**Federal Tax Law and Cost Principles: Introductory Guidance**

Background

Lobbying Activities

Lobbying is defined as any communication, written or oral, that is intended to influence the passage or defeat of specific legislation, resolution, referendum, constitutional amendment, or similar items or procedures by Congress or a state or local legislative body. The Internal Revenue Code (“IRC”) permits organizations that are exempt from federal income tax under IRC § 501(c)(3) (including PCAs-HCCNs) to engage in both direct and grassroots lobbying activities, provided that the activities do not constitute a “substantial part” of the organization’s total activities.[[1]](#footnote-1) There is no tax law limitation on the lobbying activities of a PCA-HCCN that is exempt under Section 501(c)(4) of the IRC (social welfare organizations) or Section 501(c)(6) of the IRC (trade associations and business leagues).

While federal tax law permits tax-exempt organizations to engage in a certain amount of lobbying activities, the uniform Cost Principles for federal awards to non-federal entities[[2]](#footnote-2) provides that “costs associated with … attempts to influence the outcomes of any Federal, State, or local referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity” are unallowable.[[3]](#footnote-3)Accordingly, nonprofit organizations that receive federal funds, either through a grant or cooperative agreement, may not use these funds for either direct or grassroots lobbying activities.

Additionally, the Byrd Anti-Lobbying Amendment[[4]](#footnote-4) generally prohibits recipients of federal grants and cooperative agreements from using federal (appropriated) funds for lobbying the Executive or Legislative Branches of the Federal Government in connection with a specific grant or cooperative agreement. The Byrd Anti-Lobbying Amendment also requires that each person or entity that requests or receives a federal grant or cooperative agreement exceeding $100,000 must disclose lobbying undertaken with non-federal (nonappropriated) funds.

Finally, federal law sometimes contains general limitations on the use of appropriated funds for lobbying activities. For example, the FY 2015 appropriation for the Department of Health and Human Services provides, in part:

No part of any appropriation contained in this Act . . . shall be used to pay the salary or expenses of any grant or contract recipient, or agent acting for such recipient, related to any activity designed to influence the enactment of legislation, appropriations, regulation, administrative action, or Executive order proposed or pending before the Congress or any State government, State legislature or local legislature or legislative body, other than for normal and recognized executive-legislative relationships. . . .[[5]](#footnote-5)

Similar provisions have been in Department of Health and Human Services appropriations legislation since FY 2012

Political Campaign Activities

Unlike lobbying activities, federal tax law absolutely prohibits organizations that are exempt under Section 501(c)(3) from engaging in political campaign activities, defined as intervening in any election for public office or attempting to influence the outcome of any federal, state or local election, referendum, initiative or similar procedure.[[6]](#footnote-6) While there is no express prohibition on IRC Section 501(c)(4) and (c)(6) organizations engaging in political campaign activity, an organization that does so will incur a tax, at the highest corporate rate, on the amount it expends for political campaign activity. Moreover, expenditures in support of or in opposition to a candidate in a federal election (i.e., President, Senate, House of Representatives) are prohibited under the Federal Election Campaign Act.[[7]](#footnote-7)

Advice and Recommendations[[8]](#footnote-8)

Because federal tax law limits the amount of lobbying activities in which a PCA-HCCN that is exempt under Section 501(c)(3) may engage, it is advisable that such PCAs-HCCNs carefully track and document that neither the PCA-HCCN, nor any of its affiliates, employees or agents acting on behalf of the PCA-HCCN, engages in or devotes a substantial part of PCA-HCCN activities or resources to lobbying activities. Additionally, Section 501(c)(3) PCAs-HCCNs should have in place procedures to ensure that neither the PCA-HCCN nor any of its affiliates, employees or agents acting on behalf of the PCA-HCCN, endorse or oppose any candidate for elective public office, or in any way, participate in any political campaign. Non-compliance with either of these limitations/prohibitions could jeopardize a PCA-HCCN’s tax-exempt status.

PCAs-HCCNs that are tax exempt under IRC Section 501(c)(4) and (c)(6) may establish a separate segregated fund, commonly referred to as a political action committee (PAC), to carry on political activities at the federal level, subject to rules established by the Federal Election Commission. Note that state law may regulate the political activities of corporations and other business organizations for election purposes.

One of the more difficult issues regarding the federal tax limitation on lobbying activities is the definition of “substantial.” There is no precise test for determining whether lobbying activities are a substantial part of an organization’s activities. Organizations, such as Section 501(c)(3) PCAs-HCCNs, that engage in a significant amount of lobbying activity should consider whether to elect to have their lobbying activities measured by the “expenditure test” under Section 501(h) of the IRC. Under this test, only the expenditure of funds for lobbying activities count for the purposes of measuring the organization’s allowable lobbying. The IRC rules define clearly what kind of activities are and are not considered lobbying and provide ceilings on what can be spent on lobbying activities based on the organization’s total expenditures, thereby providing a degree of certainty not found in the traditional “substantial part” test.

In order to ensure compliance with federal cost principles, all PCAs-HCCNs should consider taking affirmative action to document that lobbying activities are supported solely by non-federal resources, including revenues unrelated to the activities supported by federal grant funds, unrestricted donations, investment income, and program income. At a minimum, non-compliance could result in the disallowance of the costs of such activities. Further, a violation could trigger further investigation of the PCA-HCCN, as well as other punitive measures.

Finally, it is also important to note that state and/or private funding awards may include restrictions regarding lobbying activities, and, as such, should be reviewed prior to engaging in any lobbying activities.

* [Lobbying and political campaign activities: Sample policy and procedure](http://www.healthcentercompliance.com/subscriber/pca-toolkit/volume-2/879)
1. See IRC Section 501(c)(3). [↑](#footnote-ref-1)
2. 45 C.F.R. Part 75, Subpart E. [↑](#footnote-ref-2)
3. See 45 C.F.R. § 75.450(c) [↑](#footnote-ref-3)
4. 31 U.S.C. 1352. [↑](#footnote-ref-4)
5. P.L. 113-235, Section 503(b). [↑](#footnote-ref-5)
6. See IRC Section 501(c)(3). [↑](#footnote-ref-6)
7. For more details, see [Introductory Guidance: Federal Election Campaign Act](http://www.healthcentercompliance.com/subscriber/pca-toolkit/volume-2/880). [↑](#footnote-ref-7)
8. The Authors of these materials include attorneys at the law firm of Feldesman Tucker Leifer Fidell LLP. The advice and recommendations consist of general guidance based on federal law and regulations and do not necessarily apply to all PCAs-HCCNs under all facts and circumstances. Further, these materials do not replace, and are not a substitute for, legal advice from qualified legal counsel. [↑](#footnote-ref-8)