



IRS Provides Needed Guidance on Grants from Public Charities to other Public Charities

Internal Revenue Service (IRS) regulations address the treatment of grants from public charities by applying an earmarking standard. That is, a grant is considered lobbying if it is earmarked for lobbying. Unfortunately, the regulations do not provide a clear path to determine when a grant is not earmarked. Alliance for Justice sought a ruling to clarify the proper treatment of such grants.

This ruling only applies directly to Alliance for Justice, the organization to which it is addressed. However, it is important for public foundations and all other public charities that make grants if they have elected to follow the 501(h) expenditure test. Although organizations other than AFJ may not rely on the ruling or cite it as precedent, it does reflect the approach the IRS likely will take in evaluating grants from one charity to another. Its reasoning potentially applies not only to formal grants programs but to any transaction where a public charity provides support to another charity.

The regulations governing charities that have elected to measure their lobbying under the expenditure test state that certain grants are to be treated as direct or grassroots lobbying. Unlike private foundations, public charities have not had clear rules to allow them to treat certain kinds of grants as non-lobbying expenditures. This ruling indicates that the IRS will allow an electing charity to rely on the rules that govern grant making by private foundations. It does not say that such charities are required to follow the private foundation rules.

What the Private Letter Ruling Says

According to the Private Letter Ruling Alliance for Justice received:

- 1. A public charity may treat general support grants to a public charity as non-lobbying expenditures so long as the grant is not earmarked for lobbying.**

This ruling makes explicit the common understanding and practice that grants not earmarked for lobbying do not count towards the grantor's lobbying limits—regardless of whether the grantee spends the grant funds on lobbying.

Example: Public charity Community Fund knows that public charity Advocates for Children is short on funds. Community Fund makes a general support grant of \$10,000 to Advocates for Children. After receiving this money, which was not anticipated, Advocates for Children revises its budget to allow an additional \$10,000 to be spent on lobbying activities. Community Fund need not count the grant funds against its lobbying limit unless the grant was earmarked for lobbying -- that is, unless there exists a side agreement whereby Community Fund can cause Advocates for Children to use the general support grant for lobbying.

2. A grant restricted for use within a specific project is not solely, by virtue of that restriction, earmarked for lobbying.

A grant provided to a public charity for a specific program, rather than its general operations, is not automatically assumed to be lobbying, even if the program includes a lobbying component.

Example: Rather than making a general support grant to public charity Advocates for Children, Community Fund wants its grant to be used by Advocates for Children's public health program only. Community Fund does not need to count this grant toward its own lobbying limits unless the grant is otherwise earmarked for lobbying.

3. A public charity may treat a project grant as not earmarked for lobbying if the grant amount, combined with its other grants for that project during the year, do not exceed the non-lobbying portion of the project's budget (and it does not doubt, or have reason to doubt, the budget information provided by the grantee).

The tax regulations clearly state that a private foundation may make a specific project grant to a public charity for a project that includes lobbying. When making a specific project grant, the foundation must review the grantee's project budget and may give a grant (combined with any other grants given that year to the same project) in an amount up to the non-lobbying portion of the budget. As long as there is no agreement that the grant is otherwise earmarked for lobbying, there is no taxable expenditure to the private foundation if the grantee were to use grant funds for lobbying. This ruling extends the same safe harbor to public charities.

Example: Public charity Advocates for Children submits a proposal for \$15,000 for its immigrant advocacy program to Community Fund. The budget included with the proposal explains that of the \$30,000 total budgeted for the project, \$20,000 will be used for public education purposes and \$10,000 will be used for lobbying. Community Fund trusts the veracity of the budget, and has no formal or informal agreement with Advocates for Children about whether the grant funds will be spent on lobbying. Community Fund need not count the \$15,000 grant towards its own lobbying limit. Even if Advocates for Children spends some of the grant funds on lobbying, Community Fund will not need to count toward its own lobbying limit the funds spent by Advocates for Children on lobbying.

4. If the project grant exceeds the non-lobbying portion of the project budget, then the public charity must treat as a lobbying expenditure the amount by which the grant exceeds the non-lobbying amount.

If a specific project grant exceeds the amount budgeted for non-lobbying activities, only the amount in excess of the non-lobbying activities will be considered a lobbying expenditure. This treatment is consistent with the regulations for private foundations.

Example: Public charity Advocates for Children submits a proposal to Community Fund for its \$100,000 public health program. The budget accompanying the proposal describes that \$35,000 will be used for education purposes and \$65,000 will be used for lobbying. Community Fund decides to make a \$50,000 grant to Advocates for Children’s public health program. Community Fund must count \$15,000 towards its own lobbying limits.

5. The IRS declined to rule on whether a public charity may treat a grant to another public charity as a non-lobbying expenditure if the grantor expresses a desire, request, or suggestion (in the grant letter or prior or subsequent communications) that the funds be used to support a specific project, even if there is no other agreement or understanding with regard to the use of the funds.

Alliance for Justice asked about a situation where it makes an unrestricted grant and imposes no enforceable limitations on usage, but makes a non-binding request that the funds be used for a particular project or program. Can such a grant be treated as a non-lobbying expenditure because the grantor is not legally causing or requiring it to be used for lobbying? Unfortunately, the IRS declined to answer.

The regulations say a grant is a lobbying expenditure if it is “earmarked” for lobbying, and “earmarked” means that “there exists an agreement, oral or written, whereby the [grantor] may cause the [grantee] to expend amounts [for lobbying] or the [grantee] agrees to expend an amount” for lobbying. The IRS ruling said that whether a grantor may cause a grantee to use the funds for a particular purpose (lobbying) “depends on an analysis of all of the facts and circumstances” and refused to issue a ruling on the general request. On the other hand, the IRS also did not rule that making such a non-binding request would automatically cause the grant to be earmarked for the requested purpose.

Example: Public charity Community Fund wants to fund the environmental advocacy program of public charity Advocates for Children. That program will include a large amount of lobbying, and Community Fund does not want to designate its grant for the program because it will incur a significant lobbying expense. Community Fund makes an unrestricted general support grant to Advocates for Children, and subsequently one of its staff members tells Advocates for Children, “We’d love to see you use this funding for your environmental advocacy program, but of course it’s up to you; we want you to decide what’s best.” There is no other agreement or expectation of how Advocates for Children will use the funds. The IRS has declined to rule that Community Fund may treat this as a non-lobbying grant. Community Fund could treat the grant to Advocates

for Children's environmental advocacy program as a specific project grant and follow the principles described in rulings 3 and 4 above. Alternatively, Community Fund may seek legal advice about the application of the earmarking rules to its specific circumstances.