**Module 5**

**Introduction to the 501(h) Election**

**PowerPoint Script**

**Slide 1: Title Page**

Welcome to brief overview on the 501(h) election.

**Slide 2: Learning Objectives**

Today we are going to spend some time talking about lobbying and charitable organizations. The purpose of this session is to provide a brief overview of the 501(h) election. If your charity is considering undertaking any lobby activities, this election is really something you will want to consider. We will talk about the purpose of the election and the benefits it provides. Next, we will do a brief overview of the calculation itself. Yes, there is some math involved, but do not worry. You won’t have to dust off your honors grade calculator from high school as we have a calculator that will run the numbers for you. From there we will move on to items you will want to consider. Finally, we talk briefly on how the election is made.

As we go through the material today it is important to remember this just a brief overview. You can find on our website substantially more detail on the material covered today.

**Slide 3: 501(h) Election: Overview**

Let’s start with a brief overview of the calculation. Simply but, the 501(h) expenditure test provides an annual cap on a charity’s lobbying expenses for the year. The cap is based on a sliding scale percentage of the charity’s total expenditures for the year. I am oversimplifying a bit as there two caps to consider, but we will get to that in a moment.

If there is a calculation, that must mean there are inputs. Fortunately, this calculation only requires three pieces of information: the charity’s exempt purpose expenditures, its lobbying expenditures, and its grassroots lobbying expenditures. Let’s provide some brief definitions for these terms:

* Exempt purposes expenditures is the total amount paid by the charity to accomplish its exempt purpose. This figure would include its lobbying expenditures as well.
* Lobbying (communication) expenditures is any expenditure made for the purpose to influence any legislation. In order to constitute a lobbying expenditure, the communication must refer to specific legislation and reflect a view on the legislation.
* Grassroots lobbying (communication) expenditures is a subset of lobbying expenditures. Grassroots lobbying expenditures is any expenditure made for the purpose to influence any legislation through an attempt to affect the opinions of the general public. In order to constitute a grassroots lobbying expenditure, the communication must refer to specific legislation, must reflect a view on such legislation and encourage the recipient of the communication to take action with respect to such legislation.

So, I mentioned there are actual two caps to consider. In addition to the cap on a charity’s total lobbying expenditures, there is a separate cap on its grassroots lobbying expenditures. We will show how you how it looks with some actual numbers, but let’s first talk about why you would want to make this election.

**Slide 4: 501(h) Election: Benefits**

With this election in place, you have a black and white test to follow which calculates the amount a charity can spend on lobbying expenses for a given year based on the charity’s total expenditures for the year. Because you are using hard and fast numbers, rather than a facts and circumstances test, you have certainty as to whether your organization is in compliance or not. The use of a mathematical equation allows a charity to plan/budget how much lobbying expenditures it can make in the coming year. Also, it simplifies the charity’s tax reporting. All charitable organizations must file Form 990 with the IRS and report their expenses paid in connection with lobbying. However, charities without this election in place must complete Schedule C Part II-B of the Form 990 which requires a detailed breakout of their lobbying expenditures. Charities with the election in place only need to complete the simpler Schedule C Part II-A. This section only requires the charity to report their lobbying expenditure in two broad categories: direct lobbying expenditures and grassroots lobbying expenditures.

Let’s take a look at some numbers to see how this works practically speaking.

**Slide 5: Numbers**

This chart illustrates how the total lobbying cap and grassroots lobbying cap is calculated. As you can see, the amount that can be spent on lobbying is tied directly to your charity’s total expenditures. If the charity has less than $500,000 of expenditures in a given year, then it would be allowed to spend 20% of that amount on lobbying. Its grassroots lobbying expenditures would be capped at 5% of its total expenditures. As the charity’s expenditures go up, the percentage that may be spent on lobbying expenditures decreases. It is important to note that “lobbying expenditures” do not include just cash outlays spent on lobbying (e.g., postage for mailing) but also includes a portion of staff salaries based on their percentage of time spent on lobbying activities.

Remember not to get to bogged down with these numbers. There is a calculator that will run this calculation for your charitable organization.

**Slide 6: Considerations**

We have reviewed the benefits. We have gone over the calculation. Now let’s briefly touch on what happens if a charity goes over the cap. You should be aware of two penalties associated with the 501(h) election. First, if an organization goes 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 which ever one is higher. Its not a great result, but at least the charity 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.

The second penalty is the one you really want to pay attention to. 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. See the penalty section for more information on the calculation.

So here is the takeaway. Yes, a charity can face penalties if they make the 501(h) election. However, the penalties are only tripped if the charity goes 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.

**Slide 7: Election Procedure**

Finally, now we have provided a brief background on the election, let’s talk about how to make the election. It is really simple. All you need to do is file Form 5768 with the IRS. The election is effective beginning of the year the election is filed.

**Closing:**

This has been a brief overview of the 501(h) election. If you want to learn more about the election or lobbying restrictions in general, make sure to check out our website.