claiming deductions for taxable years beginning before that date if the claims are not barred by the statute of limitations. Paragraphs (a)(3) and (4) of this section are effective as set forth in §1.83–8(b).

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PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 4. In §602.101, paragraph (c) is amended by adding the entry ''1.83–6.... 1545–1448'' in numerical order to the table.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved June 19, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 18, 1995, 8:45 a.m., and published in the issue of the Federal Register for July 19, 1995, 60 F.R. 36995)

Part III.—Items Specifically Excluded from Gross Income

Section 103.—Interest on State and Local Bonds

What are the conditions under which an issuer of State or local bonds may make payments to the U.S. to reduce the yield on investments purchased with the proceeds of advance refunding bonds on a date when the issuer is unable to purchase U.S. Treasury securities—State and Local Government Series (''SLGS'') because the Department of the Treasury has suspended sales of SLGS? See Rev. Proc. 95–47, page 417.

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26 CFR 1.103–1: Interest upon obligations of a State, Territory, etc.

The qualified census tracts for Puerto Rico and the Virgin Islands are set forth for use in determining the portion of loans required to be placed in targeted areas under section 143(h) of the Code. See Rev. Proc. 95–31, page 378.

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26 CFR 1.103–1: Interest upon obligations of a State, Territory, etc.

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 95–32, page 379.

Section 132.—Certain Fringe Benefits

The Service is providing inflation adjustments to the limitation on the exclusion of a qualified transportation fringe for taxable years beginning in 1996. See Rev. Proc. 95–53, page 445.

Section 135.—Income from United States Savings Bonds Used to Pay Higher Education Tuition and Fees

The Service is providing inflation adjustments to the limitation on the exclusion of income from United States savings bonds for taxpayers who pay qualified higher education expenses for taxable years beginning in 1996. See Rev. Proc. 95–53, page 445.

Part IV.—Tax Exemption Requirements for State and Local Bonds

Subpart A.—Private Activity Bonds

Section 143.—Mortgage Revenue Bonds: Qualified Mortgage Bond and Qualified Veterans' Mortgage Bond

26 CFR 6a.103A–2: Qualified mortgage bond.

The qualified census tracts for Puerto Rico and the Virgin Islands are set forth for use in determining the portion of loans required to be placed in targeted areas under section 143(h) of the Code. See Rev. Proc. 95–31, page 378.

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26 CFR 6a.103A–2: Qualified mortgage bond.

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 95–32, page 379.

Subpart B.—Requirements Applicable to All State and Local Bonds

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Section 148.—Arbitrage

What are the conditions under which an issuer of State or local bonds may make payments to the U.S. to reduce the yield on investments purchased with the proceeds of advance refunding bonds on a date when the issuer is unable to purchase U.S. Treasury securities—State and Local Government Series (''SLGS'') because the Department of the Treasury has suspended sales of SLGS? See Rev. Proc. 95–47, page 417.

Part V.—Deductions for Personal Exemptions

Section 151.—Allowance of Deductions for Personal Exemptions

26 CFR 1.151.4: Amount of deduction for each exemption under section 151.

The Service is providing inflation adjustments to the personal exemption and to the threshold amounts of adjusted gross income above which the exemption amount phases out for taxable years beginning in 1996. See Rev. Proc. 95–53, page 445.

Part VI.—Itemized Deductions for Individuals and Corporations

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Section 162.—Trade or Business Expenses

26 CFR 1.162–17: Reporting and substantiation of certain business expenses of employees.

The rules for substantiating the amount of a deduction or expense for business use of an automobile that most nearly represents current costs are set forth. See Rev. Proc. 95–54, page 450.

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26 CFR 1.162–20: Expenditures attributable to lobbying, political campaigns, attempts to influence legislation, etc., and certain advertising.

T.D. 8602

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Lobbying Expense Deductions—Dues, Allocation of Costs to Lobbying Activities, and Influencing Legislation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that define influencing legislation for purposes of the deduction disallowance for certain amounts

paid or incurred in connection with influencing legislation. It also contains final regulations concerning allocating costs to influencing legislation or the official actions or positions of certain federal executive branch officials and the deductibility of dues (and other similar amounts) paid to certain tax-exempt organizations. These regulations are necessary because of changes made to the Internal Revenue Code by the Omnibus Budget Reconciliation Act of 1993. These rules will assist businesses and certain tax-exempt organizations in complying with the Internal Revenue Code.

DATES: These regulations are effective July 21, 1995.

For dates of applicability, see §§1.162–20, paragraphs (c)(5) and (d), 1.162–28(h), and 1.162–29(h).

SUPPLEMENTARY INFORMATION:

Background

On December 27, 1993, the IRS published in the Federal Register temporary regulations (58 FR 68294 [TD 8511, 1994–1 C.B. 37]) under section 162 of the Internal Revenue Code (Code) relating to the dues deduction disallowance and a notice of proposed rulemaking (58 FR 68334 [IA–60–93, 1994–1 C.B. 802]) cross-referencing the temporary regulations. On the same day, the IRS published in the Federal Register a notice of proposed rulemaking (58 FR 68330 [IA–57–93, 1994–1 C.B. 797]) under section 162 of the Code relating to the allocation of costs to lobbying activities. On May 13, 1994, the IRS published in the Federal Register a notice of proposed rulemaking (59 FR 24992 [IA–23–94, 1994–1 C.B. 809]) under section 162 concerning the definition of influencing legislation. Written comments responding to the notices were received and public hearings were held on allocating costs to lobbying activities on April 6, 1994, and on influencing legislation on September 12, 1994. After careful consideration of all the comments, the proposed regulations are adopted, as revised and renumbered by this document. The issues described in this preamble are the principal issues considered in adopting the final regulations. However, a number of other technical and clarifying changes were made.

Lobbying Expense Deductions—Dues—§1.162–20.

The proposed regulations are adopted without change.

Allocation of Costs to Lobbying Activities—§1.162–28.

The proposed regulations generally describe the costs that are properly allocable to lobbying activities and permit taxpayers to use any reasonable method to allocate those costs between lobbying activities and other activities. Under the proposed regulations, a method is not reasonable unless it is applied consistently, allocates a proper amount of costs (including labor costs and general and administrative costs) to lobbying activities, and is consistent with certain special rules of the regulations. The proposed regulations provide that a taxpayer may use the following methods of allocating costs to lobbying activities: (1) the ratio method; (2) the gross-up method; and (3) an allocation method that applies the principles of section 263A and the regulations thereunder.

While the proposed regulations are intended to allow any reasonable method, some commentators interpreted the proposed regulations as treating only the three specified methods as reasonable methods of allocating costs. The final regulations clarify that taxpayers may use any reasonable method of allocating costs to lobbying activities, including, but not limited to, the three specified methods.

Some commentators stated that the regulations should provide that a cost allocation method is not unreasonable simply because it allocates a lesser amount of costs to lobbying activities than any one of the three specified methods. Whether any other allocation method is reasonable depends on the facts and circumstances of a particular case. The three specified methods, alone or in combination, do not establish a baseline allocation against which to compare other methods.

The proposed regulations direct taxpayers to see section 6001 and the regulations thereunder for recordkeeping requirements. Numerous commentators requested additional guidance concerning recordkeeping for lobbying activities. Some commentators recommended that the regulations should provide that the IRS will accept good faith or reasonable estimates of time spent on lobbying activities. Other commentators recommended that the regulations, like the preamble to the proposed regulations, should state explicitly that taxpayers are not required to maintain any particular records of costs of lobbying activities, such as daily time reports, daily logs, or similar documents.

Section 6001 already requires a taxpayer to keep records necessary for the taxpayer to apply its reasonable method of allocating costs to lobbying activities. Thus, each taxpayer must use methods appropriate for its trade or business. The proposed regulations, nevertheless, do not require a taxpayer to maintain its records of costs of lobbying activities in any particular form. The IRS and Treasury believe that the final regulations should not provide guidance concerning recordkeeping in addition to that already provided in section 6001 and, therefore, no changes were made in response to these suggestions.

Under the ratio method of the proposed regulations, a taxpayer multiplies its total costs of operations (excluding third-party costs) by a fraction, the numerator of which is the taxpayer's lobbying labor hours and the denominator of which is the taxpayer's total labor hours. The taxpayer adds the result of this calculation to its third-party costs to allocate its costs to lobbying activities.

The proposed regulations define the term *total costs of operations* as the total costs of the taxpayer's trade or business for a taxable year, excluding third-party costs. Commentators questioned the scope of the definition and suggested that certain costs should be excluded from the definition. For example, several commentators inquired whether total costs of operations means costs reflected on a company's financial statements or its tax returns. In addition, commentators inquired whether the term included depreciation, charitable contributions, or federal tax expenses. With respect to tax-exempt organizations, commentators inquired whether total costs of operations included the costs of educational conferences, conventions, books and other publications, and unrelated business activities. Among the costs that commentators recommended excluding from the definition of total costs of operations are purchases and other costs of goods sold and all third-party costs unrelated to lobbying activities.

As indicated above, the final regulations clarify that taxpayers may use any reasonable method of allocating costs to lobbying activities. The regulations set forth the ratio method as one simplified method that taxpayers have the option of using. If the regulations were modified to provide a specific definition of total costs of operations encompassing a complex set of exclusions designed to suit the circumstances of all businesses, the ratio method would no longer be a simplified method and would require complex analysis by taxpayers and the IRS. Therefore, the definition of total costs of operations is not changed in the final regulations. Taxpayers who do not find the simple ratio method appropriate to their circumstances may use another reasonable method.

The proposed regulations provide that for purposes of the ratio method, a taxpayer may treat as zero the lobbying labor hours of personnel engaged in secretarial, maintenance, and other similar activities. The IRS and Treasury invited comments on whether this rule will distort the costs allocated to lobbying activities. Most commentators responded favorably to this rule. Some indicated that the administrative benefits far outweighed any minimal distortion. Commentators also requested guidance concerning the term ''other similar activities.''

The final regulations clarify that a taxpayer using the ratio method may treat as zero the hours of personnel engaged in secretarial, clerical, support, and other administrative activities (as opposed to activities involving significant judgment with respect to lobbying activities). For example, because paraprofessionals and analysts when engaged in a lobbying activity may engage in activities involving significant judgments with respect to the lobbying activity, taxpayers may not treat their time as zero.

Under the gross-up method of the proposed regulations, a taxpayer allocates costs to lobbying activities by multiplying the taxpayer's basic labor costs for lobbying labor hours by 175 percent. For this purpose, the taxpayer's basic labor costs are limited to wages or other similar costs of labor, such as guaranteed payments for services. Thus, for example, pension costs and other employee benefits are not included in basic labor costs. As with the ratio method, third party costs are then added to the result of the calculation to arrive at the total costs to allocate to lobbying activities.

Although the proposed gross-up method provides a simple way to calculate costs allocated to lobbying activities, some commentators noted that the proposed gross-up method did not simplify recordkeeping because taxpayers had to keep track of the lobbying labor hours of clerical and support staff in order to determine lobbying labor costs.

In response to this concern, the final regulations provide an alternative gross-up method. Under this alternative, taxpayers may treat as zero the lobbying labor hours of personnel who engage in secretarial, clerical, support, and other administrative activities that do not involve significant judgment with respect to the lobbying activity. However, if a taxpayer uses this alternative, it must multiply costs for lobbying labor hours by 225 percent.

Many commentators suggested that the proposed gross-up percentage of 175 percent was too high, based on information from their industry. The gross-up factors (including the 225 percent factor added to the final regulations) are intended to approximate the average gross-up factors for all taxpayers. The IRS and Treasury believe that these factors are the appropriate factors as averages for all taxpayers. If the regulations were further modified to provide a set of gross-up factors to suit the circumstances of various businesses or industries, the gross-up method would no longer be a simplified method. The final regulations clarify that taxpayers may use any reasonable method of allocating costs to lobbying activities. Thus, taxpayers who do not find the gross-up method appropriate to their circumstances may use another reasonable method.

The proposed regulations provide that taxpayers that do not pay or incur reasonable labor costs for persons engaged in lobbying activities may not use the ratio method or the gross-up method. Several commentators requested that the IRS reconsider this restriction. In addition, some commentators expressed concern that this restriction would prevent tax-exempt organizations from using the ratio method or gross-up method if they used volunteers in their lobbying activities. One commentator inquired whether an exempt organization that uses volunteers should account for the time of volunteers in allocating costs to lobbying activities.

The final regulations provide that all taxpayers may use the ratio method, but prohibit use of the gross-up method by a taxpayer (other than one subject to section 6033(e)) that does not pay or incur reasonable labor costs for its personnel engaged in lobbying. Moreover, tax-exempt organizations affected by the lobbying disallowance rules can use the gross-up method or the ratio method even if some of their lobbying activities are conducted by volunteers. Because volunteers are not taxpayers' personnel, time spent by volunteers is excluded from the taxpayer's lobbying labor hours and total labor hours (although the hours may be included in their employer's lobbying labor hours or total labor hours).

Under the proposed regulations, taxpayers who use the ratio method or the gross-up method must account for certain third-party costs. The proposed regulations define these third-party costs as amounts paid or incurred for lobbying activities conducted by third parties (such as amounts paid to lobbyists and dues that are allocable to lobbying expenditures) and amounts paid or incurred for travel and entertainment relating to lobbying activities.

Some commentators asked that the final regulations clarify that the lobbying-related travel and entertainment expenses of an employee of the taxpayer are not treated as third-party costs for either the ratio or gross-up method. The IRS and Treasury intend for taxpayers to account for employee travel and entertainment expenses separately as third-party costs under both methods. Thus, the final regulations do not adopt this recommendation. However, the final regulations clarify that if a cost defined as a third-party cost is allocable only partially to lobbying activities, then only that portion of the cost must be allocated to lobbying activities under the ratio method and gross-up method.

The proposed regulations provide a special *de minimis* rule for labor hours spent by personnel on lobbying activities. Under this *de minimis* rule, a taxpayer may treat time spent by personnel on lobbying activities as zero if less than five percent of the person's time is spent on lobbying activities.

The *de minimis* rule for labor hours does not apply to direct contact lobbying with legislators and covered executive branch officials. Thus, all hours spent by a person on direct contact lobbying as well as the hours that

person spends in connection with direct contact lobbying (such as background meetings) must be allocated to lobbying activities. For this purpose, an activity is direct contact lobbying if it is a meeting, telephone conversation, letter, or other similar means of communication with a legislator (other than a local legislator), or covered executive branch official (as defined in section 162(e)(6)) and otherwise qualifies as a lobbying activity.

Commentators requested that the *de minimis* percentage be increased and that the direct contact exception be eliminated. The final regulations do not adopt these recommendations. The final regulations do, however, clarify that the direct contact exception applies only to the individuals who make the direct contact, not to support personnel who engage in research, preparation, and other background activities but who do not make a direct contact.

Influencing Legislation—§1.162–29.

The proposed regulations provide definitions of *influencing legislation* and other terms necessary to apply the rules. In general, commentators approved of these definitions. The final regulations modify the definitions only to clarify their application. However, no substantive change is intended by these modifications.

Some commentators stated that the final regulations should distinguish between influencing legislation and educating legislators. The final regulations do not adopt this suggestion. The IRS and Treasury believe that the statute does not draw this distinction and neither should the regulations. Activities undertaken to educate a legislator may constitute influencing legislation under definitions in the final regulations. Further, the legislative history confirms that Congress did not intend to provide an exception for providing technical advice or assistance.

The proposed regulations provide that a lobbying communication is any communication that (1) refers to specific legislation and reflects a view on that legislation, or (2) clarifies, amplifies, modifies, or provides support for views reflected in a prior lobbying communication. The proposed regulations provide that the term *specific legislation* includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the taxpayer either supports or opposes.

Several commentators stated that the phrase ''reflects a view'' should be defined to mean an explicit statement of support or opposition to legislative action. Some commentators also suggested that the regulations should make clear that a taxpayer is not reflecting a view on specific legislation if it presents a balanced analysis of the merits and defects of the legislation.

The final regulations do not adopt either of these recommendations. A taxpayer can reflect a view on specific legislation without specifically stating that it supports or opposes that legislation. Thus, as illustrated in §1.162–29(b)(2), *Example 8*, a taxpayer reflects a view on specific legislation even if the taxpayer does not explicitly state its support for, or opposition to, action by a legislative body. Moreover, a taxpayer's balanced or technical analysis of legislation reflects a view on some aspect of the legislation and, thus, is a lobbying communication.

The proposed regulations do not contain a definition of the term ''specific legislative proposal,'' but do contain several examples to illustrate the scope of the term. For instance, in *Example 5* of §1.162–29(b)(2) of the proposed regulations, a taxpayer prepares a paper indicating that increased savings and local investment will spur the state economy. The taxpayer forwards a summary of the paper to legislators with a cover letter that states, in part:

> You must take action to improve the availability of new capital in the state.

The example concludes that the taxpayer has not made a lobbying communication because neither the summary nor the cover letter refers to a specific legislative proposal.

In *Example 6* of that section, a taxpayer prepares a paper concerning the benefits of lowering the capital gains tax rate. The taxpayer forwards a summary of the paper to its representative in Congress with a cover letter that states, in part:

> I urge you to support a reduction in the capital gains tax rate.

The example concludes that the taxpayer has made a lobbying communication because the communication refers to and reflects a view on a specific legislative proposal.

Numerous commentators stated that they do not perceive a distinction between the two examples. In addition, certain commentators requested that the term ''specific legislative proposal'' be defined.

Whether a communication refers to a specific legislative proposal may vary with the context. The communication in *Example 5* is not sufficiently specific to be a specific legislative proposal, and no other facts and circumstances indicate the existence of a specific legislative proposal to which the communication refers. In *Example 6*, however, support is limited to a proposal for reduction of a particular tax rate. Although commentators suggested a number of definitions of the term ''specific legislative proposal,'' none was entirely satisfactory in capturing the full range of communications referred to in section 162(e)(4)(A). Thus, the final regulations do not adopt these suggestions.

The proposed regulations provide that an attempt to influence legislation means a lobbying communication and all activities such as research, preparation, and other background activities engaged in for a purpose of making or supporting a lobbying communication. The purpose or purposes for engaging in an activity are determined based on all the facts and circumstances.

The proposed regulations provide two presumptions concerning the purpose for engaging in an activity that is related to a lobbying communication. The first presumption provides that if an activity relating to a lobbying communication is engaged in for a nonlobbying purpose prior to the first taxable year preceding the taxable year in which the communication is made, the activity is presumed to be engaged in for all periods solely for that nonlobbying purpose (favorable presumption). Conversely, the second presumption provides that if an activity relating to a lobbying communication is engaged in during the taxable year in which the lobbying communication is made or the immediately preceding taxable year, the activity is presumed to be engaged in solely for a lobbying purpose (adverse presumption).

The adverse presumption was intended to prevent taxpayers from abusing an intent- or purpose-based rule by labelling their lobbying activities as

mere monitoring. On the other hand, the favorable presumption provides substantial certainty to taxpayers who engage in an activity for a nonlobbying purpose a sufficient time before a lobbying communication is made.

While commentators approved of the purpose test, many criticized the presumptions. Many commentators argued that the presumptions would create unreasonable recordkeeping burdens requiring detailed records concerning the purpose of a taxpayer's every activity. Several commentators also argued that the presumptions operated over too great a period of time and recommended that, if retained, they should apply to a period of 6 months or, alternatively, a calendar year. A number of commentators expressed a belief that the presumptions created a 2-year lookback recharacterizing activities as lobbying activities. Other commentators further argued that the presumptions used undefined terms and would be difficult to rebut.

Although the presumptions were intended as an aid in identifying activities that were more or less likely to be lobbying activities, the IRS and Treasury believe that the presumptions have been viewed by the commentators as undermining and complicating the purpose-based test. Therefore, the final regulations eliminate the presumptions, replacing them with a list of some of the facts and circumstances to be considered in determining whether an activity is engaged in for a lobbying purpose.

In addition, in response to various comments concerning the treatment of activities engaged in for the purpose of deciding to lobby, the final regulations clarify that the activity of deciding to lobby is to be treated in the same manner as research, preparation, and other background activities. Thus, a taxpayer who engages in the decision-making process may be treated as engaged in that activity for a lobbying purpose. This rule applies to a taxpayer who alone or as part of a group is deciding whether a lobbying communication should be made.

Under the proposed regulations, if a taxpayer engages in an activity for a lobbying purpose and for some nonlobbying purpose, the taxpayer must treat the activity as engaged in partially for a lobbying purpose and partially for a nonlobbying purpose (multiple-purpose rule). While many commentators approved of a facts and circumstances analysis to determine whether a taxpayer engages in an activity for a lobbying purpose, some of these commentators thought that an activity should be subject to section 162(e)(1)(A) only if the principal or primary purpose of the activity is to make or support a lobbying communication. According to these commentators, a principal or primary purpose rule would be easier to administer than the proposed multiple purpose rule. Several commentators noted that a principal or primary purpose test would eliminate the burden of dividing the costs of an activity among purposes under the proposed multiple-purpose rule.

The IRS and Treasury continue to believe that a principal or primary purpose test does not avoid the necessity of determining the various purposes for engaging in an activity and the relative importance of those purposes, and it has a substantial ''cliff'' effect. Therefore, the final regulations do not adopt a principal or primary purpose test.

The proposed regulations do not specify methods for accomplishing a reasonable cost allocation in the case of multiple purpose activities. Rather, the proposed regulations specify two methods that may not be appropriate. A taxpayer's treatment of multiple purpose activities will, in general, not result in a reasonable allocation if it allocates to influencing legislation (1) only the incremental amount of costs that would not have been incurred but for the lobbying purpose; or (2) an amount based on the number of purposes for engaging in that activity without regard to the relative importance of those purposes.

Some commentators requested additional guidance (by way of example) concerning how a taxpayer should determine the ''relative importance'' of purposes. In response to these comments, the final regulations are clarified to treat allocations based solely upon the number of purposes for engaging in an activity as generally not reasonable. The IRS and Treasury intend this change to indicate that an allocation based on the number of purposes may be reasonable if it reflects the relative importance of various purposes, even if the allocation is not precise. For instance, if a taxpayer engages in an activity for two purposes of substantially similar importance, treating the activity as engaged in 50 percent for each purpose is reasonable.

The final regulations provide special rules for activities engaged in for a lobbying purpose (including deciding to lobby) where the taxpayer later concludes that no lobbying communication will be made regarding that activity. Specifically, the final regulations treat these activities as if they had not been engaged in for a lobbying purpose if, as of the taxpayer's timely filed return, the taxpayer no longer expects, under any reasonably foreseeable circumstances, that a lobbying communication will be made that is supported by the activity. Thus, the taxpayer need not treat any amount allocated to that activity for that year under §1.162–28 as an amount to which section 162(e)(1)(A) applies. On the other hand, if the taxpayer reaches that conclusion at any time after the filing date, then the amount (not previously satisfying these special rules) allocated to that activity under §1.162–28 is treated as an amount that is paid or incurred only at that time and that is not subject to section 162(e)(1)(A). Thus, in effect, the taxpayer is treated as if it incurred the costs relating to that activity in that later year in connection with a nonlobbying activity. A special rule is provided for exempt organizations to which section 6033(e) applies, which permits those organizations to instead treat these amounts as reducing (but not below zero) their expenditures to which section 162(e)(1) applies beginning with that year and continuing for subsequent years to the extent not treated in prior years as reducing those expenditures.

The proposed regulations provide a special rule for so-called ''paid volunteers.'' If, for the purpose of making or supporting a lobbying communication, one taxpayer uses the services or facilities of a second taxpayer and does not compensate the second taxpayer for the full cost of the services or facilities, the purpose and actions of the first taxpayer are imputed to the second taxpayer. Thus, for example, if a trade association uses the services of a member's employee, at no cost to the association, to conduct research or similar activities to support the trade association's lobbying communication, the trade association's purpose and actions are imputed to the member. As a result, the member is treated as influencing legislation with respect to the employee's work in support of the trade association's lobbying communication.

The IRS and Treasury intended the special imputation rule to deny a deduction for the amounts paid or incurred by a taxpayer participating in a group activity involving a lobbying purpose and a lobbying communication, even if the lobbying communication was made by a person other than the taxpayer. The final regulations clarify the rule. In addition, in response to commentators who requested clarification on when an employer must account for employee volunteer lobbying activities, the final regulations provide, by way of example, that if a taxpayer's employee not acting within the scope of employment volunteers to engage in activities influencing legislation, then the taxpayer is not influencing legislation.

Certain commentators have indicated that participation in the activities of government advisory bodies, such as federal advisory committees, should be exempt from section 162(e). Commentators argued that federal advisory committees provide information and advice to assist the federal government in matters it specifies, not to influence legislation.

The statutory term *influencing legislation* includes lobbying communications with government employees or officials who may participate in the formulation of legislation. Section 162(e) does not except lobbying communications made by participating in federal advisory committees. Further, the legislative history strongly suggests that no exceptions were intended other than for communications pursuant to subpoena or similar compulsion. Thus, participating in a federal advisory committee is influencing legislation if the purpose of the participant's activities is to make or support a lobbying communication, even if the lobbying communication is made by another participant or by the federal advisory committee as a whole.

The proposed regulations defining influencing legislation propose an effective date of May 13, 1994. Several commentators requested that the effective date of the final regulations be the date they are published or later. The final regulations on influencing legislation adopt this suggestion and are effective as of the date of publication, as are the final regulations on allocating costs to lobbying activities. Taxpayers must adopt a reasonable interpretation of section 162(e) for amounts paid or incurred prior to the effective date.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

* * * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In §1.162–20, paragraphs (c)(5) and (d) are added to read as follows:

§1.162–20 Expenditures attributable to lobbying, political campaigns, attempts to influence legislation, etc., and certain advertising.

* * * * * *

(c) * * *

(5) *Expenses paid or incurred after December 31, 1993, in connection with influencing legislation other than certain local legislation.* The provisions of paragraphs (c)(1) through (3) of this section are superseded for expenses paid or incurred after December 31, 1993, in connection with influencing legislation (other than certain local legislation) to the extent inconsistent with section 162(e)(1)(A) (as limited by section 162(e)(2)) and §§1.162–20(d) and 1.162–29.

(d) *Dues allocable to expenditures after 1993.* No deduction is allowed under section 162(a) for the portion of dues or other similar amounts paid by the taxpayer to an organization exempt from tax (other than an organization described in section 501(c)(3)) which the organization notifies the taxpayer under section 6033(e)(1)(A)(ii) is allocable to expenditures to which section 162(e)(1) applies. The first sentence of this paragraph (d) applies to dues or other similar amounts whether or not paid on or before December 31, 1993. Section 1.162–20(c)(3) is superseded to the extent inconsistent with this paragraph (d).

§1.162–20T [Removed]

Par. 3. Section 1.162–20T is removed.

Par. 4. Section 1.162–28 is added to read as follows:

§1.162–28 Allocation of costs to lobbying activities.

(a) *Introduction*—(1) *In general.* Section 162(e)(1) denies a deduction for certain amounts paid or incurred in connection with activities described in section 162(e)(1)(A) and (D) (*lobbying activities*). To determine the nondeductible amount, a taxpayer must allocate costs to lobbying activities. This section describes costs that must be allocated to lobbying activities and prescribes rules permitting a taxpayer to use a reasonable method to allocate those costs. This section does not apply to taxpayers subject to section 162(e)(5)(A). In addition, this section does not apply for purposes of sections 4911 and 4945 and the regulations thereunder.

(2) *Recordkeeping.* For recordkeeping requirements, see section 6001 and the regulations thereunder.

(b) *Reasonable method of allocating costs*—(1) *In general.* A taxpayer must use a reasonable method to allocate the costs described in paragraph (c) of this section to lobbying activities. A method is not reasonable unless it is applied consistently and is consistent with the special rules in paragraph (g) of this section. Except as provided in paragraph (b)(2) of this section, reasonable methods of allocating costs to lobbying activities include (but are not limited to)—

(i) The ratio method described in paragraph (d) of this section;

(ii) The gross-up method described in paragraph (e) of this section; and

(iii) A method that applies the principles of section 263A and the regula-

tions thereunder (see paragraph (f) of this section).

(2) *Taxpayers not permitted to use certain methods.* A taxpayer (other than one subject to section 6033(e)) that does not pay or incur reasonable labor costs for persons engaged in lobbying activities may not use the gross-up method. For example, a partnership or sole proprietorship in which the lobbying activities are performed by the owners who do not receive a salary or guaranteed payment for services does not pay or incur reasonable labor costs for persons engaged in those activities and may not use the gross-up method.

(c) *Costs allocable to lobbying activities*—(1) *In general.* Costs properly allocable to lobbying activities include labor costs and general and administrative costs.

(2) *Labor costs.* For each taxable year, labor costs include costs attributable to full-time, part-time, and contract employees. Labor costs include all elements of compensation, such as basic compensation, overtime pay, vacation pay, holiday pay, sick leave pay, payroll taxes, pension costs, employee benefits, and payments to a supplemental unemployment benefit plan.

(3) *General and administrative costs.* For each taxable year, general and administrative costs include depreciation, rent, utilities, insurance, maintenance costs, security costs, and other administrative department costs (for example, payroll, personnel, and accounting).

(d) *Ratio method*—(1) *In general.* Under the ratio method described in this paragraph (d), a taxpayer allocates to lobbying activities the sum of its third-party costs (as defined in paragraph (d)(5) of this section) allocable to lobbying activities and the costs determined by using the following formula:

$$\frac{\text{Lobbying labor hours}}{\text{Total labor hours}} \times \text{Total costs of operations.}$$

(2) *Lobbying labor hours.* Lobbying labor hours are the hours that a taxpayer's personnel spend on lobbying activities during the taxable year. A taxpayer may use any reasonable method to determine the number of labor hours spent on lobbying activities and may use the de minimis rule of paragraph (g)(1) of this section. A taxpayer may treat as zero the lobbying labor hours of personnel engaged in secretarial, clerical, support, and other administrative activities (as opposed to activities involving significant judgment with respect to lobbying activities). Thus, for example, the hours spent on lobbying activities by paraprofessionals and analysts may not be treated as zero.

(3) *Total labor hours.* Total labor hours means the total number of hours that a taxpayer's personnel spend on a taxpayer's trade or business during the taxable year. A taxpayer may make reasonable assumptions concerning total hours spent by personnel on the taxpayer's trade or business. For example, it may be reasonable, based on all the facts and circumstances, to assume that all full-time personnel spend 1,800 hours per year on a taxpayer's trade or business. If, under paragraph (d)(2) of this section, a taxpayer treats as zero the lobbying labor hours of personnel engaged in secretarial, clerical, support, and other administrative activities, the taxpayer must also treat as zero the total labor hours of all personnel engaged in those activities.

(4) *Total costs of operations.* A taxpayer's total costs of operations means the total costs of the taxpayer's trade or business for a taxable year, excluding third-party costs (as defined in paragraph (d)(5) of this section).

(5) *Third-party costs.* Third-party costs are amounts paid or incurred in whole or in part for lobbying activities conducted by third parties (such as amounts paid to taxpayers subject to section 162(e)(5)(A) or dues or other similar amounts that are not deductible in whole or in part under section 162(e)(3)) and amounts paid or incurred for travel (including meals and lodging while away from home) and entertainment relating in whole or in part to lobbying activities.

(6) *Example.*The provisions of this paragraph (d) are illustrated by the following example.

Example. (i) In 1996, three full-time employees, A, B, and C, of Taxpayer W engage in both lobbying activities and nonlobbying activities. A spends 300 hours, B spends 1,700 hours, and C spends 1,000 hours on lobbying activities, for a total of 3,000 hours spent on lobbying activities for W. W reasonably assumes that each of its three employees spends 2,000 hours a year on W's business.

(ii) W's total costs of operations are $300,000. W has no third-party costs.

(iii) Under the ratio method, X allocates $150,000 to its lobbying activities for 1996, as follows:

$$\frac{\text{Lobbying labor hours}}{\text{Total labor hours}} \times \text{Total costs of operations} + \text{Allocable third-party costs} = \text{Costs allocable to lobbying activities}$$

$$\frac{[300 + 1{,}700 + 1{,}000}{6{,}000} \times \$300{,}000] + [0] = \$150{,}000.$$

(e) *Gross-up method*—(1) *In general.* Under the gross-up method described in this paragraph (e)(1), the taxpayer allocates to lobbying activities the sum of its third-party costs (as defined in paragraph (d)(5) of this section) allocable to lobbying activities and 175 percent of its basic lobbying labor costs (as defined in paragraph (e)(3) of this section) of all personnel.

(2) *Alternative gross-up method.* Under the alternative gross-up method described in this paragraph (e)(2), the taxpayer allocates to lobbying activities the sum of its third-party costs (as defined in paragraph (d)(5) of this section) allocable to lobbying activities and 225 percent of its basic lobbying labor costs (as defined in paragraph (e)(3)), excluding the costs of personnel who engage in secretarial, clerical, support, and other administrative activities (as opposed to activities involving significant judgment with respect to lobbying activities).

(3) *Basic lobbying labor costs.* For purposes of this paragraph (e), basic lobbying labor costs are the basic costs of lobbying labor hours (as defined in paragraph (d)(2) of this section) determined for the appropriate personnel. For purposes of this paragraph (e), basic costs of lobbying labor hours are wages or other similar costs of labor, including, for example, guaranteed payments for services. Basic costs do not include pension, profit-sharing, employee benefits, and supplemental unemployment benefit plan costs, or other similar costs.

(4) *Example.* The provisions of this paragraph (e) are illustrated by the following example.

Example. (i) In 1996, three employees, A, B, and C, of Taxpayer X engage in both lobbying activities and nonlobbying activities. A spends 300 hours, B spends 1,700 hours, and C spends 1,000 hours on lobbying activities.

(ii) X has no third-party costs.

(iii) For purposes of the gross-up method, X determines that its basic labor costs are $20 per hour for A, $30 per hour for B, and $25 per hour for C. Thus, its basic lobbying labor costs are ($20 × 300) + ($30 × 1,700) + ($25 × 1,000), or ($6,000 + $51,000 + $25,000), for total basic lobbying labor costs for 1996 of $82,000.

(iv) Under the gross-up method, X allocates $143,500 to its lobbying activities for 1996, as follows:

175%	×	Basic lobbying labor costs of all personnel	+	Allocable third-party costs	=	Costs allocable to lobbying activities
[175%	×	$82,000]	+	[0]	=	$143,500.

(f) *Section 263A cost allocation methods*—(1) *In general.* A taxpayer may allocate its costs to lobbying activities under the principles set forth in section 263A and the regulations thereunder, except to the extent inconsistent with paragraph (g) of this section. For this purpose, lobbying activities are considered a service department or function. Therefore, a taxpayer may allocate costs to lobbying activities by applying the methods provided in §§1.263A–1 through 1.263A–3. See §1.263A–1(e)(4), which describes service costs generally; §1.263A–1(f), which sets forth cost allocation methods available under section 263A; and §1.263A–1(g)(4), which provides methods of allocating service costs.

(2) *Example.* The provisions of this paragraph (f) are illustrated by the following example.

Example. (i) Three full-time employees, A, B, and C, work in the Washington office of Taxpayer Y, a manufacturing concern. They each engage in lobbying activities and nonlobbying activities. In 1996, A spends 75 hours, B spends 1,750 hours, and C spends 2,000 hours on lobbying activities. A's hours are not spent on direct contact lobbying as defined in paragraph (g)(2) of this section. All three work 2,000 hours during 1996. The Washington office also employs one secretary, D, who works exclusively for A, B, and C.

(ii) In addition, three departments in the corporate headquarters in Chicago benefit the Washington office: public affairs, human resources, and insurance.

(iii) Y is subject to section 263A and uses the step-allocation method to allocate its service costs. Prior to the amendments to section 162(e), the Washington office was treated as an overall management function for purposes of section 263A. As such, its costs were fully deductible and no further allocations were made under Y's step allocation. Following the amendments to section 162(e), Y adopts its 263A step-allocation methodology to allocate costs to lobbying activities. Y adds a lobbying department to its step-allocation program, which results in an allocation of costs to the lobbying department from both the Washington office and the Chicago office.

(iv) Y develops a labor ratio to allocate its Washington office costs between the newly defined lobbying department and the overall management department. To determine the hours allocable to lobbying activities, Y uses the *de minimis* rule of paragraph (g)(1) of this section. Under this rule, A's hours spent on lobbying activities are treated as zero because less than 5 percent of A's time is spent on lobbying (75/2,000 = 3.75%). In addition, because D works exclusively for personnel engaged in lobbying activities, D's hours are not used to develop the allocation ratio. Y assumes that D's allocation of time follows the average time of all the personnel engaged in lobbying activities. Thus, Y's labor ratio is determined as follows:

Employee	Lobbying Hours	Departments Overall Management Hours	Total Hours
A	0	2,000	2,000
B	1,750	250	2,000
C	2,000	0	2,000
Totals	3,750	2,250	6,000

$$\text{Lobbying Department Ratio} = \frac{3{,}750}{6{,}000} = 62.5\%$$

$$\text{Overall Management Department Ratio} = \frac{2{,}250}{6{,}000} = 37.5\%$$

(v) In 1996, the Washington office has the following costs:

Account	Amount
Professional Salaries and Benefits	$ 660,000
Clerical Salaries and Benefits	50,000
Rent Expense	100,000
Depreciation on Furniture and Equip.	40,000
Utilities	15,000
Outside Payroll Service	5,000
Miscellaneous	10,000
Third-Party Lobbying (Law Firm)	90,000
Total Washington Costs	$ 970,000

(vi) In addition, $233,800 of costs from the public affairs department, $30,000 of costs from the insurance department, and $5,000 of costs from the human resources department are allocable to the Washington office from departments in Chicago. Therefore, the Washington office costs are allocated to the Lobbying and Overall Management departments as follows:

Total Washington department costs from above	$ 970,000
Plus Costs Allocated from Other Departments	268,800
Less third-party costs directly allocable to lobbying	(90,000)
Total Washington office costs	$1,148,800

	Lobbying Department	Overall Mgmt. Department
Department Allocation Ratios	62.5%	37.5%
× Washington Office Costs	$1,148,800	$1,148,800
= Costs Allocated to Departments	$ 718,000	$ 430,800

(vii) Y's step-allocation for its Lobbying Department is determined as follows:

Y's Step-Allocation	Lobbying Department
Washington Costs Allocated To Lobbying Department	$ 718,000
Plus Third-Party Costs	90,000
Total Costs of Lobbying Activities	$ 808,000

(g) *Special rules.* The following rules apply to any reasonable method of allocating costs to lobbying activities.

(1) *De minimis rule for labor hours.* Subject to the exception provided in paragraph (g)(2) of this section, a taxpayer may treat time spent by an individual on lobbying activities as zero if less than five percent of the person's time is spent on lobbying activities. Reasonable methods must be used to determine if less than five percent of a person's time is spent on lobbying activities.

(2) *Direct contact lobbying labor hours.* Notwithstanding paragraph (g)(1) of this section, a taxpayer must treat all hours spent by a person on direct contact lobbying (as well as the hours that person spends in connection with direct contact lobbying, including time spent traveling that is allocable to the direct contact lobbying) as labor hours allocable to lobbying activities. An activity is direct contact lobbying if it is a meeting, telephone conversation, letter, or other similar means of communication with a legislator (other than a local legislator) or covered executive branch official (as defined in section 162(e)(6)) and otherwise qualifies as a lobbying activity. A person who engages in research, preparation, and other background activities related to direct contact lobbying but who does not make direct contact with a legislator or covered executive branch official is not engaged in direct contact lobbying.

(3) *Taxpayer defined.* For purposes of this section, a taxpayer includes a tax-exempt organization subject to section 6033(e).

(h) *Effective date.* This section is effective for amounts paid or incurred on or after July 21, 1995. Taxpayers must adopt a reasonable interpretation of sections 162(e)(1)(A) and (D) for amounts paid or incurred before this date.

Par. 5. Section 1.162–29 is added to read as follows:

§1.162–29 Influencing legislation.

(a) *Scope.* This section provides rules for determining whether an activity is influencing legislation for purposes of section 162(e)(1)(A). This section does not apply for purposes of sections 4911 and 4945 and the regulations thereunder.

(b) *Definitions.* For purposes of this section—

(1) *Influencing legislation.* Influencing legislation means—

(i) Any attempt to influence any legislation through a lobbying communication; and

(ii) All activities, such as research, preparation, planning, and coordination, including deciding whether to make a lobbying communication, engaged in for a purpose of making or supporting a lobbying communication, even if not yet made. See paragraph (c) of this section for rules for determining the purposes for engaging in an activity.

(2) *Attempt to influence legislation.* An attempt to influence any legislation through a lobbying communication is making the lobbying communication.

(3) *Lobbying communication.* A lobbying communication is any communication (other than any communication compelled by subpoena, or otherwise compelled by Federal or State law) with any member or employee of a legislative body or any other government official or employee who may participate in the formulation of the legislation that—

(i) Refers to specific legislation and reflects a view on that legislation; or

(ii) Clarifies, amplifies, modifies, or provides support for views reflected in a prior lobbying communication.

(4) *Legislation.* Legislation includes any action with respect to Acts, bills, resolutions, or other similar items by a legislative body. Legislation includes a proposed treaty required to be submitted by the President to the Senate for its advice and consent from the time the President's representative begins to negotiate its position with the prospective parties to the proposed treaty.

(5) *Specific legislation.* Specific legislation includes a specific legislative proposal that has not been introduced in a legislative body.

(6) *Legislative bodies.* Legislative bodies are Congress, state legislatures, and other similar governing bodies, excluding local councils (and similar governing bodies), and executive, judicial, or administrative bodies. For this purpose, administrative bodies include school boards, housing authorities, sewer and water districts, zoning boards, and other similar Federal, State, or local special purpose bodies, whether elective or appointive.

(7) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples.

Example 1. Taxpayer P's employee, A, is assigned to approach members of Congress to gain their support for a pending bill. A drafts and P prints a position letter on the bill. P distributes the letter to members of Congress. Additionally, A personally contacts several members of Congress or their staffs to seek support for P's position on the bill. The letter and the personal contacts are lobbying communications. Therefore, P is influencing legislation.

Example 2. Taxpayer R is invited to provide testimony at a congressional oversight hearing concerning the implementation of The Financial Institutions Reform, Recovery, and Enforcement Act of 1989. Specifically, the hearing concerns a proposed regulation increasing the threshold value of commercial and residential real estate transactions for which an appraisal by a state licensed or certified appraiser is required. In its testimony, R states that it is in favor of the proposed regulation. Because R does not refer to any specific legislation or reflect a view on any such legislation, R has not made a lobbying communication. Therefore, R is not influencing legislation.

Example 3. State X enacts a statute that requires the licensing of all day-care providers. Agency B in State X is charged with writing rules to implement the statute. After the enactment of the statute, Taxpayer S sends a letter to Agency B providing detailed proposed rules that S recommends Agency B adopt to implement the statute on licensing of day-care providers. Because the letter to Agency B neither refers to nor reflects a view on any specific legislation, it is not a lobbying communication. Therefore, S is not influencing legislation.

Example 4. Taxpayer T proposes to a State Park Authority that it purchase a particular tract of land for a new park. Even if T's proposal would necessarily require the State Park Authority eventually to seek appropriations to acquire the land and develop the new park, T has not made a lobbying communication because there has been no reference to, nor any view reflected on, any specific legislation. Therefore, T's proposal is not influencing legislation.

Example 5. (i) Taxpayer U prepares a paper that asserts that lack of new capital is hurting State X's economy. The paper indicates that State X residents either should invest more in local businesses or increase their savings so that funds will be available to others interested in making investments. U forwards a summary of the unpublished paper to legislators in State X with a cover letter that states in part:

> You must take action to improve the availability of new capital in the state.

(ii) Because neither the summary nor the cover letter refers to any specific legislative proposal and no other facts or circumstances indicate that they refer to an existing legislative proposal, forwarding the summary to legislators in State X is not a lobbying communication. Therefore, U is not influencing legislation.

(iii) Q, a member of the legislature of State X, calls U to request a copy of the unpublished paper from which the summary was prepared. U forwards the paper with a cover letter that simply refers to the enclosed materials. Because U's letter to Q and the unpublished paper do not refer to any specific legislation or reflect a view on any such legislation, the letter is not a lobbying communication. Therefore, U is not influencing legislation.

Example 6. (i) Taxpayer V prepares a paper that asserts that lack of new capital is hurting the national economy. The paper indicates that lowering the capital gains rate would increase the availability of capital and increase tax receipts from the capital gains tax. V forwards the paper to its representatives in Congress with a cover letter that says, in part:

> I urge you to support a reduction in the capital gains tax rate.

(ii) V's communication is a lobbying communication because it refers to and reflects a view on a specific legislative proposal (*i.e.*, lowering the capital gains rate). Therefore, V is influencing legislation.

Example 7. Taxpayer W, based in State A, notes in a letter to a legislator of State A that State X has passed a bill that accomplishes a stated purpose and then says that State A should pass such a bill. No such bill has been introduced into the State A legislature. The communication is a lobbying communication because it refers to and reflects a view on a specific legislative proposal. Therefore, W is influencing legislation.

Example 8. (i) Taxpayer Y represents citrus fruit growers. Y writes a letter to a United States senator discussing how pesticide O has benefited citrus fruit growers and disputing problems linked to its use. The letter discusses a bill pending in Congress and states in part:

> This bill would prohibit the use of pesticide O. If citrus growers are unable to use this pesticide, their crop yields will be severely reduced, leading to higher prices for consumers and lower profits, even bankruptcy, for growers.

(ii) Y's views on the bill are reflected in this statement. Thus, the communication is a lobbying communication, and Y is influencing legislation.

Example 9. (i) B, the president of Taxpayer Z, an insurance company, meets with Q, who chairs the X state legislature's committee with jurisdiction over laws regulating insurance companies, to discuss the possibility of legislation to address current problems with surplus-line companies. B recommends that legislation be introduced that would create minimum capital and surplus requirements for surplus-line companies and create clearer guidelines concerning the risks that surplus-line companies can insure. B's discussion with Q is a lobbying communication because B refers to and reflects a view on a specific legislative proposal. Therefore, Z is influencing legislation.

(ii) Q is not convinced that the market for surplus-line companies is substantial enough to warrant such legislation and requests that B provide information on the amount and types of risks covered by surplus-line companies. After the meeting, B has employees of Z prepare

estimates of the percentage of property and casualty insurance risks handled by surplus-line companies. B sends the estimates with a cover letter that simply refers to the enclosed materials. Although B's follow-up letter to Q does not refer to specific legislation or reflect a view on such legislation, B's letter supports the views reflected in the earlier communication. Therefore, the letter is a lobbying communication and Z is influencing legislation.

(c) *Purpose for engaging in an activity*—(1) *In general.* The purposes for engaging in an activity are determined based on all the facts and circumstances. Facts and circumstances include, but are not limited to—

(i) Whether the activity and the lobbying communication are proximate in time;

(ii) Whether the activity and the lobbying communication relate to similar subject matter;

(iii) Whether the activity is performed at the request of, under the direction of, or on behalf of a person making the lobbying communication;

(iv) Whether the results of the activity are also used for a nonlobbying purpose; and

(v) Whether, at the time the taxpayer engages in the activity, there is specific legislation to which the activity relates.

(2) *Multiple purposes.* If a taxpayer engages in an activity both for the purpose of making or supporting a lobbying communication and for some nonlobbying purpose, the taxpayer must treat the activity as engaged in partially for a lobbying purpose and partially for a nonlobbying purpose. This division of the activity must result in a reasonable allocation of costs to influencing legislation. See §1.162–28 (allocation rules for certain expenditures to which section 162(e)(1) applies). A taxpayer's treatment of these multiple-purpose activities will, in general, not result in a reasonable allocation if it allocates to influencing legislation—

(i) Only the incremental amount of costs that would not have been incurred but for the lobbying purpose; or

(ii) An amount based solely on the number of purposes for engaging in that activity without regard to the relative importance of those purposes.

(3) *Activities treated as having no purpose to influence legislation.* A taxpayer that engages in any of the following activities is treated as having done so without a purpose of making or supporting a lobbying communication—

(i) Before evidencing a purpose to influence any specific legislation referred to in paragraph (c)(3)(i)(A) or (B) of this section (or similar legislation)—

(A) Determining the existence or procedural status of specific legislation, or the time, place, and subject of any hearing to be held by a legislative body with respect to specific legislation; or

(B) Preparing routine, brief summaries of the provisions of specific legislation;

(ii) Performing an activity for purposes of complying with the requirements of any law (for example, satisfying state or federal securities law filing requirements);

(iii) Reading any publications available to the general public or viewing or listening to other mass media communications; and

(iv) Merely attending a widely attended speech.

(4) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples.

Example 1. (i) *Facts.* In 1997, Agency F issues proposed regulations relating to the business of Taxpayer W. There is no specific legislation during 1997 that is similar to the regulatory proposal. W undertakes a study of the impact of the proposed regulations on its business. W incorporates the results of that study in comments sent to Agency F in 1997. In 1998, legislation is introduced in Congress that is similar to the regulatory proposal. Also in 1998, W writes a letter to Senator P stating that it opposes the proposed legislation. W encloses with the letter a copy of the comments it sent to Agency F.

(ii) *Analysis.* W's letter to Senator P refers to and reflects a view on specific legislation and therefore is a lobbying communication. Although W's study of the impact of the proposed regulations is proximate in time and similar in subject matter to its lobbying communication, W performed the study and incorporated the results in comments sent to Agency F when no legislation with a similar subject matter was pending (a nonlobbying use). On these facts, W engaged in the study solely for a nonlobbying purpose.

Example 2. (i) *Facts.* The governor of State Q proposes a budget that includes a proposed sales tax on electricity. Using its records of electricity consumption, Taxpayer Y estimates the additional costs that the budget proposal would impose upon its business. In the same year, Y writes to members of the state legislature and explains that it opposes the proposed sales tax. In its letter, Y includes its estimate of the costs that the sales tax would impose on its business. Y does not demonstrate any other use of its estimates.

(ii) *Analysis.* The letter is a lobbying communication (because it refers to and reflects a view on specific legislation, the governor's proposed budget). Y's estimate of additional costs under the proposal supports the lobbying communication, is proximate in time and similar in subject matter to a specific legislative proposal then in existence, and is not used for a nonlobbying purpose. Based on these facts, Y estimated its additional costs under the budget proposal solely to support the lobbying communication.

Example 3. (i) *Facts.* A senator in the State Q legislature announces her intention to introduce legislation to require health insurers to cover a particular medical procedure in all policies sold in the state. Taxpayer Y has different policies for two groups of employees, one of which covers the procedure and one of which does not. After the bill is introduced, Y's legislative affairs staff asks Y's human resources staff to estimate the additional cost to cover the procedure for both groups of employees. Y's human resources staff prepares a study estimating Y's increased costs and forwards it to the legislative affairs staff. Y's legislative staff then writes to members of the state legislature and explains that it opposes the proposed change in insurance coverage based on the study. Y's legislative affairs staff thereafter forwards the study, prepared for its use in opposing the statutory proposal, to its labor relations staff for use in negotiations with employees scheduled to begin later in the year.

(ii) *Analysis.* The letter to legislators is a lobbying communication (because it refers to and reflects a view on specific legislation). The activity of estimating Y's additional costs under the proposed legislation relate to the same subject as the lobbying communication, occurs close in time to the lobbying communication, is conducted at the request of a person making a lobbying communication, and relates to specific legislation then in existence. Although Y used the study in its labor negotiations, mere use for that purpose does not establish that Y estimated its additional costs under the proposed legislation in part for a nonlobbying purpose. Thus, based on all the facts and circumstances, Y estimated the additional costs it would incur under the proposal solely to make or support the lobbying communication.

Example 4. (i) *Facts.* After several years of developmental work under various contracts, in 1996, Taxpayer A contracts with the Department of Defense (DOD) to produce a prototype of a new generation military aircraft. A is aware that DOD will be able to fund the contract only if Congress appropriates an amount for that purpose in the upcoming appropriations process. In 1997, A conducts simulation tests of the aircraft and revises the specifications of the aircraft's expected performance capabilities, as required under the contract. A submits the results of the tests and the revised specifications to DOD. In 1998, Congress considers legislation to appropriate funds for the contract. In that connection, A summarizes the results of the simulation tests and of the aircraft's expected performance capabilities, and submits the summary to interested members of Congress with a cover letter that encourages them to support appropriations of funds for the contract.

(ii) *Analysis.* The letter is a lobbying communication (because it refers to specific legislation (*i.e.*, appropriations) and requests passage). The described activities in 1996, 1997, and 1998 relate to the same subject as the lobbying communication. The summary was prepared specifically for, and close in time to, that communication. Based on these facts, the summary was prepared solely for a lobbying purpose. In contrast, A conducted the tests and revised the

specifications to comply with its production contract with DOD. A conducted the tests and revised the specifications solely for a nonlobbying purpose.

Example 5. (i) *Facts.* C, president of Taxpayer W, travels to the state capital to attend a two-day conference on new manufacturing processes. C plans to spend a third day in the capital meeting with state legislators to explain why W opposes a pending bill unrelated to the subject of the conference. At the meetings with the legislators, C makes lobbying communications by referring to and reflecting a view on the pending bill.

(ii) *Analysis.* C's traveling expenses (transportation and meals and lodging) are partially for the purpose of making or supporting the lobbying communications and partially for a nonlobbying purpose. As a result, under paragraph (c)(2) of this section, W must reasonably allocate C's traveling expenses between these two purposes. Allocating to influencing legislation only C's incremental transportation expenses (*i.e.,* the taxi fare to meet with the state legislators) does not result in a reasonable allocation of traveling expenses.

Example 6. (i) *Facts.* On February 1, 1997, a bill is introduced in Congress that would affect Company E. Employees in E's legislative affairs department, as is customary, prepare a brief summary of the bill and periodically confirm the procedural status of the bill through conversations with employees and members of Congress. On March 31, 1997, the head of E's legislative affairs department meets with E's President to request that B, a chemist, temporarily help the legislative affairs department analyze the bill. The President agrees, and suggests that B also be assigned to draft a position letter in opposition to the bill. Employees of the legislative affairs department continue to confirm periodically the procedural status of the bill. On October 31, 1997, B's position letter in opposition to the bill is delivered to members of Congress.

(ii) *Analysis.* B's letter is a lobbying communication because it refers to and reflects a view on specific legislation. Under paragraph (c)(3)(i) of this section, the assignment of B to assist the legislative affairs department in analyzing the bill and in drafting a position letter in opposition to the bill evidences a purpose to influence legislation. Neither the activity of periodically confirming the procedural status of the bill nor the activity of preparing the routine, brief summary of the bill before March 31 constitutes influencing legislation. In contrast, periodically confirming the procedural status of the bill on or after March 31 relates to the same subject as, and is close in time to, the lobbying communication and is used for no nonlobbying purpose. Consequently, after March 31, E determined the procedural status of the bill for the purpose of supporting the lobbying communication by B.

(d) *Lobbying communication made by another.* If a taxpayer engages in activities for a purpose of supporting a lobbying communication to be made by another person (or by a group of persons), the taxpayer's activities are treated under paragraph (b) of this section as influencing legislation. For example, if a taxpayer or an employee of the taxpayer (as a volunteer or otherwise) engages in an activity to assist a trade association in preparing its lobbying communication, the taxpayer's activities are influencing legislation even if the lobbying communication is made by the trade association and not the taxpayer. If, however, the taxpayer's employee, acting outside the employee's scope of employment, volunteers to engage in those activities, then the taxpayer is not influencing legislation.

(e) *No lobbying communication.* Paragraph (e) of this section applies if a taxpayer engages in an activity for a purpose of making or supporting a lobbying communication, but no lobbying communication that the activity supports has yet been made.

(1) *Before the filing date.* Under this paragraph (e)(1), if on the filing date of the return for any taxable year the taxpayer no longer expects, under any reasonably foreseeable circumstances, that a lobbying communication will be made that is supported by the activity, then the taxpayer will be treated as if it did not engage in the activity for a purpose of making or supporting a lobbying communication. Thus, the taxpayer need not treat any amount allocated to that activity for that year under §1.162–28 as an amount to which section 162(e)(1)(A) applies. The filing date for purposes of paragraph (e) of this section is the earlier of the time the taxpayer files its timely return for the year or the due date of the timely return.

(2) *After the filing date*—(i) *In general.* If, at any time after the filing date, the taxpayer no longer expects, under any reasonably foreseeable circumstances, that a lobbying communication will be made that is supported by the activity, then any amount previously allocated under §1.162–28 to the activity and disallowed under section 162(e)(1)(A) is treated as an amount that is not subject to section 162(e)(1)(A) and that is paid or incurred only at the time the taxpayer no longer expects that a lobbying communication will be made.

(ii) *Special rule for certain tax-exempt organizations.* For a tax-exempt organization subject to section 6033(e), the amounts described in paragraph (e)(2)(i) of this section are treated as reducing (but not below zero) its expenditures to which section 162(e)(1) applies beginning with that year and continuing for subsequent years to the extent not treated in prior years as reducing those expenditures.

(f) *Anti-avoidance rule.* If a taxpayer, alone or with others, structures its activities with a principal purpose of achieving results that are unreasonable in light of the purposes of section 162(e)(1)(A) and section 6033(e), the Commissioner can recast the taxpayer's activities for federal tax purposes as appropriate to achieve tax results that are consistent with the intent of section 162(e)(1)(A), section 6033(e) (if applicable), and this section, and the pertinent facts and circumstances.

(g) *Taxpayer defined.* For purposes of this section, a taxpayer includes a tax-exempt organization subject to section 6033(e).

(h) *Effective date.* This section is effective for amounts paid or incurred on or after July 21, 1995. Taxpayers must adopt a reasonable interpretation of section 162(e)(1)(A) for amounts paid or incurred before this date.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved June 29, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

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26 CFR 1.162–20: Expenditures attributable to lobbying, political campaigns, attempts to influence legislation, etc., and certain advertising.

Guidance is provided to organizations exempt from taxation under § 501(a) of the Code on the application of amendments made to §§ 162(e) and 6033(e) by § 13222 of the Omnibus Budget Reconciliation Act of 1993. The procedure identifies certain tax-exempt organizations that will be treated as satisfying the requirements of § 6033(e)(3). Those organizations will not be subject to the reporting and notice requirements of § 6033(e)(1) or the tax imposed by § 6033-(e)(2). Procedures for other exempt organizations to establish that they satisfy the requirements of § 6033(e)(3) are also provided. See Rev. Proc. 95–35, page 391.

Section 167.—Depreciation

26 CFR 1.167(e)–1: Change in method.

If a taxpayer changes the method of computing the depreciation allowance for consumer durable property subject to rent-to-own contracts as