

the first year for which the organization is treated as described in section 501(c)(3). For 1977, Y need not determine whether it has normally made lobbying expenditures or grass roots expenditures in excess of the corresponding ceiling amount for purposes of determining whether it is denied exemption under section 501(h) for its taxable year 1978.

(7) For determination year 1978, Y must determine whether it has normally made lobbying or grass roots expenditures in excess of the corresponding ceiling amount, taking into account expenditures for the base years 1977 and 1978. For Y, the determination under paragraph (b)(2) of this section considers the same base years as the determination under paragraph (b)(1) of this section and is, therefore, redundant. Accordingly, Y proceeds to determine, under (b)(1), whether it is denied exemption. Y's grass roots expenditures for 1977 and 1978 (\$65,000) did not exceed 150 percent of the sum of its grass roots nontaxable amounts for those years (\$103,125). Y's lobbying expenditures for 1977 and 1978 (\$406,750) did not exceed 150% of its lobbying nontaxable amount for those years ( $150\% \times \$275,000 = \$412,500$ ). Therefore, Y is not denied tax exemption under section 501(h) for its taxable year 1979.

(8) For determination year 1979, the sum of Y's grass roots expenditures in base years 1977, 1978, and 1979 does not exceed 150 percent of its grass roots nontaxable amount (calculation omitted). However, the sum of Y's lobbying expenditures for the base years (\$670,750) does exceed 150% of the sum of the lobbying nontaxable amounts for those years ( $150\% \times \$435,000 = \$652,500$ ). Since Y was not described in section 501(c)(3) prior to 1977, only the years 1977, 1978, and 1979 may be considered in determining whether Y has normally made lobbying expenditures in excess of its lobbying ceiling. Therefore, Y determines that it has normally made lobbying expenditures in excess of its lobbying ceiling. Under section 501(h), Y is denied tax exemption under section 501(a) as an organization described in section 501(c)(3) for its taxable year 1980. For its taxable year 1981, and any taxable year thereafter, Y is exempt from tax as an organization described in section 501(c)(3) only if Y applies for recognition of its exempt status under paragraph (d) of this section and is recognized as exempt from tax.

*Example 4.* Organization M made the expenditure test election under section 501(h) effective for taxable years beginning with 1977 and has not revoked the election. M has \$500,000 of exempt purpose expenditures during each of the years 1981 through 1984. In addition, during each of those years, M spends \$75,000 for direct lobbying and \$25,000 for grass roots lobbying. Since the amount expended for M's lobbying (both total lobbying and grass roots lobbying) is within the respective nontaxable expenditure limitations,

M is not liable for the 25 percent excise tax imposed under section 4911(a) upon excess lobbying expenditures, nor is M denied tax-exempt status by reason of section 501(h).

*Example 5.* Assume the same facts as in Example 4, except that, on behalf of M, numerous unpaid volunteers conduct substantial lobbying activities with no reimbursement. Since the substantial lobbying activities of the unpaid volunteers are not counted towards the expenditure limitations and the amount expended for M's lobbying is within the respective nontaxable expenditure limitations, M is not liable for the 25 percent excise tax under section 4911, nor is M denied tax-exempt status by reason of section 501(h).

[T.D. 8308, 55 FR 35589, Aug. 31, 1990]

#### § 1.501(k)-1 Communist-controlled organizations.

Under section 11(b) of the Internal Security Act of 1950 (50 U.S.C. 790(b)), as amended, which is made applicable to the Code by section 7852(b) of that Code, no organization is entitled to exemption under sections 501(a) or 521(a) for any taxable year if at any time during such year such organization is registered under section 7 of such Act or if there is in effect a final order of the Subversive Activities Control Board established by section 12 of such Act requiring such organization to register under section 7 of such Act, or determining that it is a Communist-infiltrated organization.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960; redesignated by T.D. 8100, 51 FR 31615, Sept. 4, 1986]

#### § 1.502-1 Feeder organizations.

(a) In the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the ground that all the profits of such organization are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501.

(b) If a subsidiary organization of a tax-exempt organization would itself