THE IMPORTANCE OF USING AFFILIATED § 501(c)(4) AND § 501(c)(3) ORGANIZATIONS FOR ADVOCACY

Responding to Rosemary E. Fei and Eric K. Gorovitz, Practitioner Perspectives on Using § 501(c)(4) Organizations for Charitable Lobbying: Realities and An Alternative

Response by Terence Dougherty*

INTRODUCTION

Fei and Gorovitz assess nonprofit lobbying in a thorough and clear manner. The tax laws regulating nonprofit advocacy form a complicated statutory and regulatory regime, and their article presents the regime in a manner that is accessible both to new practitioners and to leaders of nonprofits that engage in advocacy. Likewise, Fei and Gorovitz are admirably unapologetic toward nonprofits that lobby. For many years, advocacy has been considered a suspect activity for nonprofits. This suspicion has only increased in recent years as political actors have formed nonprofits exempt under the tax law to support

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or oppose the election of specific candidates for public office—in many cases using nonprofit exemption categories that, in my view, were not intended to be used to support or oppose candidates in this manner. Fei and Gorovitz successfully present lobbying and even candidate endorsements as what they are—legal and useful advocacy tools.

This Response will present comments and reactions to a number of the topics covered in the Fei and Gorovitz article. And then I will spend a bit more time discussing two topics—governance of affiliated § 501(c)(3) and § 501(c)(4) organizations and the recent enhanced suspicion of nonprofit advocacy.

I. SECTION 501(H) LOBBYING BY § 501(C)(3) ORGANIZATIONS

As Fei and Gorovitz indicate, a § 501(c)(3) organization that is a public charity may engage in some lobbying, but too much lobbying activity may cause the organization to lose its tax-exempt status. Under the default “substantial part” test, a § 501(c)(3) public charity is engaging in too much lobbying when lobbying constitutes a substantial part of its activities. A charity may make a § 501(h) election, however, allowing it to instead be subject to the expenditure test, which sets out clear lobbying limits depending on the charity’s annual expenditures. The expenditure test and the regulations under § 501(h) and § 4911 of the Internal Revenue Code (the “Code”) give real clarity to § 501(c)(3) organizations that want to lobby, especially as compared to the vague substantial part regime. In light of Fei and Gorovitz’s careful explanation of these rules, I point out two things.

First, Congress should revisit the expenditure test to increase the current expenditure cap and also to automate a periodic increase in the cap in order to adjust it for inflation. As Fei and Gorovitz note, the amount of lobbying an electing nonprofit may do under § 501(h) is a percentage of a specific calculation of that nonprofit’s exempt purpose expenditures, but that percentage limit caps at $1 million. This means that organizations with exempt purpose expenditures above $17 million all are subject to the $1 million limit, no matter how large they are. This may not have had a significant impact in 1976 when § 501(h) was enacted—the number of § 501(c)(3) organizations in the United States in 1976 with expenditures exceeding $17 million may
have been small—but that no longer appears to be the case.² And in today’s dollars, that $1 million would be well over $4 million when adjusted for inflation.³ Some larger charities have revoked their § 501(h) election because they believe that a far higher number than $1 million in lobbying expenditures could be permissible under the “substantial part” test given their size and activities. It is not in the interests of the charitable sector or of the Internal Revenue Service (“IRS”) to have a significant number of § 501(h) electing charities revoke their election.

Second, Fei and Gorovitz rightly point out that an electing charity that does not expect to reach its § 501(h) expenditure limit during a year can consider making a contribution of the unspent amount to a § 501(c)(4) organization, including a related § 501(c)(4) entity. Given that the annual expenditure amount is “use it or lose it,” the ability to contribute any unspent sum to a related § 501(c)(4) organization is an important one. In order to ensure—and demonstrate—proper stewardship of its fund, I would recommend, and I suspect Fei and Gorovitz would agree, that a charity making such contributions enter into a formal grant agreement that (1) outlines that the grant is for a lobbying activity that is consistent with the charity’s mission, (2) requires some kind of documentation of the use of the funds by the § 501(c)(4) organization, and (3) compels a return of funds not expended on the purpose of the grant. This should apply even if the grant is to the charity’s related § 501(c)(4) organization.

II. FUNDING LOBBYING

A. Private Foundations Funding § 501(c)(3) and § 501(c)(4) Lobbying

Fei and Gorovitz’s paper outlines clearly the limitations on private foundations’ funding of lobbying activity. However, it is important to take note of the fact that these limitations are applicable to private foundations that are subject to the U.S. tax laws. There are numerous non-U.S. private foundations that are organized in jurisdictions whose laws do not include limitations on lobbying and that are interested in funding § 501(c)(3) and § 501(c)(4) organizations. It is important for a U.S. nonprofit to carefully consider the legal implications of receiving such a grant, including the following considerations.

³. Id.
First, while previously it was unclear whether a grant to the 501(c)(4) organization could be subject to gift tax, the PATH Act of 2015 now makes clear that contributions of cash or property are not. This creates an opportunity for U.S. nonprofits seeking grants from non-U.S. foundations for lobbying.

Second, the nonprofit should consider whether the grant may be used for ballot initiative work. Under the U.S. tax law applicable to nonprofit advocacy, ballot initiative work is treated as lobbying. Federal campaign finance law, by contrast, regulates “elections” in general, not limiting the reach of the law to candidate elections. And it is unlawful for a foreign national “directly or indirectly” to make “a contribution or donations of money or other thing of value in connection with a Federal, State or local election.”

The broad reference to elections may be simply because there are no federal ballot initiatives and so it is possible, if not likely, that Congress did not intend the federal campaign finance laws to apply to ballot initiatives. But given the prohibition on non-U.S. entities and individuals influencing elections, some non-U.S. foundations may be reluctant to fund ballot initiative work by a § 501(c)(3) or a § 501(c)(4) organization. This question has been put before the FEC, which deadlocked on the issue in a 3-3 decision along partisan lines, meaning that, at least for now, contributions by non-U.S. entities and individuals to fund U.S. ballot initiatives should not be prohibited.

Third, the grantor and grantee should consider whether the nonprofit receiving the grant is subject to the Foreign Agent Registration Act, a 1938 law that was enacted by Congress “to require the registration of certain persons employed by agencies to disseminate propaganda in the United States and for other purposes.” A key factor in considering whether registration may be required is where the nonprofit receiving the funds is acting “at the order, request, or under the direction or control, of a foreign principal” and was engaged in those activities “for or in the interests of such foreign principal.”

grant from a non-U.S. foundation to a U.S. nonprofit would not involve such control by the non-U.S. foundation, but an analysis of FARA is advisable.

B. Funding § 501(c)(4) Lobbying

While I agree wholeheartedly with Fei and Gorovitz’s assertion that § 501(c)(3) organizations have an easier time fundraising from individuals—given the availability of the tax deduction for contributions to § 501(c)(3) organizations and given that § 501(c)(4) organizations often must rely on small dollar donations—it is nonetheless possible for § 501(c)(4) groups to raise large dollar contributions. Consider the following.

First, there are donors whose philanthropy is so extensive that they contribute beyond the contribution limits on individuals for deductible contributions to § 501(c)(3) organizations.

Second, as large dollar campaign contributions by individuals—contributions that are not deductible—have increased in the United States, more and more politically motivated individuals may be used to donating funds for political purposes without receiving a deduction and therefore more willing to donate large dollar donations to § 501(c)(4) organizations in the off years of the election cycle.

Third, individuals may be willing to include in their estate planning documents language that provides for a contribution to a § 501(c)(3) charity to the extent the estate can deduct that contribution and any additional contribution to the § 501(c)(3) charity’s related § 501(c)(4) organization.

III.

RELATED § 501(C)(3) AND § 501(C)(4) ORGANIZATIONS AND GOVERNANCE

Fei and Gorovitz discuss in great detail the complicated planning, documentation and recordkeeping required by § 501(c)(3) and § 501(c)(4) related organizations. In particular, they very nicely lay out options for board governance of the two related organizations that each are organized as corporations under state law. At one end of the spectrum are completely separate corporate boards with neither board controlled by the other, which Fei and Gorovitz discourage as impractical because the two organizations may drift away from each other in their conception of the originally shared mission. I agree that model is impractical for that reason.
At the other end of the spectrum is complete overlap of the two corporate boards. Fei and Gorovitz state that the risk of improper governance—and presumably also the potential loss of exemption by the § 501(c)(3) for improperly relating with a § 501(c)(4)—posed by complete overlap of the two organizations’ boards is “unacceptably high.” I think that interpretation may be a bit too conservative.

Complete overlap—either in the form of identical boards or in the form of the board of the controlled organization comprising a subset of the board of the controlling organization—may be more in line with the purpose and intention of working through related § 501(c)(3) and § 501(c)(4) organizations. Usually, related § 501(c)(3) and § 501(c)(4) organizations are not separate organizations that come together because they recognize they are pursuing a common goal. Instead they are usually a group of collective minded individuals who set up the two entities to achieve advocacy goals within the limitations on speech imposed by § 501(c). As Justice Blackmun stated in his concurrence in Regan v. Taxation With Representation,8 a § 501(c) may form and speak through another § 501(c).9

Of course, the two organizations must follow all corporate formalities—separate meetings, voting, elections, minutes, and filings. In addition, given the difference in permissible activities by each, and the fact that the § 501(c)(3) may receive donations that were deductible by the donors, the two organizations must comply with a number of requirements that ensure there is appropriate financial separation. For example, the organizations must have separate budgets, ensure only § 501(c)(3) funds raised are used for § 501(c)(3) activities, account for and hold each organization’s funds separately, and be absolutely clear in their solicitation of donors to which organization the donor is making its contribution.

If the organizations comply with all of these formalities, I do not think complete overlap creates an unacceptably high risk of problems arising. Given the shared mission of the two organizations, it seems unlikely that situations will arise that result in one organization being prioritized over the other, or one becoming the alter ego of the other.

8. This reasoning ultimately was adopted by a majority of the Supreme Court in FCC v. League of Women Voters of California, 468 U.S. 364, 400 (1984).
9. Regan v. Taxation With Representation of Wash., 461 U.S. 540, 552 (1983) (explaining that the nonprofit “may use its present § 501(c)(3) organization for its nonlobbying activities and may create a § 501(c)(4) affiliate to pursue its charitable goals through lobbying”).
IV.
SEPARATELY SEGREGATED LOBBYING FUND ("SSLF")

A § 501(c)(3) organization that wants to lobby beyond an amount that is permissible under § 501(c)(3) may form a related § 501(c)(4), as Fei and Gorovitz state. I agree with their view that this involves substantial initial and ongoing planning, corporate housekeeping, and reporting, and that this may be a bar for smaller nonprofits that do not have the employee and outside counsel resources necessary to operate through two or more related organizations. It also may be a bar for a nonprofit of any size that generally does not lobby or does very minor lobbying work but feels a need to do more of this work in a given year (for example, a museum that rarely lobbies but wants to weigh in heavily on a new de-accessioning bill). The SSLF may be a useful structure for those organizations.

However, I am sure Fei and Gorovitz would agree that the likelihood of the current Congress amending the tax law to provide for such a structure seems small. If the goal is to allow a § 501(c)(3) organization to engage in lobbying beyond its statutory limit using non-tax-deductible funds, might a § 501(c)(3) charity be able to accomplish this goal absent a statutory solution?

A nonprofit may operate as an unincorporated association. And in some states, it may do so and achieve limited liability for its directors and officers. What if a number of a § 501(c)(3) organization’s leaders—e.g., its President, Treasurer and CEO—were to set up an unincorporated association controlled by the President, Treasurer and CEO, ex officio, and set up a bank account in that association’s name? Since an entity does not need to apply for and obtain from the IRS § 501(c)(4) tax-exempt status to be treated as tax-exempt under § 501(c)(4), this unincorporated association could operate within the rules applicable to § 501(c)(4) organizations, file an annual IRS Form 990 as a § 501(c)(4), and raise funds directly into its account. The § 501(c)(3) and the unincorporated § 501(c)(4) could enter into a simple agreement that outlines their sharing of resources (such as employees or space), and the § 501(c)(4) organization would need to consider whether it is required to register as a nonprofit under state law regulating doing business and fundraising. Given how unlikely it is that Congress will enact legislation that allows § 501(c)(3) groups to set up SSLFs, it might be worth exploring this option further as a simpler solution than setting up a new § 501(c)(4) organization.
V.
THE CASE FOR A HALO AROUND ADVOCACY ORGANIZATIONS

As I note at the outset, Fei and Gorovitz do not express reservations about nonprofits engaging in advocacy work, but rather see advocacy as an appropriate tool for social change. I wholeheartedly agree with that position. However, historically, nonprofit advocacy has been treated skeptically and called “propaganda” or “agitation.”10 The IRS originally took the position that it was not appropriate for § 501(c)(3) organizations to engage with issues considered controversial.”11 More recently, in 2002, Larry Summers, then the President of Harvard, claimed that charities should stick to public service work, such as helping the needy, and not spend their time advocating for social change.12

This skepticism has increased, as Fei and Gorovitz point out, since the Supreme Court’s 2010 decision in Citizens United v. FEC, which gave nonprofits more flexibility to endorse and oppose candidates for public office.13 As Fei and Gorovitz note, the decision has resulted in calls to limit the candidate-related work a § 501(c)(4) organization may do. It also has led to the enactment of legislation that requires unconstitutionally broad donor disclosure by nonprofits doing advocacy work.14 And during this conference, several participants have commented that spending in elections has become such a threat to democracy that nonprofits should be prohibited from engaging in certain kinds of advocacy work. Others have asserted that nonprofits should be subject to full disclosure of all of their donors if they do this work, no matter how small, despite the serious First Amendment concerns this raises.15

10. Section 501(c)(3) itself refers to the lobbying limitation as a limitation on “carrying on propaganda, or otherwise attempting, to influence legislation.” The Second Circuit referred to lobbying work as “agitation.” See Sle v. Comm’r, 42 F.2d 184, 185 (2d Cir. 1930).
11. For example, in 1919, the Treasury Department organization stated that organizations “formed to disseminate controversial or partisan propaganda were not educational”. See Treas. Reg. 45, Art. 517 (1919). See also Big Mama Rag, Inc. v. United States, 631 F.2d 1030, 1036 (2d Cir. 1980) (holding that the IRS’s position that an organization could not promote controversial positions without providing a “full and fair exposition of pertinent facts” was unconstitutionally vague).
14. See, e.g., N.Y. EXEC. LAW § 172-e to -f.
15. As Justice Brennan stated in Roberts v. United States Jaycees, “Government actions that may unconstitutionally infringe upon [the freedom of association] can
While I understand that spending in elections is a significant concern in the United States, I think that preventing nonprofits from doing advocacy or subjecting them to onerous disclosure for doing this work is like throwing the baby out with the bath water. While *Citizens United* may have resulted in an increase in candidate-related activity by traditional advocacy organizations, its greater impact is that the decision has resulted in a dramatic increase in the use of nonprofit structures by individuals whose sole goal is the election of candidates for public office.\(^\text{16}\) It is these latter organizations, and not all § 501(c) organizations, that should be the subject of the public’s focus.

As we are seeing now during the Trump Administration, traditional advocacy organizations are one of the primary means of speaking out about the importance of fairness, justice and democratic ideals. Individuals make change through groups—neighborhood associations, large nonprofits, religious institutions—that focus on social change. Those groups are advocacy organizations. And they are one of the primary means in the United States for individuals to express themselves politically. As Justice Brennan wrote in the Supreme Court’s decision in *Roberts v. United States Jaycees*:

> An individual’s freedom to speak, to worship, and to petition the government for the redress of grievances could not be vigorously protected from interference by the State unless a correlative freedom to engage in group effort toward those ends were not also guaranteed. According protection to collective effort on behalf of shared goals is especially important in preserving political and cultural diversity and in shielding dissident expression from suppression by the majority. Consequently, we have long understood as implicit in the right to engage in activities protected by the First Amendment a corresponding right to associate with others in pur-

\(^{16}\) In the typical structure, a § 501(c)(4) organization and an unconnected PAC are established to advance the electoral promise of a particular candidate. The § 501(c)(4) organization is organized for a broad purpose, such as advancing progressive or conservative principles. But the § 501(c)(4) entity does not have any real purpose other than supporting—and providing a means for shielding disclosure of donors to—a specific candidate. That § 501(c)(4) entity is completely distinct from a traditional advocacy organization—the Sierra Club, the NRA, Planned Parenthood, etc.—formed to advance a social goal and which may at times endorse or oppose candidates in connection with that social goal.
suit of a wide variety of political, social, economic, educational, religious, and cultural ends.\textsuperscript{17}

Fei and Gorovitz acknowledge the traditional halo around § 501(c)(3) organizations. I think we should extend that halo to advocacy organizations more generally, including the advocacy work done by § 501(c)(3) and § 501(c)(4) organizations and by groups working through related § 501(c)(3) and § 501(c)(4) organizations. These are groups of individuals joining together in furtherance of the freedom to speak, worship and petition the government for the redress of grievances. This activity is the core of a democracy.

\textsuperscript{17} 468 U.S. 609, 622 (1984) (citations omitted).