Elements of Governance®

Providing CEOs, board chairs, directors, and support staff with the fundamentals of healthcare governance

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Advocating Legally: Privilege or Curse?

A Supplement to Elements of Governance™: Advocacy

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Elements of Governance™

Elements of Governance™ is designed to provide CEOs, board chairs, trustees, and support staff with the fundamentals of not-for-profit governance. These comprehensive and concise governance guides offer quick answers, guidelines, and templates that can be adapted to meet your board's individual needs. Whether you are a new or experienced leader, the Elements of Governance series will help supply you and your board with a solid foundation for quality board work.

This *Elements of Governance*™ was adapted from a Governance Institute white paper entitled **Best Practices in Advocacy: The Role of Senior Leaders and the Board in Creating Positive Change** (Summer 2005), written by Larry Stepnick, vice president & director, The Severyn Group; L. Edward Bryant, Jr., partner and founding chair, Health Law Practice, Gardner Carton & Douglas; Paul D. Gilbert, partner, Healthcare Transactions, Waller Lansden Dortch & Davis; and Robert C. Louthian, III, partner, McDermott Will & Emery.

The Governance Institute

The Governance Institute serves as the leading, independent source of governance information and education for healthcare organizations across the United States. Founded in 1986, The Governance Institute provides conferences, publications, videos, and educational materials for non-profit boards and trustees.

Recognized nationally as the preeminent source for unbiased governance knowledge, The Governance Institute conducts research studies, tracks industry trends, and showcases the best practices of leading healthcare boards across the country. The Governance Institute is committed to its mission of improving the effectiveness of boards by providing the tools, skills, and learning experiences that enable trustees to maximize their contributions to the board.

We believe that strong leadership and sound decision-making skills foster excellent governance. The valuable time, expertise, and personal commitment of our nation's voluntary trustees can be put to their highest and best uses when a commitment to continuous governance education is present. Only when the trustees are recognized for their hard work, provided the latest information, and exhorted to their highest level of service can the organization achieve great success.

The Governance Institute creates such an environment for its members and leverages the good work of boards across the country on behalf of each of its member organizations.

Introduction

Organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986 (the "Code") are subject to a limitation on their legislative (or "lobbying") activities and a prohibition on their political activities. Failure to adhere to the *lobbying limitation* or the *political activities prohibition* raises tax-exemption and excise tax issues for 501(c)(3) organizations, whether such activities were conducted knowingly or not. The purpose of this supplement to *Elements of Governance™: Advocacy* is to address the lobbying limitation and political activities prohibition imposed on 501(c)(3) organizations.[1]

In general, lobbying activities conducted by 501(c)(3) organizations are subject to a "no substantial part" test. More specifically (as described more fully below in the section entitled The Lobbying Limitation), Section 501(c)(3) of the Code provides that "no substantial part" of an organization's activities may consist of "carrying on propaganda, or otherwise attempting to influence legislation."[2]

As an alternative to the no substantial part test, certain organizations may elect to have their lobbying activities measured under a mechanical "expenditures" test (the so-called "501(h) election"), instead of the vague no substantial part test.

The prohibition against political activities provides that no part of the activities of an organization may consist of participating or intervening in a political campaign on behalf of or in opposition to any candidate for public office. Unlike the lobbying limitation, the prohibition against political activities is absolute. In theory, a single dollar for a political activity is grounds for revocation of tax-exempt status.

Because an organization acts publicly through individuals (i.e., its board of directors, senior officers and executives and, perhaps, volunteers), the actions of these individuals frequently come under scrutiny by the general public and the IRS. To be clear, there is no federal tax limitation or prohibition against an individual from engaging in lobbying or political activities on his or her own behalf. If, however, the individual is acting as an agent of an organization, the individual's actions may be attributed to the organization and raise troubling exemption issues. Accordingly, when a director, officer, or volunteer engages in lobbying or political activities, the facts and circumstances surrounding such activities must be carefully reviewed to determine the likelihood that such activities could be attributed to the organization, and whether additional affirmative actions should be taken by the organization to clarify that the individual's activities were neither conducted nor condoned by the organization.

Compliance Priorities to Avoid Legal Problems and Protect Tax-Exempt Status

1. Orient all integrated auxiliary organizations (including the medical staff) concerning their legal dependent exempt status and how they are affected by federal tax rules.

2. Charge the corporate compliance program and corporate compliance officer with monitoring federal and state taxation or tax-exemption basic compliance.

3. Include continuing governance education on the issues of the lobbying limitation and political activities prohibition in the board's ongoing education agenda.

4. Assure that the board is fully aware of the IRS Form 990, and include an annual full board review of Form 990 to help assure compliance on lobbying and political activity.

[1] Throughout this section, "organization" or "organizations" refers to Section 501(c)(3) organizations.

[2] The term "legislation" is generally defined as the introduction by Congress, any state legislature, any local council, or similar governing body, of any acts, bills, resolutions, or similar items, or by public in referendum, ballot initiative, constitutional amendment, or similar procedure. "Legislation" does not include actions by executive, judicial, or administrative bodies.

The Lobbying Limitation

A substantial part of the activities of hospitals or health systems exempt from federal taxation pursuant to Section 501(c)(3) of the Code may not consist of "carrying on propaganda, or otherwise attempting, to influence legislation." A violation of this statutory prohibition, often referred to as the lobbying limitation, can lead to the revocation of the offending organization's tax-exempt status through the application of the fairly vague and subjective no substantial part test. The expenditures test set forth in Sections 501(h) and 4911 of the Code, however, offers an alternative to organizations that desire more certainty than the application of the no substantial part test provides. Under either test, however, not-for-profit organizations must monitor their direct and indirect lobbying efforts.

Against this backdrop, it is important to understand which activities fall within the lobbying limitation of Section 501(c)(3). Except as outlined below, charities may not, whether through direct or indirect communications, "attempt to influence legislation." ***Direct*** communications include those held with a legislator, an employee of a legislative body, or a government official who may formulate legislation. ***Indirect*** communications include those made through the media, mass mailings, the general population, and other "grass roots" methods. Communications between a charity and its members are relevant in this analysis if they encourage members to influence legislation, whether directly or indirectly.

A general understanding of the evolution of the lobbying limitation may provide a helpful context for these issues. Prior to 1934, organizations that "disseminated propaganda to legislators" often lost their tax-exempt status because, upon challenge, their activities were found not to be conducted exclusively for charitable purposes. Some commentators have suggested that organizations pressing controversial issues prior to 1934 were more likely than others to fail judicial scrutiny of their lobbying efforts. Perhaps as a result, the IRS Code was amended in 1934 to provide that "no substantial part" of the activities of a tax-exempt organization may be to carry on propaganda or otherwise attempt to influence legislation. With this change, the no substantial part test was created and the lobbying limitation was redirected towards the *extent* of an organization's efforts to influence legislation rather than the nature of the legislation at issue.

Under the no substantial part test, a determination as to whether an organization's attempts to influence legislation violate the limits of Section 501(c)(3) for any given tax year will be made based upon the relevant facts and circumstances of each case. Although one federal appeals court applying the no substantial part test has suggested that activities constituting less than five percent of an organization's total activities should fall within a "safe harbor" of sorts, and although other federal courts applying the test have found greater percentages to be acceptable, no bright line has developed under the no substantial part test against which lobbying efforts can be measured. Rather, the best view of the no substantial part test seems to be that the amount of funds spent lobbying (in relation to an organization's total expenditures) is an important, but not conclusive, factor.

Other relevant factors to be considered when applying the no substantial part test include the significance of the total amount spent on lobbying (without regard to how it compares to an organization's total expenditures in furtherance of its mission), the amount of time spent on the efforts, the effect and impact of the lobbying efforts, and the number of employees and volunteers engaged. In short, the analysis under the no substantial part test remains fairly subjective and outcomes remain difficult to predict.

The Lobbying Limitation

- *No substantial part test—no bright line has developed under the no substantial part test against which lobbying efforts can be measured.*
- *Expenditures test—a tax-exempt organization may seek to directly influence legislation if its related, annual expenditures fall below the lesser of (a) a percentage of the total amount spent by the organization to further its charitable purpose, or (b) $1,000,000 (for larger organizations).*

The Political Activities Prohibition

501(c)(3) organizations are subject to an absolute ban on the conduct of political activities—they are prohibited from participating in, or intervening in any political campaign on behalf of or in opposition to any candidate for public office. The prohibition against political activities is absolute. Accordingly, one dollar spent by a tax-exempt organization is arguably sufficient to justify revocation of tax-exempt status.

The prohibition against participation or intervention in a political campaign applies both to direct intervention in a political campaign and indirect political activities.

Another fundamental change to the lobbying limitation was made in 1976 with the adoption of the expenditures test. This test, which only applies if the Section 501(c)(3) elects to be covered under it by filing an IRS form, was established, in large part, to provide objective standards against which lobbying efforts can be measured and to supplement the range of available enforcement sanctions. The 1976 amendments also exempted a number of activities that were previously understood to clearly constitute lobbying. As stated above, however, these provisions only apply to eligible charities (such as not-for-profit hospitals) that have elected to be subject to them rather than to the no substantial part test.

Generally, under the expenditures test, a tax-exempt organization may seek to directly influence legislation if its related, annual expenditures fall below the lesser of (a) a percentage of the total amount spent by the organization to further its charitable purpose (as specified in a sliding scale set forth in Section 4911), or (b) $1,000,000 (for larger organizations). In addition, this same organization may seek to indirectly influence legislation if its related, annual expenditures do not exceed 25 percent of the organization's limit for direct lobbying expenditures.

The analysis under the "no substantial part" test remains fairly subjective and outcomes remain difficult to predict.

Lobbying expenditures that exceed the applicable ceilings during any one tax year are subject to an excise tax equal to 25 percent of the excess expenditures. If a particular organization significantly exceeds the applicable limitations over a four-year period, the offending organization's tax-exempt status can be revoked. In addition, in such cases, if individual managers approved expenditures knowing that they were reasonably likely to result in the loss of an organization's exemption, then the managers may be subject to an excise tax equal to 5 percent of the excess expenditures.

The relative certainty of the expenditures test should provide greater comfort to not-for-profit hospitals that want to actively influence legislation. Proponents of lobbying by not-for-profits such as the Independent Sector and the Center for Lobbying in the Public Interest, among others, make compelling arguments that lobbying by not-for-profit organizations is an important aspect of our democracy, that *lobbying in the public interest builds public trust and that many not-for-profits have the unique ability to shape policy and public opinion in ways important to society at large.* As our national health system goes through looming changes and reforms, it seems reasonable to expect that many not-for-profit hospitals and health systems will seek to directly influence critical legislation. In these efforts, they will be able to take a fair measure of comfort under the expenditures test.

The Political Activities Prohibition

Section 501(c)(3) organizations are subject to an absolute ban on the conduct of political activities. More specifically, they are prohibited from participating in, or intervening in (including the publishing or distributing of statements), any political campaign on behalf of or in opposition to any candidate for public office.[3] As noted above, the IRS takes the position that the prohibition against political activities is absolute. Accordingly, one dollar spent by a tax-exempt organization is arguably sufficient to justify revocation of tax-exempt status.

The prohibition against participation or intervention in a political campaign applies both to direct and indirect activities.

[3] For purposes of the prohibition against political activities, a "candidate for public office" is anyone who offers him/herself, or is proposed by others, as a candidate for an elective public office. Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii). It is irrelevant whether the public office is national, state, or local.

Direct intervention in a political campaign includes such activities as contributions to a Political Action Committee (PAC) or a candidate's campaign committee (even if otherwise permitted under applicable election laws); purchasing tickets to political fundraisers; or providing non-financial support (such as providing space or mailing lists, sponsor a political event, or permitting its name to be used to solicit contributions) to a PAC or candidate's campaign committee.

Indirect political activities include, for example, reimbursement of employee or director political contributions and the transfer of funds to a non-exempt organization (for example, a coalition or a for-profit subsidiary) and having the subsidiary make the contribution.

Typically, an organization is faced with a variety of activities that raise issues under the political activities prohibition, especially during an election year. Some activities are clearly prohibited, but many fall within the proverbial gray area as to whether such activities are proscribed political activities. The following activities are examples of impermissible political activities and, accordingly, should be avoided completely by 501(c)(3) organizations.

Impermissible Political Activities

- Making direct or indirect contributions to a PAC or a candidate's campaign committee (even if otherwise permitted under applicable election laws)
- Forming a PAC
- Reimbursing employees or executives for their contributions to a candidate or his/her PAC
- Endorsing or opposing, directly or indirectly, a candidate for public office
- Purchasing tickets to political fundraisers or reimbursing employees for their attendance at political fundraisers
- Transferring or loaning funds to another entity, either related or unrelated, then having that entity make a political contribution
- Providing non-financial support to a candidate or his/her PAC such as providing space, sponsoring an event, or permitting the organization's name to be used to solicit contributions
- Providing use of a mailing list to a candidate
- Rating candidates for public office

The following activities are permissible but, nonetheless, should only be entered into with the advice of competent counsel.

Permissible Political Activities

- Voter registration
- Get-out-the-vote efforts
- Conducting candidate education programs
- Inviting candidates to speak at events
- Participating in candidate forums

Some of the more difficult (and frequent) issues faced by organizations during election years include the following:

- ***Employee participation in political activities.*** Permitting employees to engage in political activities while on company time could be interpreted as impermissible intervention in a political campaign, depending upon the facts and circumstances. While employees are permitted to engage in political activities outside of their employment, the payment of compensation to such person while engaged in such activities (e.g., paid leave to work on a campaign) could be problematic.
- ***Renting space or facilities to a candidate.*** Frequently, organizations are asked by candidates to rent space or facilities. Provided the organization charges fair market value for the rental, there should be no direct or indirect support of a candidate and, accordingly, no proscribed political activities. However, certain facts and circumstances could arise where even charging a fair rental value may constitute proscribed intervention in a campaign. For example, if an organization rented its facilities to one candidate for fair market value, but refused to rent its facilities to the opposing candidate even at fair market value, the IRS could take the position that renting to only one candidate constitutes improper political activities. Finally, even in the situation where an organization charged fair market rent to a candidate, the IRS could still take the position that such activity was a proscribed political activity if the other candidate(s) was not notified that he/she could rent the space as well. While this argument would not be strong, the advice of competent counsel is advised prior to entering into these types of agreements.
- ***Inviting candidates to speak at events.*** Depending upon the facts and circumstances of the event, an organization may invite a candidate to speak at an event without being considered to have participated or intervened in a political campaign. If a candidate is invited to speak at an event sponsored by the organization, or to visit the facilities of the organization, the first inquiry is whether such candidate was invited to speak in his/her capacity as a candidate or as an individual. If the candidate is invited in his/her individual capacity, there is no requirement to provide equal access to other candidates. In such circumstance, however, the organization must take steps to make sure that no campaign activity occurs during the visit. Finally, if the candidate is to receive an award or other public recognition, it should be made clear that the award is for past recognition of service for non-political causes supported by the organization. Again, careful consultation with competent counsel is recommended prior to inviting candidates to speak at events to determine whether other candidates should be notified, invited, or both.
- ***Internet activities.*** One other area in which proscribed political activities issues (as well as lobbying issues) arise is the organization's Internet site. Frequently, the persons responsible for maintaining the Internet site are not educated with respect to the prohibition against political activities. Accordingly, it is not uncommon to see accidental statements or pictures that either directly or indirectly imply endorsement of (or objection to) a candidate for public office. Periodic monitoring of the Internet site during election periods is advised.

Ultimately, whether a particular activity constitutes impermissible participation or intervention in a political campaign is a "facts and circumstances test." During election years, the IRS, the local press, and competitors are quick to make public those activities of a 501(c)(3) organization that raise political campaign prohibition issues. Because the possible sanction for violating the political campaign prohibition is revocation of tax-exempt status, organizations should consider adopting official policies regarding the prohibition against political activities and educating their board members, officers, volunteers, and employees as to such limitations. Part of this policy should be a statement that indicates the organization's e-mail system is not to be used for political campaign purposes.

Advocacy, like so many other things concerning hospitals, ought to be budgeted and well planned, on an annual basis. If it is not, over-expenditure can have grave consequences.

Political Action Committees

One of the most common ways for individuals to engage in political activities is through forming, operating, and/or contributing to PACs. Stated simply, a 501(c)(3) organization may not form or contribute to a PAC without raising serious tax-exemption issues. Unlike Section 501(c)(3) of the Code, however, Section 501(c)(4) of the Code does *not* contain a prohibition against political activities. Accordingly, a Section 501(c)(4) organization may engage in political activities provided that its primary activities remain the promotion of social welfare.[4] Many large, non-profit systems contain both Section 501(c)(3) and Section 501(c)(4) organizations. Accordingly, the issue frequently arises as to whether a Section 501(c)(4) organization within a tax-exempt system that contains Section 501(c)(3) organizations may create or contribute to a PAC. The answer is a cautious "yes."

First, while there is no prohibition against political activities by Section 501(c)(4) organizations, the system must make certain that the related Section 501(c)(3) organization is not subsidizing the Section 501(c)(4) organization's activities. Any subsidization of the Section 501(c)(4)'s activities (such as below market rent or grants) could be viewed by the IRS as an indirect political contribution. Second, to the extent any solicitations for political contributions are made by the Section 501(c)(4), the entity must be careful not to use the e-mail system or payroll deductions of the related Section 501(c)(3) for such contributions as exemption issues could be raised.[5] Again, because of the potential risk to the Section 501(c)(3) organization's tax-exempt status, careful counsel is advised prior to using a related entity to participate in political activities.

Boards particularly need to know that, with the proliferation of new regulatory laws and rules for exempt organizations, taking affirmative steps to safeguard exempt status is every bit as important as avoiding Medicare fraud problems. Boards also often need to be reminded that tax exemption is not just a nice thing to have. It is the justification for issuing tax-exempt bonds, which total in the many billions across the country for hospitals. With each such bond issue and bond indenture, there is a solemn written covenant by the hospital that it will retain its exempt status.

Non-Connected PACs

While the Code places a prohibition against Section 501(c)(3) organizations from engaging in political activities, such prohibition does not apply to the board of directors, officers, or senior executives of such organization provided such individuals act in their individual capacities as opposed to on behalf of the organization. This strategy is obviously not without its risks. Again, any evidence that the 501(c)(3) organization directly or indirectly supports the non-connected PAC raises exemption issues. Use of the organization's copiers, letterhead, logo, secretarial staff, and e-mail system all raise troubling issues, even if the individual is acting in his/her own individual capacity. Further, if the acts of the individuals could be attributed to the organization (for example, the individual makes a speech that implies he/she is speaking on behalf of the organization), then exemption issues are raised as well. If the non-connected PAC strategy is adopted by directors, officers, key employees, or even volunteers, *all* PAC activities should be conducted off campus, no Section 501(c)(3) organization personnel or equipment should be used, and all meetings should occur outside of normal business hours and not during board or committee meetings.

Hypothetical and Discussion

A CEO of a Section 501(c)(3) hospital invites a politician to the dedication of a new wing of the hospital. The dedication ceremony occurs one month before the election in which the politician is running for the U.S. Congress. At the presentation, the politician makes a speech in which she announces the upcoming election and thanks the CEO for his support. Staff members hand out pamphlets that encourage support of the politician in the upcoming election. The nurses union, which opposes the election of the politician, carries placards and signs indicating the union opposition to the politician. The newspapers carry a picture of the politician standing in front of the tax-exempt hospital with the caption "Congressman Continues Campaign at XYZ Hospital."

[4] Treas. Reg. § 1.501(c)(4)-2.

[5] While outside the scope of this paper, both state laws and Federal election laws also impose limitations and conditions on the ability to participate in political campaigns. Accordingly, an organization should not engage in political activities without consulting these areas as well.

The above hypothetical is a classic situation in which the hospital has not intentionally done anything wrong, but the way the facts developed clearly raises exemption issues for the hospital for improperly participating in a campaign. In order to protect against possible adverse actions by the IRS, the hospital should have taken certain action before the event and, whether it took prior actions or not, should consider taking additional actions after the event.

Prior to the event, it would be beneficial to know whether the politician has visited the hospital campus in the past. If the politician has previously visited the campus, her presence to dedicate a new wing raises fewer questions. Because the opening of the new wing coincides with an election period, it may have been wise for the hospital to send a letter to the politician prior to visiting the campus reminding her that as a Section 501(c)(3) organization, it does not endorse any candidate for office and that the hospital would appreciate it if no electioneering activities (handing out pamphlets, collecting monies, etc.) were to occur during the visit. Even if the politician does it anyway, at least the hospital will be on record as having tried to prevent such activity. Likewise, if the hospital was aware that the nurses union might be picketing the event, a letter to the union affirming the political activities prohibition would be a paper trail indicating that the hospital tried to eliminate the potential for political activities to occur.

After the event occurred, the hospital had to determine whether damage control was necessary. Because of the events that took place and the photo in the newspaper, some response may be warranted. For example, the hospital could consider sending a letter to the newspaper correcting the story and strongly indicating that the hospital does not support or oppose any candidate for public office, and the politician was on the campus dedicating a new wing in her individual capacity, not as a candidate for public office.

Distinguishing the Lobbying Limitation from the Political Activities Prohibition in Setting Board Policy

The two overriding legal duties of boards of directors of non-profit corporations are the duties of loyalty and of care. Ironically, when the limitations and prohibitions of Internal Revenue Code Section 501(c)(3) are translated into policies being debated by boards of directors, these duties sometimes seem almost to conflict. Hospital and health system boards often find, upon analysis, that there are inclinations to do on behalf of the institution that which is legally prohibited, but not usually known to be.

One of the clearest implications of the duty of care, for example, is the obligation to see that all applicable laws are obeyed, both in letter and in spirit. For federally tax-exempt corporations that are also Medicare providers, this generally means adopting a corporate compliance mentality with a clear board-monitored policy behind it. Reduced to its essence, a corporate compliance program is an internal methodology for proving a negative; i.e., for demonstrating that the entity and its management, governance, and/or medical staff are not violating laws. This is never easily done. But the art of doing so has developed in much clearer form in recent years.

Side by side with the duty of care as a fundamental governance responsibility is the duty to attempt to assure that the organization is true to its mission and that it does not succumb to the financial and other pressures of the moment that might conflict with its mission. This is the duty of loyalty at work. With the growing number of financial and reputational risks for the majority of hospitals, there is a concomitant desire to find answers through the political system. And in the U.S. federal system, political answers might be federal, state, or local.

Governmental hospitals and investor-owned hospitals, both of which compete with non-profit, tax-exempt hospitals, do not have the lobbying limitations or political activities prohibitions found in the Code Section 501(c)(3)—nor do most physician organizations, which more and more are competing with hospitals. If the competition can lobby without limitation and can support or oppose (to some degree) named politicians to help with their causes, it becomes easy to believe that *all* hospitals ought to be permitted to work together in these ways. Unfortunately, this is a very dangerous supposition for 501(c)(3) hospitals and their boards.

The first step in assuring compliance with these two related limitations on conduct is to distinguish them. Since one (lobbying limitation) is a *limitation* on the amount of lobbying or funds spent to influence legislation while the other is an out-and-out *prohibition* (political activities prohibition), discerning the difference is critical.

When the duty of loyalty to "protect" the hospital from untoward results bumps into the duty of care to see that the applicable laws are followed, boards must see to it every time that the duty of care triumphs.

The case law and the commentators agree that the first distinguishing characteristic is that between supporting (or fighting) a pending or potential bill, on the one hand, and supporting (or fighting) a candidate or elected public servant, on the other. Whether the support (or objection) is done by one or by several or many 501(c)(3) organizations is usually irrelevant. But a hospital needs to be especially careful that it does not give financial or other support for what it believes is a legislative cause to a third party, only to have the third party contribute the total to a candidate or a political party. As we all have come to know, politics can be very nasty. What is initially billed as an open forum or public session with several candidates to debate an important issue can, with one cancellation or a little deception, turn into a campaign rally for a single candidate. ***This can turn a genuine lobbying effort into a prohibited political action, so the organizers and the tax-exempt sponsors must know the difference between the two and must avoid the latter.***

Many members of the public and, unfortunately, many candidates for public office do not appreciate the rules that are applicable to 501(c)(3) organizations. What are deemed to be "public" issues are thought to be fair game for everyone and every organization. For example, the Chicago newspapers in early 2005 reported that the campaign contributions to several aldermanic candidates included ones from established churches, which have Section 501(c)(3) status. While jumping to repay contributions that could threaten those churches' exempt status, the candidates and pastors alike indicated in interviews that they didn't know political action contributions by churches or other charities were wrong. Moreover, they asked, how else could social welfare institutions that care about various issues that will come before a legislative body let the wishes of their constituents be known?

The answer, of course, is clear upon consideration. Without directly supporting or targeting any candidate by name, social welfare institutions can, within the lobbying limitation, buy advertising for a cause. They can testify in legislative hearings about the issues before the legislature. And with signs, Web sites, newsletters, BLOGs (Web logs), and retained public speakers, they can let the public know how they stand on an issue. When organizations do so, their expenditures for such activity are subjected to either the no substantial part test or the formulaically limited expenditures test for influencing legislation under Section 501(c)(3).

A rarely asked but legitimate question is how much, if anything, a tax-exempt hospital may expend in order to promote contributions by others to a PAC known to support a particular candidate for office. The correct answer is nothing. It would be much better legally for a hospital to pay its regular dues to a hospital trade association that might promote contributions to the PAC. A trade association is tax exempt under Section 501(c)(6) and does not have the same legal constraints.

Set forth below are some examples of frequently recurring fact situations in the operations of Section 501(c)(3) hospitals about which their non-profit boards of directors need to be more conversant. The fact that

these instances occur repeatedly is good evidence that non-profit boards are not being adequately oriented in their legal duties and that many people cannot distinguish lobbying efforts from political activity.

1. **Direct or indirect reimbursement of PAC contributions.** Nearly every hospital trade association consisting even in part of 501(c)(3) hospitals has created an affiliated PAC through which it gives political gifts to federal, state, or local legislators or candidates for office who will publicly support a particular piece of legislation or a particular cause. Contributions to a PAC are not tax-deductible to the donor. And, since they support a particular candidate, the contributions to the PAC are strictly prohibited by the Section 501(c)(3) organization. Fertile minds for years have attempted to devise methods of legitimately or secretly getting institutional funds into the hands of hospital officers and directors to "reimburse" them for intended PAC contributions. These ideas include director fees, increased officer compensation, intentional over-reimbursement of expenses for continuing governance education, and compensation for non-existent duties. In one case, the hospital's bylaws required annual charitable contributions from each board member of a specified minimum; this requirement was informally waived upon proof of a similar PAC contribution to an "approved" PAC. Of these, only the following are sustainable: (1) reasonable director fees taken as income and *without* an enforceable contract to make a PAC contribution, and (2) reasonable increased officer compensation *without* an enforceable contract to make a PAC contribution. The other ruses would all be subject to intermediate sanctions excise taxes for excess benefits under IRC Section 4958 and could cause a loss of exempt status, especially if not repaid.

2. **Political action by integrated auxiliaries, such as the medical staff.** When an organized hospital medical staff is appropriately overseen by the hospital board (no medical staff bylaws amendments without board approval) and does not have its own corporate status, its dues income is federally tax exempt by virtue of what is known as "integrated auxiliary" status. The same goes for other hospital auxiliary affiliates that have not obtained their own exemption rulings. The income and expenses of such organizations should be included on the hospital's IRS Form 990 and in its audited financials. The integrated auxiliary, since it derives its exempt status from the hospital, is part of the analysis at any point of Section 501(c)(3) compliance. Contributions from the medical staff treasury to a PAC or a political candidate are grounds for loss of the hospital's exemption. Most medical staff officers, who are under constant pressure from medical societies to contribute to PACs, do not know this. Use of the integrated auxiliary's funds for lobbying would be included within the hospital's analysis under either the no substantial part test or the alternative expenditures test of IRC Sec. 4911. This alone requires at least annual orientation of the officers of all integrated auxiliaries affiliated with the hospital so as to assure compliance and to avoid the inadvertent loss of the exemption. When such political action transactions are discovered, the only workable remedy is for the hospital to seek repayment from the payee, never a happy alternative!

3. **Accumulation of lobbying expenses.** Whether the hospital defaults to the no substantial part test or elects the expenditures test for evaluation of the scope of its efforts to influence legislation, all such expenditures in a fiscal year must be cumulated and reported on IRS Form 990. This means that if the maximum amount were spent on, say, lobbying for a moratorium on specialty hospitals, there would be nothing left to spend on a campaign for medical malpractice reform or greater medical appropriations for hospitals under Medicare or Medicaid. Put another way, advocacy, like so many other things concerning hospitals, ought to be budgeted and well planned, on an annual basis. If it is not, over-expenditure can have grave consequences.

4. **Indirect support of political candidate.** Situation: a hospital's auxiliary has a tradition of sponsoring public forums on issues of public import. In a year other than an election year, it invites the local congressman to address a forum on the subject of funding medical research from

the National Institutes of Health in programs that would include the hospital's academic medical staff. The congressman is on record as favoring federal funding of stem cell research and is willing to say so in his speech, to which the press has been invited. A local politician in the other party writes the hospital board chair, and notifies her that it is his opinion that the hospital is supporting a political personality in violation of the political activities prohibition, but also indicates he will not turn them in if he is permitted to speak at the forum on the other side of the stem cell issue. He also copies the local print and electronic media with his letter to the chair. How does the hospital handle this, and is it handled differently if it arises in an election year?

What started out as a "harmless" and relatively inexpensive educational effort, probably having little or no lobbying implications, can turn into possibly prohibited political activity. This is a very real example of the type of factual situation for which hospital boards must be prepared and for which they usually are not.

5. **Use of the Internet.** Individuals and organizations are increasingly using the Internet for communications, and hospitals are no exception. Before BLOGs or Web sites are instituted by a hospital for communication with the public, special precautions should be taken to assure they are not "taken over" or over-utilized by those with a political agenda (or, worse yet, by a single political candidate). Since it is nearly impossible to stop the use of a BLOG by anyone, precautions would generally take the form of appropriate waivers and declarations of intent. The only good thing about a BLOG is that it costs virtually nothing. This also makes it easily subject to abuse. If the hospital starts it to talk about the issues and the participants only talk about candidates, is the political activities prohibition inadvertently violated?

The sanctions for material violations of either or both the lobbying limitation and the political activities prohibition under Section 501(c)(3) are truly draconian. Non-profit boards of hospitals cannot risk the hospital's existence by ignoring these important rules. The following section deals with practical compliance ideas for avoiding problems under either the limitation or the prohibition.

Compliance Priorities for Assuring the Avoidance of Legal Problems

There are four principal methods available for a Section 501(c)(3) exempt healthcare organization to assure that its sometimes far-flung operations are not incurring risk from the violation of the lobbying limitation and the political activities prohibition.

- The first is to take affirmative steps to orient "integrated auxiliary" organizations concerning their legal dependent exempt status and how they are affected by these federal tax rules. Unlike the hospital board and senior management, the organized medical staff and the hospital auxiliaries usually change leadership every year, which leaves insufficient institutional memory to recall and enforce such rules. It is the responsibility of the board to mandate overall legal compliance for the organization, and it is the responsibility of management to implement it.

  Shortly after new sets of officers and directors are installed in office for each integrated auxiliary, hospital administration should be available to assist in orientation and to answer all questions regarding applicable state and federal taxation rules (including income, employment, sales, real estate taxes, etc.). Because this orientation is generally not done in hospitals, most of the tax problems that occur within the hospitals and health systems relate to relationships with physicians and volunteers. Disputes between hospital executives and the medical staff or another auxiliary can be severe. It is far better to prevent big problems with annual orientation than it is to duke it out later trying to undo a transaction that jeopardizes the exempt status of both the hospital and the auxiliary.

- Second, the organization's corporate compliance program and corporate compliance officer should be charged with responsibilities going beyond Medicare and Medicaid, specifically including federal and state taxation or tax-exemption basic compliance. Long before the current rash of lawsuits and legislative reforms regarding charity care issues relating to exempt status, successfully managed tax-exempt hospitals and health systems have worried about assuring compliance with all the basics and the many vagaries of Section 501(c)(3). Corporate compliance programs in for-profit companies have long included tax issues, including the direct-report authority to a board committee when problems occur. Loss of tax exemption is highly analogous to loss of Medicare participation for a hospital.

  As described above, a Section 501(c)(3) organization may, since 1976, elect to have its lobbying efforts reported and analyzed pursuant to a designated expenditures test rather than the no substantial part test. Bringing oversight for tax compliance within the corporate compliance program (importantly, this is *not* the same as taking away the responsibility of the chief financial officer for preparing and signing IRS filings) should also help in making sure that the appropriate election—that is, expenditures test vs. no substantial part test—is made and observed from year to year.

  Along with the lobbying and political activity aspects of retaining exempt status, a second critical compliance component of the IRS rules applicable to exempt organizations involves the application of IRC Section 4958, the intermediate sanctions law. Boards particularly need to know that, with the proliferation of new regulatory laws and rules for exempt organizations, taking affirmative steps to safeguard exempt status is every bit as important as avoiding Medicare fraud problems. Boards also often need to be reminded that tax exemption is not just a nice thing to have. It is the justification for issuing tax-exempt bonds, which total in the many billions of dollars across the country for hospitals. With each such bond issue and bond indenture, there is a solemn written covenant by the hospital that it will retain its exempt status. Failure to do so will render the interest paid to bondholders taxable rather than tax exempt, which in turn usually prompts a lawsuit against those persons causing such a loss.

  For all these reasons, corporate compliance programs at tax-exempt healthcare facilities should always include oversight for the ongoing eligibility to retain federal tax-exempt status. And the corporate compliance officer should always be assured the ability, if necessary, to contact and interact directly with the chair of either the board or a responsible board committee.

- Third, the board's governance committee (or one assuming the roles played by such a committee) should include on its ongoing agenda for continuing governance education the issues of the lobbying limitation and the political activities prohibition under IRC Section 501(c)(3). Every new board member should be apprised of the significant problems that can flow from ignoring the dictates of Section 501(c)(3), including those in addition to the lobbying limitation and the political activities prohibition.

  It is an oft-encountered problem in healthcare that recognized expertise in one area seems to imply expertise in another. Thus, an outstanding clinician is assumed also to be an experienced businessperson. Similarly, a business executive on a board is assumed to know about tax-exemption rules and tax-exempt organizations. Neither is necessarily true, and both are often patently wrong. The fiduciary duty of care imposed by law upon non-profit directors or trustees, however, means that assumptions of expertise are insufficient. This is why, as regulatory complexity increases, continuing education for governance should increase concomitantly. Designating a standing, non-episodic board committee with the responsibility to keep the board educated is a recognized best practice for avoiding, among other problems, violations of the lobbying limitation and political activities prohibition.

- Fourth, the board clearly needs to be aware of the IRS Form 990. It is an "information return" filed each year within five and a half months after the end of the fiscal year of a Section 501 (c)(3) organization having annual revenues in excess of $25,000. If the hospital also has "unrelated business income-taxable" (also known as "UBIT"), it must also file an IRS Form 990-T and pay corporate rates tax on the UBIT. The Form 990 discloses the extent of the organization's lobbying expense. It also asks, under penalty of perjury, whether the organization, among other things, has engaged in political activity. Annual *full board* review of the Form 990 will help assure compliance on the lobbying and political activity aspects of Section 501(c)(3).[6]

The lobbying limitation and political activities prohibition provisions of the Internal Revenue Code Section 501(c)(3) do not usually receive all the publicity of the anti-inurement and intermediate sanctions laws. But there is a growing need for all hospitals to influence legislation that will continue fair payment by federal and state governmental payers. Given the confusion between supporting a bill and supporting the bill's sponsor when he or she is running for office, it is safe to assume that there will be growing scrutiny of this arena by Congress, the IRS, and the public. Rather than being surprised and embarrassed, hospital boards should be prepared.

The Governance Institute expresses its deep appreciation to the writers for contributing this supplement on advocacy and the law:

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Conclusion

Advocacy is a critically important issue for hospital and health system CEOs and board members, and it seems to be getting more important every day as new legislation and regulations affect the industry. Hospitals that have made advocacy a priority have enjoyed considerable successes, securing vitally needed funding and programs for their institutions and the community at large. These successes, however, are no accident. Rather, they are the result of careful planning related to all aspects of their advocacy efforts, beginning with strategies to position the organization for success and ending with the execution of a specific advocacy campaign. These planning efforts also include the development of guidelines for when and how to involve the board in advocacy activities.

Public sector issues are having more and more impact on not-for-profit hospitals and health systems, and the future sustainability of some organizations may depend upon how these public sector issues are resolved. Hospital and health systems should play a more active role in advocacy activities that relate to influencing the public sector decision-making process, and engage their boards in these advocacy efforts in appropriate ways.

[6] There is a separate overriding reason why board members should always know what is on the Form 990. It requires disclosure of the five highest paid employees' compensation and asks if board members are being compensated. And the form is, by law, a public document. Nothing is more disconcerting to a volunteer board member than to learn in the press or in the locker room at the country club important information that the board member should know.

This last issue is particularly timely for boards. The IRS, in early 2005, announced its intention of examining as many as 2,000 tax-exempt health-care organizations on the subjects of executive compensation, executive benefits, and compliance with the Form 990 filing requirements concerning such compensation and benefits. This action underscores the need for the non-profit boards to be fully oriented on Form 990 compliance.