount to which IRC 162(e)(1)(A) applies.
  - The filing date for this purpose is the earlier of the time the organization files its timely return for the year of the due date of the timely return.
- On the other hand, if the organization reaches the conclusion at any time after the filing date, then any amount previously disallowed with respect to that activity is treated as an amount that is paid at that time that is not subject to IRC 162(e)(1)(A).
  - Thus, the organization is effectively treated as if it incurred the costs relating to the activity in the later year in connection with a non-lobbying activity.
  - Exempt organizations to which IRC 6033(e) applies may treat such amounts as reducing (but not below zero) their lobbying costs.
  - The organization may carry forward any amount not used to reduce lobbying costs to subsequent years.

Is There an Anti-avoidance Rule?

Yes. Reg. 1.162-29(f) provides:

- If an organization, alone or with others, structures its activities with a principal purpose of achieving results that are unreasonable in light of the purposes of IRC 162(e) and IRC 6033(e),
- The Service can recast the organization's activities for federal tax purposes to achieve tax results that are consistent with the intent of these provisions and the pertinent facts and circumstances.

6. Cost Allocations

How Must Costs Be Allocated?

When an organization engages in an activity that has both a lobbying and a non-lobbying purpose, it must allocate the cost of the activity between the two using a reasonable method. Reg. 1.162-29(c)(2) and Reg. 1.162-28(b)(1).

- Reg. 1.162-28 describes costs that must be allocated to lobbying activities and methods that may be used to allocate those costs.
    - Reg. 1.162-28 does not apply, however, to organizations that are engaged in the trade or business of conducting lobbying activities on behalf of another person.
        - IRC 162 (e)(5)(A) provides that organizations that are engaged in the trade or business of conducting lobbying activities on behalf of another person are not subject to the general disallowance rules.
    - Furthermore, the regulation is not intended to be applied for purposes of IRC 4911 and 4945 and the regulations thereunder.
    - The organization must maintain records in accordance with IRC 6001 and its regulations.

What Is a Reasonable Method of Allocation?

Reg. 1.162-28(b) permits organizations to use any reasonable method to allocate costs between lobbying and non-lobbying activities.

- A method is considered reasonable if it is applied consistently, allocates a proper amount of costs to lobbying activities (including labor and administrative costs), and is consistent with the special rules regarding labor hours outlined in Reg. 1.162-28(2)(g).
- Reg. 1.162-28 describes three different allocation methods that are considered reasonable:
    - A ratio method,
    - A gross-up method, and
    - An allocation method that applies IRC 263A principles.

Continued on next page

6. Cost Allocations, Continued

What Is a Reasonable Method of Allocation?, continued

Whether any other allocation method is reasonable depends on the facts and circumstances of a particular case. The three specified methods, alone or in combination, do not establish a baseline allocation against which to compare other methods. Therefore, another cost allocation method is not unreasonable simply because it allocates a lower amount of costs to lobbying activities than any of the three specified methods.

- Because some commentators interpreted the proposed regulations as treating only the three specified methods as reasonable, the final regulations clarify that organizations may use any reasonable method.

However, Reg. 1.162-29(c)(2) provides that an organization's treatment of multiple purpose activities will not result in a reasonable allocation if it allocated to influencing legislation

(1) Only the incremental amount of costs that would not have been incurred but for the lobbying purpose or

(2) An amount based on the number of purposes for engaging in that activity without regard to the relative importance of those activities.

What Costs Are Allocable to Lobbying Activities?

Reg. 1.162-28(c) provides that the costs properly allocable to lobbying activities include labor costs and general and administrative costs.

Labor costs include costs attributable to
- Full-time
- Part-time, and
- Contract employees.

This includes all elements of compensation, including
- Overtime pay,
- Vacation pay,
- Holiday pay,
- Sick leave pay,
- Payroll taxes,
- Pension costs,
- Employee benefits, and
- Payments to a supplemental unemployment benefit plan.

Continued on next page

6. Cost Allocations, Continued

What Costs Are Allocable to Lobbying Activities?, continued

General and administrative costs include:

- Depreciation,
- Rent, utilities,
- Insurance,
- Maintenance costs,
- Security costs, and
- Other administrative department costs (for example, payroll, personnel, and accounting.)

What Is the "Ratio Method?"

Under the ratio method set forth in Reg. 1.162-28(d), an organization multiplies its total costs of operations (excluding third-party costs) by a fraction. The numerator of the fraction is the organization's lobbying labor hours and the denominator is the organization's total labor hours.

The formula is expressed as follows:

$$\frac{\text{Lobbying labor hours}}{\text{Total labor hours}} \text{ X Total costs of operations}$$

The product of this calculation is added to the organization's third-party lobbying costs, as defined in Reg. 1.162-28(d)(5).

- Payments to independent contractors for lobbying purposes would not fall under labor costs. They would however, be included in third-party lobbying costs. Third-party lobbying costs are:
  - Amounts paid or incurred in whole or in part for lobbying activities conducted by third parties
  - Amounts paid or incurred for travel (including meals or lodging while away from home) and
  - Entertainment relating in whole or in part to lobbying activities.

Continued on next page

6. Cost Allocations, Continued

What Is the "Ratio Method?", continued

Thus, third-party costs include amounts paid to lobbying organizations and dues or other similar amounts allocable to lobbying paid to exempt organizations.

Reg. 1.162-28(d)(2) provides that an organization may use any reasonable method to determine the number of labor hours spent on lobbying activities and may use the de minimis rule of Reg. 1.162-28(g)(1).

- Reg. 1.162-28(g)(1) provides that an organization may treat time spent by an individual on lobbying activities as zero if less than five percent of the person's time is spent on lobbying activities.
    - Reasonable methods may be used to determine if that time is less than five percent. However, pursuant to Reg. 1.162-28(g)(2), any time spent by an employee on "direct contact lobbying" (including the hours spent by that employee in connection with direct contact lobbying, such as allocable travel time relating to direct contact lobbying) may not be excluded under the rule of Reg. 1.162-28(g)(1).
        - "Direct contact lobbying" is defined as a meeting, telephone conversation, letter, or other similar means of communication with a federal or state legislator or covered federal executive branch official that otherwise qualifies as a lobbying activity.
        - Reg. 1.162-28(g)(2) specifically provides that a person who engages in research, preparation, and other background activities related to direct contact lobbying but who does not make direct contact with a legislator or covered executive branch official is not engaged in direct contact lobbying.
        - It further provides that an organization may treat as zero the hours spent by personnel engaged in secretarial, clerical, support, and other administrative activities as opposed to activities involving significant judgment with respect to lobbying activities.
            - Therefore, as Reg. 1.162-28(d)(2) explicitly provides, the hours spent on lobbying activities by para-professionals and analysts may not be treated as zero.

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6. Cost Allocations, Continued

What Is the "Ratio Method?", continued

Reg. 1.162-28(d)(3) defines total labor hours as the total number of hours of labor that an organization's personnel spend on the organization's trade or business during the year and provides that an organization may make reasonable assumptions concerning total hours spent by personnel on its trade or business.

- Reg. 1.162-28(d)(3) also provides that if the organization treats as zero the lobbying labor hours spent by personnel engaged in secretarial, maintenance, and other similar activities, it must also treat as zero the total labor hours of all personnel engaged in those activities.

Reg. 1.162-28(d)(6) illustrates the operation of the ratio method.

Example:

Three employees of an organization engage in both lobbying and non-lobbying activities. One spends 300 hours, another spends 1,700 hours, and the third spends 1,000 hours on lobbying activities, for a total of 3,000 hours for the year. The organization reasonably estimates that each of its three employees spends 2,000 hours a year working for the organization. The organization's total costs of operations are $300,000 and it has no third-party costs. Under the ratio method, the organization allocates $150,000 to its lobbying activities for the year, calculated as follows:

$$\left[\frac{\text{Lobbying labor hours}}{\text{Total labor hours}} \times \text{Total costs of operations}\right] + \text{Allocable third-party costs} = \text{Costs allocable lobbying activities}$$

$$\left[\frac{300 + 1{,}700 + 1{,}000}{6{,}000} \times \$300{,}000\right] + [0] = \$150{,}000$$

Continued on next page

6. Cost Allocations, Continued

What Is the "Gross-up Method?"

Under the general gross-up method, which is described in Reg. 1.162-28(e)(1), an organization multiplies its basic labor costs for lobbying labor hours by 175 percent.

- Pursuant to Reg. 1.162-28(e)(3), basic labor costs are limited to wages or other similar costs, such as guaranteed payments for services.

  Costs attributable to
  - Pensions
  - Profit-sharing
  - Employee benefits
  - Supplemental unemployment compensation plans, or
  - Similar items,

  are **not** included in basic labor costs.

- Third-party lobbying costs are then added to the result of the calculation to arrive at total lobbying costs.

Under Reg. 1.162-28(e)(2), an organization may use an alternative gross-up method. This method allows an organization to treat as zero the lobbying labor hours of personnel who engage in:

- Secretarial
- Clerical, support, or
- Other administrative activities that do not involve significant judgment with respect to lobbying.

- However, if an organization uses this alternative method, it must multiply costs for lobbying labor hours by 225 percent.

Reg. 1.162-28(b)(2) provides that an organization (other than one subject to IRC 6033(e)) that does not pay or incur reasonable labor costs for persons engaged in lobbying activities may not use the gross-up method.

- Such organizations would include a partnership or sole proprietorship in which the lobbying activities are performed by the owners who do not receive a salary or guaranteed payment for services.

Continued on next page

6. Cost Allocations, Continued

What Is the "Gross-up Method?", continued

- This provision is significantly different from its predecessor in the proposed regulations. Under the proposed regulations, **any** organization that did not pay reasonable labor costs for people engaged in lobbying activities could use neither the ratio or gross up method. 58 FR 68330, 68332 (Dec. 27, 1993). Tax-exempt organizations contended that they would be prevented from using either or these methods if they used volunteers in their lobbying activities (since no labor costs were incurred).

- Under the final regulations, tax-exempt organizations can use either the ratio or gross-up methods even if their lobbying activities are conducted by volunteers. Because volunteers are not organizations' personnel, time spent by volunteers is excluded from an organization's lobbying labor hours and total labor hours (although the hours may be included in their own employer's lobbying labor hours or total labor hours).

- Reg. 1.162-28(e)(4) illustrates the operation of the gross-up method to the same facts discussed above with regard to the ratio method. In this instance, the organization determines that its basic labor costs are $20 per hour for the first employee, $30 per hour for the second employee and $25 per hour for the third employee. Thus, its basic lobbying labor costs are $82,000 (($20 x 300) + ($30 x 1,700) + ($25 x 1,000)). Under the gross-up method, the organization allocates $143,500 to its lobbying activities for the year, calculated as follows:

		Basic lobbying labor costs of all personnel		Allocable third-party costs		Costs allocable to lobbying activities
175%	X		+		=	

[175% X $82,000] + [0] = $143,500

Continued on next page

6. Cost Allocations, Continued

What Is the "IRC 263A Method?"

Many organizations engaged in lobbying activities are subject to the uniform capitalization rules of IRC 263A, therefore, the regulations permit organizations to use the principles of that section and the regulations thereunder to determine costs properly allocable to lobbying activities.

- Specifically, under IRC 263A, lobbying is considered a service department or function. Therefore, an organization may use its IRC 263A methodology to determine the amount of costs allocable to its lobbying department or function for purposes of complying with the regulations.

- Organizations not subject to IRC 263A may also use the principles of that section and the regulations thereunder to determine the amount of costs allocable to lobbying activities.

E. Disclosure Requirements - IRC 6113

General Requirements of IRC 6113

IRC 6113 requires IRC 527 political organizations (as well as IRC 501(c) organizations that are ineligible to receive tax deductible charitable contributions) to disclose in "an express statement (in a conspicuous and easily recognizable format)," the nondeductibility of contributions during fundraising solicitations.

- A fundraising solicitation is any solicitation of contributions or gifts that is made in written form by television or radio, or by telephone.
- A fundraising solicitation does not include any letter or telephone call that is not part of a coordinated fundraising campaign soliciting more than 10 persons during the calendar year

This requirement does not apply to political organizations that normally do not have gross receipts in excess of $100,000 during a tax year, although two or more organizations may be treated as one organization where necessary to prevent the avoidance of this provision through the use of multiple organizations.

Notice 88-120

Notice 88-120, 1988-2 C.B. 454, provides detailed guidance, including safe harbors, on the application of IRC 6113. The following is based upon Notice 88-120.

What Are Examples of Solicitations That Must Contain the Disclosure Statement?

A political organization's solicitations for:

- All voluntary contributions
- As well as solicitations for attendance at testimonials
- And other fundraising events

must include the disclosure statement.

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E. Disclosure Requirements - IRC 6113, Continued

What Are Examples of Solicitations That Must Contain the Disclosure Statement?, continued

Example 1:
Solicitations by a political organization for contributions to a Congressional campaign committee must include the disclosure statement.

Example 2:
Solicitations for memberships and annual dues are also subject to the requirements of IRC 6113.

Example 3:
Solicitations for membership and dues renewals are also subject to the requirements of IRC 6113.

What Are Examples of Situations That Do Not Require the Disclosure Statement?

Situations where a political organization is not required to make the IRC 6113 disclosure statement include:

- Billing advertisers in its publications
- Billing attendees at a conference it conducts (as distinguished from a testimonial or fundraising event).

General material discussing a political candidacy and requesting persons to vote for the candidate or "support" the candidate need not include the disclosure statement unless the material specifically requests either a financial contribution a contribution of volunteer services on behalf of the candidate.

When Does an Organization Have Annual Gross Receipts That Do Not Normally Exceed $100,000?

Reg. 1.6033-2(g) and Rev. Proc. 83-23, 1983-1 C.B. 687, provide rules for determining annual gross receipts with respect to the similar exception from the filing of annual information returns for small organizations.

In general, these rules set out a three year average as the basic rule.

- The organization must include the required disclosure statement on all solicitations made more than 30 days after reaching $300,000 in gross receipts for the three year period of the calculation.

Continued on next page

E. Disclosure Requirements - IRC 6113, Continued

When Does an Organization Have Annual Gross Receipts That Do Not Normally Exceed $100,000?, continued

Example:

On July 1 of the third year of a calculation (for an organization with a calendar year accounting period) the organization reaches $300,000 in total gross receipts for the prior two years and the first six months of the third year. It must include the required disclosure statement on all solicitations no later than August 1.

- A local, regional, or state chapter, of an organization with gross receipts under $100,000 must include the disclosure statement in its solicitations if at least 25 percent of the money solicited will go to the national, or other, unit of the organization that has annual gross receipts that exceed $100,000.

- Such solicitation is considered as being in part on behalf of such unit of the organization.

- If a trade association or labor union with over $100,000 in annual gross receipts solicits funds that will pass through a PAC with less than $100,000 in gross receipts, the solicitation must contain the required disclosure statement.

What Is a Qualifying Print Medium Format?

In the case of a solicitation by mail, leaflet, or advertisement, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following four requirements are met:

1. The solicitation includes whichever of the following statements the organization deems appropriate:

    a. "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes,"

    b. "Contributions or gifts to [name of organization] are not tax deductible," or

    c. "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;"

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E. Disclosure Requirements - IRC 6113, Continued

What Is a Qualifying Print Medium Format?, continued

2. The statement is in at least the same size type as the primary message stated in the body of a letter, leaflet, or ad.

3. The statement is included on the message side of any card or tear-off section that the contributor returns with the contribution; and

4. The statement is in the first sentence in a paragraph or itself constitutes a paragraph

What Is a Qualifying Telephone Solicitation Format?

In the case of a solicitation by telephone, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following three requirements are met:

1. The solicitation includes whichever of the following statements the organization deems appropriate:

    a. "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes,"

    b. "Contributions or gifts to [name of organization] are not tax deductible," or

    c. "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;"

2. The statement is made in close proximity to the request for contributions, during the telephone call, by the telephone solicitor; and

3. Any written confirmation or billing sent to a person pledging to contribute during the telephone solicitation complies with the requirements for print medium solicitations set forth above.

Continued on next page

E. Disclosure Requirements - IRC 6113, Continued

What I a Qualifying Television Solicitation Format?

In the case of a solicitation by television, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following two requirements are met:

1. The solicitation includes whichever of the following statements the organization deems appropriate:

    a. "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes,"

    b. "Contributions or gifts to [name of organization] are not tax deductible," or

    c. "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;" and

2. If the statement is spoken, it is in close proximity to the request for contributions; if the statement appears on the television screen, it is in large, easily readable type appearing on the screen for at least five seconds.

What is a Qualifying Radio Solicitation Format?

In the case of a solicitation by radio, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following two requirements are met:

1. The solicitation includes whichever of the following statements the organization deems appropriate:

    a. "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes,"

    b. "Contributions or gifts to [name of organization] are not tax deductible," or

    c. "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;" and

2. The statement is made in close proximity to the request for contributions during the same radio solicitation announcement.

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E. Disclosure Requirements - IRC 6113, Continued

What if an Organization Makes a Fundraising Solicitation and Does Not Follow the Formats Set Forth Above?

If an organization makes a solicitation to which IRC 6113 applies, and, the solicitation does not comply with the formats set forth above, the Service will evaluate all the facts and circumstances to determine whether the solicitation contained "an express statement" (in a conspicuous and easily recognizable format) that contributions and gifts are not deductible for Federal income tax purposes. IRC 6113(a).

- A good faith effort to comply with the requirements of IRC 6113 will be an important factor in the evaluation of the facts and circumstances.
- Disclosure statements made in the fine print will not be considered to be in compliance with the statutory requirement.

What Are the Penalties for Failure To Comply With the Requirements of IRC 6113?

The failure to include the required disclosure of the non-deductibility of contributions in fundraising solicitations to which IRC 6113 applies results in a penalty of $1,000 for each day on which such a failure occurs, up to a maximum penalty of $10,000. IRC 6710(a).

- No penalty will be imposed if the failure is due to reasonable cause. IRC 6710(b).
- In cases where the failure to make the required disclosure is due to intentional disregard of the law, the $10,000 per year limitation on the penalty does not apply and more severe penalties based on up to 50 percent of the aggregate cost of the solicitations are applicable. IRC 6710(c).
    - For purposes of determining the penalty, "each day on which a failure occurs" means the day that a solicitation is mailed, distributed, published, telecast, broadcast, or spoken by telephone. IRC 6710(d).

Example:

An organization mails 500 noncomplying solicitations on March 30 and 50 noncomplying solicitations on April 5, the penalty would be $2,000, so long as the violation did not involve intentional disregard of the disclosure requirement.

Appendix

PROXY TAX CHECKSHEET

Background

Section 6033(e)(1) of the Code imposes reporting and notice requirements on certain tax-exempt organizations described in sections 501(c)(4), (5), and (6) that incur nondeductible lobbying and political expenditures. Nondeductible lobbying and political expenditures are described in section 162(e). They include expenditures paid or incurred in connection with (1) influencing legislation; (2) participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office; (3) any attempt to influence the general public with respect to elections, legislative matters or referendums; or (4) any direct communication with a covered executive branch official in an attempt to influence the official actions or positions of that official.

Organizations that do not provide the required notices of amounts of membership dues allocable to nondeductible lobbying expenditures are subject to income tax (commonly called a "proxy tax") under section 6033(e)(2) on such expenditures. The tax is reported on Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)*) at line 37. Information about how to compute the tax is in the *Instructions for Form 990-T*.

Application

Revenue Procedure 98-19, 1998-1 C.B. 30, provides that section 6033(e) applies to the following organizations:

- Social welfare organizations described in section 501(c)(4) that are not veterans' organizations.
- Agricultural and horticultural organizations described in section 501(c)(5) [Note: Section 6033(e) does not apply to labor organizations.]
- Organizations described in section 501(c)(6).

Rev. Proc. 98-19 also provides that section 6033(e) **does not** apply to:

- Organizations whose total in-house lobbying expenditures do not exceed $2,000.
- Organizations that receive either (1) more than 90 percent of all annual dues from members of less than $75 per member, or (2) more than 90 percent of all annual dues from section 501(c)(3) organizations, state or local governmental entities, or entities whose income is exempt from tax under section 115. **NOTE**: The $75 amount will be increased for years after 1998 by a cost-of-living adjustment under IRC 1(f)(3), rounded to the next highest dollar. Rev. Proc. 98-19, § 5.05

Questions

1. Was the organization aware of the reporting and notice and proxy tax requirements of section 6033(e) of the Code?
   Yes ___No ___

If the answer to Question #1 is "No", complete Question #2. If the answer to Question #1 is "Yes", skip ahead to Question #3.

2. What were the reasons given by the officers for lack of awareness?
   a. ____Unaware of law pertaining to section 6033(e)
   b. ____Aware of law but confused about proper application
   c. ____Relied on tax professional
   d. ____Other

3. Were expenditures made for non-deductible lobbying and political expenditures as described in section 6033(e)?
   Yes ___No ___

If the answer to Question #3 is "No", STOP.

4. Is the organization excepted from the reporting and notice requirement?
   Yes ___No ___

If the answer to Question #4 is "Yes", complete Question #5.
If the answer to Question #4 is "No", skip ahead to Question #6.

5. What exception applies?
   a. ____ Substantially all dues received by the organization are not otherwise deductible to the member.
   b. ____ Total in-house lobbying expenditures do not exceed $2,000.
   c. ____ More than 90 percent of all annual dues are from members of less than $75 per member (as adjusted). See **NOTE** under **Application,** above.
   d. ____ More than 90 percent of all annual dues are from charities, governmental entities or entities whose income is exempt from tax under section 115.

6. Did the organization notify its dues paying members of the allocable portion of their membership dues that is not tax-deductible?
   Yes____No____

If "No", proceed to the next question

7. Did the organization pay the proxy tax on amounts of lobbying and political expenditures?
   Yes ___No ___

If "No", take appropriate action to bring the organization into compliance.

Detailed Subject Directory

Continued on next page

Detailed Subject Directory, continued

Continued on next page

Detailed Subject Directory, continued

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Detailed Subject Directory, continued