**Module 9**

**501(h) Election Failure to Comply Penalties**

**PowerPoint Script**

Slide 1- Penalties

* The purpose of this module is to provide information on the potential penalties a charity with a 501(h) election in place may face if it makes excessive lobbying expenditures. There are two tests to consider: the expenditure test and the normally makes test. We will review both in detail.

Slide 2 - Tax Imposed on Organization

* An organization will be subject to a tax equal to 25% of its excess lobbying expenditures for the year.
* An excess lobbying expenditure is- the greater of
* Lobbying expenditures over the lobbying nontaxable amount; **OR**
* Grassroot expenditures over the grassroots nontaxable amount.
* Lobbying expenditure chart
* The lobbying nontaxable amount for any organization for any tax year is the lesser of $1,000,000 or:
* 20% of the exempt purpose expenditures if the exempt purpose expenditures aren't over $500,000,
* $100,000 plus 15% of the excess of the exempt purpose expenditures over $500,000 if the exempt purpose expenditures are over $500,000 but not over $1,000,000,
* $175,000 plus 10% of the excess of the exempt purpose expenditures over $1,000,000 if the exempt purpose expenditures are over $1,000,000 but not over $1,500,000, or
* $225,000 plus 5% of the excess of the exempt purpose expenditures over $1,500,000 if the exempt purpose expenditures are over $1,500,000.
* Grass roots nontaxable amount- The grass roots nontaxable amount for any organization for any tax year is 25% of the lobbying nontaxable amount for the organization for that tax year.

Slide 3 - Definitions

* **Lobbying expenditures** 
  + Expenditures made for the purpose of influencing legislation
  + Consists of both direct lobbying expenditures and grassroots lobbying expenditures
* **Grassroots lobbying expenditures** 
  + Any expenditure made for the purpose of influencing any legislation through an attempt to affect the opinions of the general public
* **Lobbying nontaxable amount**
  + Total lobbying expenditures a charity can make without incurring a penalty
* **Grassroots nontaxable amount** 
  + Total grassroots lobbying expenditures a charity can make without incurring a penalty

Slide 4 - Tax Exempt Status Revoked

* A tax exempt status will be revoked if the organization either:
* Normally makes lobbying expenditures in excess of its lobbying ceiling amount; OR
* Normally makes grass roots expenditures in excess of its grass roots ceiling amount.
* The normally makes test is tested at both the general level and the grass roots level. Failure to pass either test would cause a loss of tax exemption.

Slide 5- more definitions

* **Lobbying ceiling** 
  + 150% of the organization’s lobbying nontaxable amount for a taxable year.
* **Grass roots ceiling**
  + 150% of the organization’s grass roots nontaxable amount for a taxable year.
* **Normally makes an expenditure in excess** 
  + The sum of the lobbying expenditures for the base years exceeds 150% of the sum of its lobbying nontaxable amounts for the base years, OR
  + The sum of the organization’s grass roots expenditures for its base years exceeds 150% of the sum of its grass roots nontaxable amount for the base years.
* **Base years**
  + The determination year and the three taxable years immediately preceding the determination year.
* **Determination year**
  + A taxabale year in which the expenditure test election is in effect.

Slide 6 - Special Rule

* An exception to the normal rule applies for the first, second, or third consecutive determination year for which an organization’s 501(h) election is in effect.
* The logic behind the exception is that the regular calculation requires a sum of the current year’s and the three previous year’s expenditures. For organizations without three years under their belt- the calculation would be impossible.
* The 150% test for both lobbying expenditures and grassroots expenditures test is still run; there is just a difference in the base years.
* The base years only include those years for which the expenditure test election is in effect.
* For example- running the calculation for the first year, there would only year 1 expenditures included in the base year calculation, in year two only years 1 and 2 expenditures will be calculated etc.

Slide 7 - Example

Let’s work through an example to see this test in action. Here we are running the test for 2018, so the base years would be 2015 – 2018. The total lobbying expenses (the second column) for the base years is $470,000. We need to compare that amount to 150% of the sum of the lobbying nontaxable amounts (the third column). The sum of the lobbying nontaxable amount is $580,000 which multiplied by 150% gets us $870,000. Because the actual lobbying expenditures are less than this amount ($470,000 < $870,000), the charity does not normally make lobbying expenditures in excess of its lobbying ceiling amount.

If we look at the grassroots figures, it is a closer call but the charity is still OK. The total grassroots expenditures for the period is $190,000 (fifth column). 150% of the grassroots nontaxable amount for the period is $217,000. As a result, the charity does not normally make grassroot lobbying expenditures in excess of its grassroot lobbying ceiling amount.

Overall result is the charity’s tax exemption is not revoked.

End

This has been a brief overview of the 501(h) penalties. For more information, please contact our website.