THE EFFECT OF LEGISLATIVE ACTIVITY ON THE TAX STATUS OF RELIGIOUS, CHARITABLE AND SCIENTIFIC ORGANIZATIONS

It has, for a number of years, been the policy of the federal government to create certain tax advantages for specified organizations whose goals are felt to benefit society. The most liberal treatment of this type has been accorded to organizations devoted to religious, charitable, scientific and educational purposes.[1] Some groups of this nature engage in activities whiich require contact and communication with various agencies of government and with the public to satisfy and further the purposes and desires of the given organization. This comment will discuss the type and amount of such activities which are permissible if the organization is to obtain the maximum tax benefits available.[2]

Section 501 reads in part as follows:

> (a) Exemption from taxation—An organization described in sub-section (c) . . . . shall be exempt from taxation under this sub-title . . . .
>
> (c) List of exempt organizations—The following organizations are referred to in sub-section (a) . . . .
>
> (3) Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific . . . or educational purposes . . . no part of the net earnings of which ensures to the benefit of any private share-holder or individual, no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation . . . .

The wording of the statute raises two general requirements by which activities of the questioned type may be limited. First, in requiring that the organization be organized and operated *exclusively* for the purpose allowing the advantageous status; second, that no substantial part of the activities of the organization consist of carrying on propaganda or otherwise attempting to influence legislation.[3]

To attempt to answer the question involved, one must primarily rely on the case law in this area. The legislative history does little more

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[1] The specific situation to be dealt with herein is that of the organization which qualifies for exemption under I.R.C. §501(c)(3) and by meeting the wording of that section falls within the identical wording of §170(c)(2) allowing contributors deductions. It is possible to gain exemption under other sub-sections of 501(c) without meeting the criteria necessary to allow contributors deductions.

[2] The sections creating this advantage and utilizing the same language in so ding are §501(c)(3)—(Income Tax Exemption); §170(c)(2)—(Income Tax deduction); §2106(a)(2)(ii) — (Estate Tax); §2522(a)(2) — (Gift Tax); §3121(b)(8)(b)—(Social Security).

[3] The latter limitation was added by an amendment included in the 1934 Revenue Act.

than show that the Finance Committee was displeased with the wording of the section.[4] The regulations dealing with the pertinent sections consist mainly of setting down the statutory language in a different form.[5]

EXCLUSIVE PURPOSE

Since the initial use of this section, the wording has included the qualification that the purpose of the exempted organizations should be exclusively charitable, etc.[6] Such wording has been of common usage in the different revenue statutes allowing similar advantages. It has been subject to different interpretations, ranging from a very strict construction of the word "exclusive"[7] to the more liberally construed view which is normally applied at this time.[8]

The grandfather case in this area was *Trinidad v. Sagrada Orden*,[9] in which the United States Supreme Court held that an organization might be organized and operated exclusively for religious, scientific or educational purposes and yet have a net income.[10] Several years later, the Second Circuit Court of Appeals, in the case of *Slee v. Commissioner*[11] while refusing to allow the deduction of the amount of a gift to the American Birth Control League, made the statement that "there are many charitable . . . ventures that as an incident to their success require changes in the law",[12] and "so far as the society at bar sought to relieve itself of the restraints of law in order the better to conduct its charity, we might indeed hold that it fell within the class [exclusive organizaions] of which we have just given some instances."[13] In this case, however, the manner in which these activities were to have been accomplished was considered to be political and such classification was thought to make impossible the status of being organized and operated exclusively for the statutory purpose.[14]

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[4] 78 CONG. REC. 5959 (1934).

[5] The form of the section has been changed to a listing of the pertinent elements, retaining the statutory language. Some comment has been added. See §1.501(c)(3)-2, Proposed Regulations as promulgated January, 1956.

[6] The basic wording was first used in Section 38 of the Revenue Act of 1909 and has been continued in all later statutory changes dealing with this section.

[7] Better Business Bureau of Washington, D. C. v. United States, 326 U.S. 279 (1945).

[8] Liberty National Bank & Trust Company of Louisville, Ky. v. United States, 122 F. Supp. 759 (1954).

[9] 263 U. S. 578 (1924).

[10] *Id.* at 581.

[11] 42 F. 2d 184 (2nd Cir. 1930).

[12] *Id.* at 185.

[13] *Ibid.*

[14] The presently existing law states an addition to the basic section which now includes political activity as a basis for the denial of the tax advantages granted by these sections. This amendment has been made to all of the major taxes. Prior to the amendment, the proposition of the holding in the *Slee* case was followed, and it was held in Vanderbilt v. Commissioner, 93 F. 2d 360 (1st

Weyl v. Commissioner,[15] the next case to consider the section in this context, turned its holding on the basis of giving a broad definition to the word "education" so that it might include a wide scope of activities, notwithstanding the resemblance to a political party. A 1932 case, *Leubuscher v. Commissioner*,[16] drew the distinction between two items of a will, that one was deductible as going to a trust fund created by that will and limited by the terms of the will to teach, expound and propagate ideas about the "single tax" and as such was limited to exclusively educational purposes, whereas the other gift was to a club whose charter stated as a purpose, the "abolition of tax on industry." Since the one was limited by its terms to teaching a doctrine, it was permissible, but the other which advocated a controversial idea could not fall within the scope of the statute since the dissemination of controversial propaganda took it out of the exclusive category. Note at this point, that the case deals with purpose alone.

Cochran v. Commissioner,[17] to avoid the problem of "exclusive," broadly construed the meaning of education to fit a non-controversial matter which was being advocated. *Vanderbilt v. Commissioner*[18] held that even though the purposes be exclusively educational, actual operation that was not such would cause denial of a deduction.

The first case to mention the interrelation between the "exclusive" limitation and the 1934 amendment, was *Girard Trust Company v. Commissioner*,[19] a case arising before the amendment, but decided after its passage. In considering the deduction of a gift to the "Board of Temperance, Prohibition and Public Morals of The Methodist Episcopal Church," an organization having as one of its primary goals the institution of laws causing total abstinence from alcoholic beverages, the court passed over the question of the exclusively charitable nature of the organization, stating that it did "not understand that the commissioner . . . would question . . . the deduction . . . if the purpose stopped short of any possible attempt to influence or otherwise affect legislation"[20] and since there was no limit on such activity of this nature prior to 1934, the deduction should be allowed.

In 1945 the Second Circuit Court of Appeals considered the case of *Marshall v. Commissioner*[21] and affirmed the denial of petitioner's claim under the estate tax. The will in question had provided for three trust funds; respectively, an economic trust to advocate industrial pro-

Cir. 1937) that the National Women's Party could not be considered exclusively educational due to the political nature of its activities.

[15] 48 F. 2d 811 (2nd Cir. 1931).

[16] 54 F. 2d 998 (2nd Cir. 1932).

[17] 78 F. 2d 176 (4th Cir. 1935).

[18] 93 F. 2d 360 (1st Cir. 1937).

[19] 122 F. 2d 108 (3rd Cir. 1941).

[20] *Id.* at 109.

[21] 147 F. 2d 75 (2nd Cir. 1945).

duction for use and not for profit, a civil liberties trust, and a wilderness trust to advocate the preservation of primitive forest conditions. In all of these trusts, the trustees were given very broad powers, including the power to draft and seek passage of bills dealing with these matters. The court points out, and with particular respect to the economic trust, that the only way in which the purpose of the trust may be attained is through legislation, and that the purposes advocated are in effect political. These funds were not to be used to further any purpose of a solely charitable, scientific or educational nature, and what is more, they would violate the "attempting to influence legislation" limitation even if they were considered as exclusively devoted to permissible ends.

The one point which seems to make itself obvious throughout these cases is the lack of a definition of the meaning of the word exclusive. It is shown that subsidiary purposes may exist, but the extent to which this is true is not brought out. The favorite method of the courts would seem to be that of including the subsidiary purpose within the primary purpose of redefinition of the primary purpose. This is the technique if the tax advantage is to be allowed. On the other hand, the claim which is doomed to denial will be labeled as having a controversial and political subsidiary purpose.

It has been stated in discussing the "exclusive" limitation, that "a primary devotion is enough; totality of devotion is not required."[22] The same author continues in stating that "a purpose, 'incidental, contributory, subservient, or mediate' to one of the statutory purposes, will not prevent an organization from being within the required category."[23] The cases in this area would tend to indicate that the subsidiary purpose must go to the en dresult that the primary purpose strives for, and some of these cases would seem to suggest the necessity for such lesser purpose to be of the same general nature as the "exclusive" one.

Limited Activities

The cases dealing as such with the limitation on propaganda and the attempts to influence legislation are rather sparse. In considering this portion of the statute, there are three distinct questions to be held in mind. First, it is necessary to determine the meaning of the word "propaganda" when used in this context. Then the meaning of the phrase "attempting to influence legislation" should be considered, and lastly the way in which the courts have treated the qualifying term "substantial."

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[22] 1 Paul, Federal Estate and Gift Taxation §12.19 (1942).

[23] *Ibid.* Such wording is practically identical with that employed in the Income Tax regulations requiring that substantially all activities of the organization be devoted to the principal, primary and predominate purpose and the other purpose is incidental, secondary or subservient. U.S. Treas. Reg. (Proposed) §1.501(c)(3)-2 (1956).

PROPAGANDA

The only case to raise and discuss this question at length was *Seasongood v. Commissioner*[24] and there only as dicta. The Sixth Circuit Court of Appeals was split in its opinion as to what constitutes propaganda within the meaning of this statute. Judge Simmons, though writing the opinion, took the dissenting view on this point, that the word propaganda carries a connotation of an evil, illegal, unpopular or somehow subversive dissemination of untruth.[25] The judge, after setting forth his definition, goes on to state the definition which the other members of the court would accept: "spreading of popular beliefs and opinions, . . . the planned or concerted effort to influence public opinion, . . . a movement to spread a particular doctrine, . . . or a scheme for enlightening people concerning politics or other matters."[26]

If the limitation is to be read as applicable to any propaganda, whether or not directed toward an ultimate goal of legislative achievement, and the definition of the majority of this court is accepted, it would seem to cut deeply into the area of that which could be considered as educational. If, however, on a close reading, the conclusion is reached that the limitation should not affect educational efforts, but merely those which are advanced with the advocacy of some purpose in mind, the entire proposition would seem to come closer to the mark.[26.1]

The main effect of such definition would probably be felt by the group which in attempting to carry out its permissible purpose, tries to "educate" the public so that the populace will see their side of the picture. Logically, if one were to follow this definition, such would be propaganda, since it is the advocating of and striving for a presentation which will be of advantage to the organization.

A point to be raised for the opposite construction and definition of the word is the mere fact of the normal context in which it is used. The present generation is well attuned to the context placed upon the word during the last war, when anything labeled propaganda was considered to be mere enemy untruth. The committee report of the Finance Committee considering the 1934 amendment tends to indicate that the word was used in a similar context at that time.[27]

If this latter definition were to be adopted, it would seem to restrict the application of this limitation to such matter as is in current disrepute, an application which would probably be unworkable and would never reach the courts in this framework.

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[24] 227 F. 2d. 907 (6th Cir. 1955).

[25] *Id.* at 911-912.

[26] *Ibid.*

[26.1] That this idea is adopted by the Internal Revenue Service would seem to be indicated by the regulations underlying these sections. See, for example, U. S. Treas. Reg. (Proposed) §1.501(c)(3) (1956).

[27] 78 CONG. REC. 5861, 5959, 7815, 7831 (1934).

One other complication which must be considered with this problem was raised by a 1954 speech of Mr. Nathan Sugarman[28] in which he stated that "the words 'carrying on propaganda' do not stand alone but must be interpreted in conjunction with the words 'to influence legislation.' "[29] If this statement is to be taken at face value and at the very least as casting some light on the opinion of the Internal Revenue Service, it would appear that only that propaganda which has as its objective the influencing of legislation is affected by this section. If that is so, it is quite possible that propaganda might be defined for the purpose of this section as the "indirect influencing of legislation."

This might possibly be the attitude of the Tax Commissioner. Only one thing seems certain, though, at this point, that being that the courts have made no definite holding as to what definition and context the word propaganda should be accorded.

INFLUENCING LEGISLATION

The problem of what activities are attempts to influence legislation presents a picture of no greater clarity than does the question of what constitutes propaganda. However, there have been more decisions dealing with it, and it is possible on the surface, at least, to distill some sort of pattern from the various holdings.

The League of Women Voters of Louisville, Ky., is governed by a set of by-laws which includes among the purposes that the organization should carry on legislative activities.[30] In actuality, "the league frequently takes a stand on issues of national import and in support thereof, writes or wires members of the legislature or executive branch of the government, stating the league's stand on all these issues. In some issues, the league has urged the legislature to take a certain stand on a question. The legislative activities of the league are sporadic, not continuing, depending upon the interest of the league in a specific issue." The court at a later point states that these activities were not in pursuance of any legislative program of the league.

In its holding, the court stated that the league was an ". . . organization organized and operated exclusively for educational purposes, *no part of which is carrying on propaganda or otherwise attempting to influence*

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[28] Former Deputy Tax Commissioner.

[29] See 573 CCH *Stand. Fed. Tax Rep.* ¶3033.025, giving parts of Mr. Sugarman's statement of June 2nd, 1954 as presented to the Special Committee of the House of Reprsentatives to Investigate Foundations and other Organizations. §1.501(c)(3)(2)(e)(1), U.S. Treas. Reg. (Proposed) (1956), tends to indicate the same view. It should be pointed out that the 1954 code prohibits the carrying on of political activity if one is to secure the §501(c)(3) type classification, and such limitation is susceptible of being read in conjunction with "propaganda" in the same manner as "otherwise influencing legislation has been."

[30] See note 8, *supra*.

legislation."[31] Assuming the court meant to state the proposition in this manner, and there is no basis to presume otherwise, it would seem that this judge, to have found activity attempting to influence legislation, would require either a continuing program of the type activity found here, or a more direct type of action than merely informing one's representative of their desires.

The Tax Court, in considering two cases involving the application of funds for the advocacy of state constitutional amendments, refined the problem to a further point. If the constitutional amendment is self-enabling and will require no further legislative action to effectuate its purpose, the activity promoting such amendment is not attempting to influence legislation.[32] On the other hand, if the amendment will require further legislation to become effective, the initial activity of supporting the passage or defeat of such amendment takes on the nature of an attempt to influence legislation.[33] The moral of this story would seem to be, that the efforts must be directed at legislative action, whether it be immeditae or remote, but that if it does not have the effect of casting itself on an issue which will be in legislative contention, it is not included within the limitation of this secton.

The *Mosby*[34] case did involve a legislative program which was continuing in nature and actively attempting to bring about a set goal. The efforts were, however, aimed at the constituents and not the legislative body. This case would seem to be in the nature of a maverick, since it runs somewhat contra to the view taken in *Seasongood v. Commissioner*.[35] That case, in considering the problem of influencing legislation, draws an analogy to the Lobbying Act[36] and cites *United States v. Harris*,[37] which in construing similar language stated that the ". . . purpose . . . must have been to influence the passage or defeat of legislation by Congress [and] the intended method . . . must have been through direct communication with members of Congress."[38] From the use of the above language as quoted, it would seem that the Sixth Circuit, at least, would require direct attempts to influence the members of the legislature.[39]

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[31] *Id.* at 766, emphasis added.

[32] Luther Ely Smith v. Commissioner, 3 T.C. 696 (1944) (A).

[33] Mosby Hotel Company v. Commissioner, 13 T.C.M. 996, 999 (1954).

[34] *Ibid.*

[35] See note 24, *supra*.

[36] Federal Regulation of Lobbying Act, 60 STAT. 812, 859, 2 U.S.C. §§261-270 (1946).

[37] 347 U.S. 612 (1954).

[38] Note that such action aimed at the constituents may fall within the area of prohibited activity as limited by the ban on political activity or may on the other hand eliminate the organization as not coming within the exclusive purpose of the organization.

[39] See note 24, *supra*.

In coming to this point on speculating as to the criteria for the application of this section, it would seem that the following might be generalized upon; that the activity must be aimed at influencing some legislative consideration, either present or future and that it should constitute a concerted effort on the part of the activity to bring continuing pressure on the members of the legislature with regard to some legislative program of the organization itself.

The extent to which an organization may address the members of the legislature, without endangering the organizational tax status, then comes into question. *Liberty Bank v. Commissioner*[40] indicates that the mere notification by an organization to its representatives in the legislature, of the policy and desires of that group as to some issue, does not constitute influencing legislation.[41] It would seem logically to follow, that any such group, in apprising their respective representative of their desires, should be able to request his aid and advocacy in dealing with the matter. That much, at least, would seem to be a prerogative of constituents.

Coming within a closer area, the problem of definition becomes somewhat more difficult. Lobbying, of course, will constitute activity which eliminates the tax advantage.[42] The making of a voluntary appearance before a committee of the legislature to advocate some program would probably be held to be an attempt to influence legislation.[43] It would seem that the similar practice of sending regular news releases to the individual legislators, with the hope of gaining their support, would likewise be considered as prohibited activity. On the other side of the coin, logic would dictate that an appearance before a legislative committee, if made in response to invitation or request, would not amount to an attempt to influence legislation, since the organization involved would not have appeared of its own volition.[44]

In dealing with these cases, this would seem to be the line of demarcation. The activities should be direct, voluntary and unsolicited and aimed at influencing the ultimate result of some legislative action. Although the proposition is nowhere stated, it would seem implicit from the holdings, that the criteria involved are quite flexible and subject to

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[40] See note 8, *supra*.

[41] *Ibid.*

[42] This result seems necessary in considering the relative degrees of "lobbying" and attempting to influence legislation."

[43] Such activity would probably constitute "Solicitation of the votes of the legislators for or against legislative proposals" and cause denial of exemption under §501(c)(3); U.S. Treas. Reg. §1.501(c)(3)(2)(e) (1957). See also, McClintock-Trunkey Co. v. Commissioner, 19 T.C. 297, 301 (1952), Rev'd on other grounds, 217 F. 2d 329 (1954).

[44] For a discussion touching on this type of problem under the Internal Revenue Code, see Smoky Mountains Beverage Co. v. Commissoiner, 22 T.C. 1249 (1954)(A).

relative comparisons. It would not take any great amount of voluntary legislative appearances to cause the activity to be considered as falling outside the permissible area, while a more remote program such as advocating the passage of a constitutional amendment would probably require a continuing sustained program of some type to be considered as influencing legislation.

SUBSTANTIAL

The requirement that the activity be substantial may be viewed with two possible meanings when considered in this context. Such difference would seem to be that between a quantitative and qualitative consideration of the prohibited activity when compared with the entire activities of the organization involved. The courts would seem to have adopted a purely quantitative approach to the subject. The *Liberty Bank* case[45] indicated that the activities, if considered as within the section, were not substantial, relating the fact that the fiscal outlay for questionable purposes, totaled but a minute portion of the entire expenditures of the organization,[46] while in *Seasongood*[47] the court stated that the League's activities were not substantial since they only took a little of the total time and energy consumed in organizational activities.

That such activity must be considered in respect to the organization's activities is stipulated by the statute, and there would seem to be no question of comparison with the activities of other groups, this test being more or less a test in a vacuum. This being the case, it is clear that there is no hard and fast rule by which an organization may gauge the substantiality of their activities. It has been stated that activities occupying less than 5 per cent of the total time and money would be permissible in this respect.[48] How much further an organization may go is an open question.

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[45] See note 8, *supra.*
[46] *Ibid.*
[47] See note 24, *supra.*
[48] *Id.* at 912.