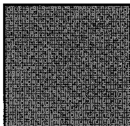

SHEILA WARREN and ROSEMARY E. FEI

LOBBYING CLAUSES IN GRANT AGREEMENTS WITH ORGANIZATIONAL GRANTEES

While the usual image of a funder is a philanthropic foundation, grantmaking occurs throughout the charitable sector, and many funders in fact are not private foundations but operating charities. Most grant agreements address the question of legislative lobbying, but the authors often find that in attempting to navigate the different rules governing grantmaking by public charities and private foundations and weave them together with the rules governing legislative activities, clients wind up crafting provisions that are either unnecessarily restrictive on the one hand or legally impermissible on the other.

Grant agreements are, first and foremost, contractual agreements between the grantor and grantee organizations. A grant agreement that is not carefully crafted may allow activities that the funder's federal tax-exempt status prohibits it from funding. The grantee may not even be aware of such restrictions if they do not appear in the grant agreement, and certainly it is not legally bound by them. Similarly, even if an activity is perfectly acceptable for a foundation to fund consistent with its obligations under federal tax law, the grantee is contractually bound if the grant agreement prohibits that activity. A grantor is always within its rights to impose stricter obligations on its grantees than the law requires, but it makes more sense to do so as a conscious decision rather than as a default, or even by mistake.

Exhibit 1 on page 238 summarizes the information in the discussion below. Note that the chart is not intended to substitute for a sample grant agreement, as it addresses only grant agreement clauses relating to lobbying and ballot measure activities.

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Private foundation funders

Amounts paid or incurred by private foundations to conduct lobbying activities are considered taxable expenditures pursuant to Section 4945. Although private foundations may not engage in lobbying activities without incurring taxation, they may make grants to public charities that lobby. Such grants will not be classified as taxable expenditures by the private foundation as long as they are not conditioned on any oral or written agreement that the grant funds be used for lobbying purposes.[1] Because of this strict rule, private foundation grantors should include language regarding lobbying in all grant agreements. In an excess of caution, many private foundations therefore prohibit all lobbying by grant recipients. Such prohibitions are often unnecessary to protect the funder and inappropriately limiting of a grantee's flexibility to use funds for legally permissible purposes, including lobbying and ballot measure activities. The authors suggest that private foundations use language prohibiting lobbying only when they specifically need or intend to do so, such as when they have concerns that a grantee might misuse grant funds or when they make a grant to a public charity for a specific project that does not include any lobbying. Two common cases in which a prohibition is excessive are those of a private foundation making (1) a general support grant or (2) a grant that is earmarked for a public charity's specific project that includes some lobbying.

Private foundations that wish to support an entire organization may make unrestricted or general support grants to public charities.[2] Under Reg. 53.4945-2(a)(6)(i), even if the public charity has lobbying activities, those activities are not attributable to the private foundation's general support grant, and cannot cause the funder to have made a taxable expenditure. To protect the funder, general support grant agreements should state that the grant is "not earmarked for lobbying."[3] With such a provision, the foundation has made clear that its grant, in keeping with its unrestricted nature, is not directed at the grantee's lobbying activities, yet the public charity retains the flexibility to use the grant funds for any purpose, including lobbying. Even if the public charity does ultimately use the money for lobbying, the private foundation will not incur a

taxable expenditure, because the public charity will have made an independent decision in its sole discretion to use the funds for lobbying activities. (It is important to explain the meaning of this clause to non-lawyers, who in the authors' experience often confuse the phrase "not earmarked" with the word "prohibited.")

Private foundations may, of course, earmark grants for specific projects of a public charity that do not involve any lobbying. They may not, of course, earmark grants for specific projects that consist entirely of lobbying activities. Less obvious is the regulation that permits a private foundation to earmark a grant for a specific project of a public charity that does include some lobbying, under special circumstances.[4] Before doing so, the private foundation must review the grantee's budget for the project and ensure that its total funding of the project does not exceed the non-lobbying portion of the grantee's budget. The grant agreement must indicate that the grant funds are earmarked for the specific project. If these conditions are met, the private foundation will not incur a taxable expenditure, even if the public charity subsequently uses some of the money for lobbying. This type of grant is commonly referred to as a McIntosh grant.[5] McIntosh grant agreements, like agreements for general support grants, should include the statement that the grant is "not earmarked for lobbying." The authors also recommend including language indicating that in making the grant, the private foundation is relying on the grantee's budget for purposes of determining the amount budgeted by a grantee for non-lobbying activities.

While many private foundations are reluctant to make grants to organizations that are not public charities, or may even have an internal policy prohibiting such grants, private foundations are permitted to make such grants, provided that they exercise "expenditure responsibility" within the meaning of Section 4945.[6] Grant agreements between private foundations and non-public charities must be restricted to specific charitable projects or programs of the recipient, must contain certain provisions related to monitoring by and reporting to the private foundation required under Section 4945, and, most relevant to the topic at hand, must specifically prohibit lobbying with grant funds. Language indicating that the grant is "not earmarked for lobbying" is not sufficient, and will not adequately protect the private foundation in such cases.

FIRST AND FOREMOST, CONTRACTUAL AGREEMENTS.

Public charity funders

Unlike private foundations, public charities are permitted to engage, either directly through their own activities or indirectly through grant-making, in limited lobbying activities. Charities that elect to have their lobbying measured by their expenditures pursuant to Section 501(h) are subject to a tax on any lobbying expenditures in excess of their allowed amounts, pursuant to Section 4911.[7] Charities that choose to be governed instead by the "no substantial part" test must also be sure to avoid making grants for lobbying that could, when considered with other lobbying activities, be considered substantial and therefore jeopardize their exempt status. Both electing and non-electing charities should therefore think carefully about the language they include in their grant agreements.

The regulations and other precedential guidance provide little insight into how the IRS will view grants by public charities to other public charities that lobby. Public charities are per-

[1] Reg. 53.4945-2(a)(5).

[2] These may sometimes be styled as "core support" or "operating support" grants, although such terminology creates the possibility that the funder's intent is to earmark the grant for these functions and prohibit the grantee from spending it on specific programs. The authors therefore prefer the terms "unrestricted" or "general support." An in-depth discussion of grants to individuals, as contemplated by Section 4945, is beyond the scope of this article. Note that in general, a "not earmrked for lobbying" clause may be appropriate.

[3] The IRS has affirmed that such language in a general support grant agreement fully protects the funder from attribution of the grantee's lobbying. In its letter to Charity Lobbying in the Public Interest, dated 12/9/04, it noted that a recitation in a grant agreement that "there is no agreement, oral or written, that directs that the grant funds be used for lobbying activities" is sufficient to satisfy the IRS that there has been no earmarking for lobbying.

[4] See Reg. 53.4945-2(a)(6)(ii).

[5] Before being codified in Reg. 53.4945-2(a)(6)(ii), these rules were first set forth in a private letter ruling issued to the McIntosh Foundation (Ltr. Rul. 7810041); hence the moniker.

[6] See Rev. Rul 68-489, 1968-2 CB 210; Reg. 53.4945-5(b)(3). A discussion of expenditure responsibility requirements is beyond the scope of this article.

[7] For an excellent summary of the Section 501(h) election, see Colvin, "The 501(h) Election Allows Many Charities to Become Aggressive Lobbyists," 5 JTEO 38 (Jul/Aug 1993).

EXHIBIT 1. Summary of Lobbying Clauses in Grant Agreements.

Type of Clause	*When required or appropriate for public charity (PC) or private foundation (PF) grantor*	*Comments*
None	*PC grantor:* Appropriate in grant to a PC. *PF grantor:* Never appropriate. (Also appropriate in any grant made by a non-charitable grantor, regardless of tax status of grantee; this is beyond the scope of this article.)	Strict rules apply if a PC makes a grant to a noncharity that lobbies without a lobbying prohibition, resulting in attribution of the noncharity's lobbying (first grassroots, then direct) to the PC.
Lobbying prohibited	*PC grantor:* Use only where grantor specifically intends to prohibit lobbying with its grant, such as in a PC's "controlled grant" to a noncharity that lobbies. *PF grantor:* Use only where grantor specifically intends to prohibit lobbying with its grant, such as where PF is concerned about grantee misuse of funds for lobbying. Not appropriate in general support grants or McIntosh grants to PCs. Acceptable in specific project grants to PCs where project does not include any lobbying.	The prohibition is contractually binding even if not required by tax law. Lobbying prohibitions are frequently included in PF grant agreements when they unnecessarily and inappropriately limit grantee freedom to use funds.
Reportable activities prohibited	*PC and PF grantors:* Use where grantee may make a ballot measure contribution, and PF or PC funder does not wish to be disclosed as a donor to a ballot measure committee. This prohibition may, depending on state law, prevent the grantee from having to allocate any of its ballot measure contribution to the funder's grant. This clause can be used alone, or with any other clause; PF's especially may want to use this clause with "not earmarked," to prevent their funds being used by the grantee for a ballot measure contribution.	Donors may be reportable on ballot measure committee campaign finance disclosure reports, even if they have not earmarked gifts for ballot measure activities.
Not earmarked for lobbying	*PC grantor:* May be used only in a grant to a PC; not appropriate in a grant to a non-charity. *PF grantor:* Use in a general support grant or McIntosh grant to a PC; do not use in a grant to a non-PC organization.	Often misunderstood by clients to mean lobbying is prohibited.
Reliance on nonlobbying shown in grantee budget	*PC grantor:* Might work in grant to PC situation; unclear. *PF grantor:* Should be used in any McIntosh grant to a PC.	
Earmarked up to dollar cap for direct/ grassroots lobbying	*PC grantor:* May be used in a PC grant to another PC or to a noncharity. Caps should be counted against grantor's lobbying limits. If in PC grant to noncharity, must include repayment of any misspent funds. Must include promise to repay any amount spent in excess of caps. *PF grantor:* Never appropriate.	

mitted to lobby, whereas private foundations are not. It therefore seems reasonable to apply to public charity grantors, by analogy, the regime that governs grants by private foundations to public charities that lobby. If a private foundation, which is prohibited from lobbying, can make a grant under given circumstances and not have the grantee's lobbying attributed to the funder, a public charity grantor that follows the same approach presumably should not have the grantee's lobbying attributed to it. Having public charities follow the private foundation rules, the authors believe, is the clearly conservative approach. If anything, the IRS would perhaps apply a less stringent approach to attributing lobbying to public charity grantors.

Accordingly, it is probably safe for grant agreements with public charities that lobby to forgo any clause addressing lobbying. If the grant is made for general support, the grantor

will not count any of the grant against its lobbying limit, regardless of the grantee's lobbying activities. Similarly, if the grant is earmarked for specific activities or programs of a grantee that do not include any lobbying, none of the grant will count as a lobbying expense by the grantor. In the preceding two situations, it is appropriate to include a "not earmarked for lobbying" clause if desired.

If and to the extent that the grant is earmarked for grantee activities that are lobbying, it will count as a lobbying expense of the grantor, and the nature of the grantee's lobbying (direct or grassroots) will similarly pass through to the grantor. In this final case, rather than having to wait and see how the grantee spends the grant, the funder can choose to control the expense contractually in advance, by (1) earmarking specific amounts of the grant for direct lobbying or for grassroots lobbying, up to specific dollar caps, and (2) providing that any amounts expended by the grantee in violation of the stated limits must be returned to the grantor. Then the grantor would treat the cap amounts as lobbying expenditures for tax purposes.

The authors do not believe that the IRS has indicated whether a version of the McIntosh grant approach works in the public charity grantor context, but, as noted above, it is reasonable to conclude it should. In other words, if a public charity makes a grant to another public charity earmarked for a specific project that includes some lobbying, and the grantor relies on the grantee's budget in determining that its grant is less than the nonlobbying budget, it is not clear whether the public charity grantor is protected from attribution of any of the grantee project's lobbying. The more conservative approach would be to allocate the grant as a lobbying expense by the grantor according to the proportion of the project budget that was allocated to lobbying.

Under Reg. 56.4911-3(c)(3), if a public charity makes a grant to a non-charity that lobbies without addressing lobbying in the grant agreement, the non-charity's lobbying is attributed to the grantor charity.[8] In these situations, merely providing that the grant is "not earmarked for lobbying" is not enough to prevent the attribution. On the other hand, the grantor should include prohibitive language only when the grantor specifically intends to make a controlled grant prohibiting lobbying.[9] The easiest way to control the amount of lobbying attributed to the grantor charity is to earmark the grant funds up to a dollar cap for lobbying. Public charities must ensure that they exercise discretion and control over grant funds,[10] meaning, for example, that adequate measures are in place in the event that grant funds are used for purposes other than those outlined in the grant agreement. Thus, earmarking language must be accompanied by the grantee's promise to repay any amount spent in excess of the caps and by language that mandates the repayment of any misspent funds.

Ballot measure activities

Both public charities and private foundations often engage in activities related to issues that also are addressed in state ballot initiatives. Public charities may even become directly involved in ballot measure campaigns, including by making contributions to them. Ballot initiatives are considered legislation by the IRS and are therefore subject to the rules governing lobbying activities.

The complicating factor is that ballot measure activities are also subject to an entirely separate and unrelated body of law. They must comply with state and local rules and regulations under state and local election and campaign finance disclosure laws. While these rules vary from one jurisdiction to another, they generally require public disclosure of ballot measure expenditures and contributions and subject them to some restrictions and regulation. These rules are not necessarily consistent or compatible with IRS rules. For example, what constitutes lobbying for IRS purposes may or may not be considered a discloseable ballot measure expenditure or contribution. Conversely, what constitutes a discloseable ballot measure expense may or may not qualify as lobbying for tax law purposes. The result is that, under some campaign finance disclosure laws, public charity and private foundation donors may be deemed to be the source of a ballot measure contribution by the grantee, and thus publicly discloseable as ballot measure contributors. This may be so even if the grant was made for general support, the grantor and the grantee

PRIVATE FOUNDATION GRANTORS SHOULD INCLUDE LANGUAGE REGARDING LOBBYING IN ALL GRANT AGREEMENTS.

[8] Strict rules apply if a public charity makes a grant to a noncharity that lobbies without a lobbying prohibition, resulting in attribution of the noncharity's lobbying (first grassroots, then direct) to the public charity.

[9] See Reg. 56.4911-3(c)(3)(i)(B).

[10] Rev. Rul. 68-489, 1968-2 CB 210.

never discussed possible ballot measure activities, and the grant agreement does not earmark funds for ballot measure activities.

If a grantor is especially concerned about being disclosed as a donor to a ballot measure and wants to minimize the possibility, the authors suggest including a provision in the grant agreement that grant funds may not be used for "reportable or discloseable activities under applicable state or local campaign finance disclosure laws" (or similar language tailored to the jurisdiction). This language should preclude the grantee from having to source any ballot measure contributions to the grant (and thereby to the donor). A private foundation may choose to include this clause alongside the clause indicating that grant funds are "not earmarked for lobbying," making clear that funds are not directed to lobbying activities but leaving open the possibility that the grantee may spend them for lobbying, yet prohibiting the grantee from spending them in such a way as to make the foundation a discloseable supporter of or donor to a ballot measure.

Other issues

All grant agreements should contain an integration clause, indicating that the grant agreement is the full and final understanding of the parties with respect to all terms. The authors believe this is especially important where issues relating to lobbying activities have arisen. Frequently, grantees and grantors have wide-ranging discussions about how a particular grant may be spent. Grantees may raise possible scenarios that involve, or could involve, lobbying, to which the grantor may have reacted. Recall that for a grant to be truly "not earmarked for lobbying," it must not be subject to any oral or written agreement or understanding that the funds be used for lobbying purposes. An integration clause not only is a sign of good drafting generally, but in the case of possible lobbying activities it also serves to put to rest any future claims by the grantee that funds were in fact allocated for lobbying purposes by the grantor.

Conclusion

Private foundations and public charities across the political spectrum are increasingly realizing the potential impact of funding advocacy and policy work and directing their charitable dollars accordingly. Even as public policy grantmaking becomes more accepted within the charitable sector, however, it is often viewed skeptically by the public—or at least by the opponents of any particular funder's policy agenda. It is critical that funders and grantees understand the law and follow it scrupulously, to give funders legal protection while maximizing grantees' flexibility and effectiveness. Board and staff members of charities who know their grant agreements will withstand regulatory scrutiny are better prepared to handle public scrutiny and weather controversy. ■