**PENALTIES FOR LOBBYING VIOLATIONS EVEN WHEN A GROUP CAN LOBBY**

Question: In the last podcast, we discussed the value of taking the 501(h) election. I think I get it. That was very helpful and I’m sure it gave groups a lot to think about. But let’s go back to a previous question, sort of. Let’s say a group takes the 501(h) election. We know that it cannot engage in unlimited lobbying. What happens if it exceeds the limits that the IRS does impose even if a group does take the election?

Answer:

For a group that does exceed the limits on lobbying imposed on groups taking the 501(h) election, there are penalties. One of the penalties that may be imposed on an organization is a 25% tax of the excess lobbying expenditures for the year. Here’s where the second calculation we talked about – the excessive lobbying expenditure calculation – comes into play. An excess lobbying expenditure is the greater of lobbying expenditures over the lobbying nontaxable amount, or grassroots expenditures over the grassroots nontaxable amount. The IRS actually has a useful chart to help a group better understand expenditures vs nontaxable amount that can be found on our website.

The lobbying nontaxable amount for any organization for any tax year is equal to 20% of the organization’s first $500,000 of exempt purposes expenditures. When an organization’s expenditures exceed $500,000, the allowable percentage gradually declines to 5%. The lobbying nontaxable amount is capped at $1,000,000 once the organization’s expenditures exceeds $17 million.

Question: OK. That seems pretty straightforward. Is that it? A group can exceed the lobbying requirements but if it does so it will just have to pay a fine? What’s stopping a group from lobbying, exceeding the limits, and just agreeing to pay the fine? Couldn’t a group try to game the system in that way and just consider the fine the cost of doing this sort of business?

Answer:

That’s a really good question, and there is always a risk that a group will just violate the law with the understanding that there is a price for doing so. That’s why this sort of tax is not the only penalty a group that violates the law can face. A group can also face about as serious a penalty a group can face. For failing to comply with regulations set out by the IRS an organization can actually LOSE ITS TAX EXEMPT STATUS!!!! To keep an organization running as a non-profit, it is imperative to maintain its tax exempt status. 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 grassroots expenditures in excess of its grassroots ceiling amount. It’s important to note the expenditure test is applied to both the general lobbying cap and the grassroots lobbying cap. Exceeding either limit could cause a loss of tax exemption.

Question: That does sound serious. Is there more a group should know about the ceiling on lobbying activities?

Answer:

Unfortunately, yes, there is. You need to know if your organization “normally” makes excess lobbying expenditures. The calculation works like this. First, total up the organization’s lobbying nontaxable ceiling amount for the current year and the prior three years. Multiple

 total up the organization’s lobbying expenditures for the current year and the prior three years. Next, multiple that figure by 150%. If the sum of an organization’s total lobbying expenditures for the current year and prior three years exceeds that amount, then the organization is deemed to normally make excess lobbying expenditures. This calculation also need to be using just the grass roots figures.

Question. Ok. This stuff is complicated. I can see that. And the calculator definitely will help groups figure some of these issues out. What happens when a group is keeping track of its expenditures but discovers that it is going over these limits in any given year?

Answer:

Excellent question. This is definitely a lot of information and you’re asking the right questions. Keeping tabs on a group’s expenditures can help prevent a group from going over these limits, but there is certainly the possibility that a group could go over these limits. And when that happens, there are two penalties that the IRS can impose on a group even if it takes the 501(h) election but still goes over these limits. If an organization does go over the lobbying cap or the grassroots cap, then it has made an excess expenditure and must pay a tax equal to 25% of the excess amount. If the charity goes over BOTH the lobbying cap and the grassroots cap, it does not have to pay a penalty for going over both caps. It just has to pay a penalty on the violation that exceeds the respective cap in a greater amount. It’s not a great result, but at least the non-profit does not lose its tax-exemption like it would under the “no substantial part” test. Plus, given that this test uses hard and fast numbers, this is something a charity can monitor throughout the year with relative ease to make sure it doesn’t go over the cap.

But that’s just the first type of penalty that can be imposed on a group. The second penalty deserves a group’s attention as well. If the organization “normally” makes excessive lobbying expenditures, then it *will* lose its tax-exempt status. This is a test based on the charity’s current year lobbying expenditures and its lobbying expenditures for the prior three years. While the penalty is harsh, it is relatively simple to avoid provided the charity is properly monitoring its lobbying expenditures throughout the years.

Question: OK. I think it’s starting to make sense. Can you summarize these penalty issues again just so that our listeners are clear?

Answer:

Of course. Here are the main takeaways. A charity can face penalties if it makes the 501(h) election. However, the penalties are only triggered if the charity crosses over the “line” and makes an excess lobbying expenditure. Unlike the “no substantial part” test, a charity will know where the line is under 501(h) and can avoid penalties by properly monitoring their lobbying expenditures. Those penalties can include financial penalties pegged to the extent to which a group has exceeded the lobbying thresholds that apply to it but could also result in a loss of exempt status if the violation of the law is common or particularly egregious.

Question: Alright, that’s a great recap. But if I understand it correctly, a group’s prior activities will help it gauge whether it is complying with IRS restrictions on lobbying should it take the 501(h) election. But what about new organizations? Can they not take the 501(h) election until they have developed a track record of financial expenditures to measure their lobbying activities against?

Answer:

That’s another great question, and, no, new non-profits can take the 501(h) election on the first day of their existence. The IRS completely understands some of these requirements make it seem like it’s impossible to begin the 501(h) election for a new group, because it seems the group needs previous years’ records in order to make the election. The IRS has made a special exception to the rules for organizations choosing to take advantage of the 501(h) election in the first three years of their existence. 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. Thus, running the calculation for the first year, there would only be a year 1 expenditure included in the base year calculation, in year two only years 1 and 2 expenditures will be calculated etc.

For example, assume this is the first year the organization made the election, had $500 of expenditures of which $60 was lobbying expenditures none of which constitutes grass roots expenditures. Its lobbying nontaxable amount, the annunal cap on lobbying expenditures, is $100 (20% of $500). The lobbying ceiling amount for the base period (which is only one year) is 150% of that amount or $150. Because the lobbying expenditures for the base period ($60) do not exceed the ceiling amount for the base period ($150) thus the organization is deemed NOT to normally make excess lobbying expenditures.

Question: That does seem to make sense. Ok, so, let’s say a group – new or old – wants to take the 501(h) election. Can you recommend any strategies for keeping track of its activities so that it can more easily report them to the IRS?

Answer: Accurate recordkeeping is essential for ensuring that a group is in compliance with the law. If a group cannot show it is in compliance with the law because it cannot accurately track its expenditures, it could find itself having problems with the IRS just as if it was violating the limits on lobbying themselves. Because charities must report their lobbying to the IRS every year, keeping track of expenditures is critical to stay within the requirements of the law. A charity must file either an annual Form 990 or Form 990-EZ because information provided on either of these forms help the IRS determine if the organization is complying with the laws and requirements according to the Internal Revenue Code. If a charity fails to adequately keep record of its expenditures in terms of its lobbying activities, it will not be able to demonstrate that it is complying with the law. As a result, the IRS could impose financial penalties on the organization and the poor recordkeeping could jeopardize the tax-exempt status of the group. As we said earlier, if a group does not comply with lobbying limits it could be subject to a 25% tax on excess lobbying or at risk of losing its tax exempt status. Good recordkeeping ensures an organization can demonstrate that it is complying with lobbying limits!

Question: Alright, I’m convinced. But are the recordkeeping requirements different for groups that have not taken the 501(h) election and those that have?

Answer:

Yes, the recordkeeping is different depending on whether a group is taking the 501(h) election or is not because different standards apply to these organizations. A group that does not take the election must engage in adequate record keeping to ensure it is not violating the “No Substantial Part” test. As we’ve said already, there is far less guidance about what records must be recorded under no substantial part test. Schedule C of Form 990 requires charities who chose the “No Substantial Part” test to report whether or not the charity lobbied via volunteers, paid staff, advertisements, mailings, published statements, grants to others for lobbying, direct contact with legislators, public events, or other means. Groups must also record “detailed descriptions” of any lobbying activities that fall outside of the above listed categories- the form states that these detailed descriptions “should include all lobbying activities, whether [or not] expenses are incurred.” The form asks, “During the year, did the filing organization attempt to influence foreign, national, state, or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, through the use of:” volunteers, paid staff, media advertisements, etc. As such, it is vital to keep detailed records provided that these questions will arise when the organization submits its requisite documents for the year.

For groups that do take the 501(h) election, they must keep records showing expenditures for grassroots and direct lobbying. The expenses that must be tracked include salaries and benefits of staff members, communication costs, a portion of overhead expenses attributed to lobbying; and grants, payments, or reimbursements made to others for lobbying.

Question: Alright, it seems like the recordkeeping for groups that might take the 501(h) election is a little more detailed? Is that right and can you go a little deeper into these details?

Answer:

Of course. A group taking the 501(h) election should keep track of its lobbying activities in all of its forms by tracking the amounts paid for lobbying, money paid or incurred as compensation for an employee’s lobbying services, money paid for out-of-pocket expenditures on behalf of the charity for lobbying, money allocated for administrative, overhead, or other general expenditures due to lobbying, money for publications and communication with members that is treated as lobbying, and money for lobbying of a controlled organization. These rules apply generally for both direct lobbying and grassroots lobbying.

There are three main things to track: (1) the value of staff time spent lobbying, (2) the direct costs associated with lobbying, and (3) overhead expenses related to lobbying. Getting a little more specific with our enumerated list, staff time will include the time spent lobbying and preparing to lobby. By tracking staff time, you are calculating the percentage of time each employee spends on lobbying and determining the portion of the individual staff member’s total salary and benefits that will have to be counted as a lobbying expenditure. Direct costs are the costs (other than staff time) that go into lobbying and preparation for lobbying. These costs are usually pretty easy to track because they are normally purchases like money spent on copying flyers, travel expenses for lobbying-related activities and things of that nature. Receipt tracking is also popular among organizations. Lastly, we have overhead expenses- costs that are not a direct cost or staff time, but are general operating costs that cannot be readily divided between lobbying vs. non-lobbying expenditures. Examples would include things such as rent, accounting fees, or office supplies. One reasonable method to allocate such fixed expenditures is based on a percentage of total organization staff time. Specifically, amount of fixed expenditures allocated to lobbying activities could be based on percentage of the aggregate amount of staff time devoted to lobbying activities over the total aggregate staff time for the year.

Question: Can you recommend the best way to keep track of staff activities?

Answer:

Time sheets have been an extremely effective way for organizations to track staff time spent on lobbying. However, some organizations opt to use reporting forms that require employees to fill out the form every time they partake in lobbying, preparation for lobbying, or any activity that MAY be categorized as lobbying. Similar to a reporting form, other organizations require employees to fill out questionnaires each time they partake in lobbying, preparation for lobbying, and/or any activity that may be counted as lobbying. The designated record keeper will then review the questionnaires and determines exactly which activities need to be reported. These questionnaires seem to be more individualized so it often gives a more in-depth look into the activities than a typical standard reporting form.

Question: What about just estimating its expenditures in general terms?

Answer:

A group can speak to its lawyer about this, but we don’t recommend making such estimates. Many would recommend using estimates only as a last resort, if there really is no other way to track a group’s activities. Because a group can face serious penalties for failing to keep its expenditures within the law’s limits, it can be risky to chance a group’s tax exempt status over inexact records. However, sometimes organizations don’t realize the importance of proper and constant tracking until the Form 990 deadline is looming. In that case- let those who actually performed the lobbying make the estimate. If employees are unsure as to what is and what isn’t lobbying they should have the direct supervisor of these employees make the estimate. It’s also important to note that estimates should be as accurate as possible. Still, there is no guarantee the IRS will accept such estimates, so, a group should strive to have effective systems in place before they begin engaging in lobbying to make sure they can comply with their reporting activities and ensure they are within the law and, more importantly, can demonstrate that they are within the law. And always consult with your lawyer before making any filing with the IRS, whether those filings contain estimates or not.