# B. DISALLOWANCE OF A DEDUCTION UNDER IRC 162 FOR LOBBYING EXPENSES

**by**
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## 1. Introduction

Section 13222 of the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993), 107 Stat. 477, which eliminated the deduction under IRC 162 for lobbying expenses, will have a significant impact on many exempt organizations recognized exempt under IRC 501(c)(4), (5), or (6). In addition to eliminating the business deduction for direct lobbying, OBRA 1993 eliminated the business deduction for dues to an exempt organization that are used for lobbying. These new rules will be an issue in many exempt organization cases, to first determine if the organization is subject to the rules and, if so, whether it has complied with the requirements.

## 2. Background

Before 1962, Treasury regulations under IRC 162 provided that all expenditures for lobbying purposes, for the promotion or defeat of legislation, for political campaign purposes, or for propaganda related to any such purposes were not deductible as "ordinary and necessary" business expenses. The Supreme Court upheld the validity of these regulations in Cammarano v. U.S., 358 U.S. 498 (1959).

In 1962, however, Congress modified the treatment of lobbying by enacting IRC 162(e). IRC 162(e) allowed business taxpayers to deduct expenses incurred in directly lobbying legislators with respect to legislation of direct interest to the taxpayer. However, Congress denied any deduction for the costs of "grass roots" lobbying, which is attempting to influence legislation through affecting the opinions of the general public or any segment of the general public and participation in political campaigns.

The 1962 decision to allow businesses to deduct the costs of direct lobbying was enacted at a time when business's role in lobbying activities was changing. Beginning in the early 1960's, the increasing focus on National legislation meant that business saw a greater need for its involvement in the affairs of government. Legislative history from both the House and the Senate indicates that Congress felt business and trade associations should not be discouraged from informing

Congress and other government officials about the impact of tax law changes. In fact, many believed that business was "entitled" to the deduction, because lobbying was by now a matter of economic "life or death." To this way of thought, business involvement in governmental affairs had become a question of efficient economic operation clearly involving "ordinary and necessary" business expenses.

The elimination of the lobbying deduction was one of the budget proposals put forth by President Clinton in February of 1993. Treasury's explanation of the change reasoned that "the deduction for lobbying expenses inappropriately subsidizes corporations and special interest groups for intervening in the legislative process." The proposal was intended to "level the playing field" for the many interests that pay for lobbying with aftertax dollars. For example, a citizen who was interested in water quality legislation that affected his or her home might lobby personally or join a local IRC 501(c)(4) that represented his or her views, but could not deduct contributions to the organization or the payment of personal lobbying expenses.

The Clinton proposal was enacted in section 13222 of OBRA 1993, 107 Stat. 477, which disallows the deductibility of direct legislative lobbying expenses at the Federal and state (but not the local) level. It also disallows deductions for contacts with certain federal officials. In addition, OBRA 1993 included pass-through provisions affecting exempt organizations, so taxpayers could not indirectly do what was disallowed directly. The costs of attempting to influence legislation through affecting the opinions of the general public or any segment of the general public ("grass roots lobbying") and participation in political campaigns for or against any candidate for public office continue to be nondeductible. IRC 162 (e)(1)(B) and (C).

3. Disallowance of the Deduction

A. Influencing Legislation

Section 13222 of OBRA 1993 amended IRC 162(e) to disallow a business expense deduction for amounts paid or incurred in connection with "influencing legislation." IRC 162(e)(4)(A) defines "influencing legislation" as "any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation." This definition is similar to the definition of "influencing legislation" in IRC 4911, which imposes an excise tax on certain lobbying activities by electing public charities. However, there are

significant differences between the two sections. Unlike IRC 4911, IRC 162(e) contains no exceptions to the term "influencing legislation." Thus, IRC 162(e) disallows a deduction for some activities that would not be considered "direct lobbying" under IRC 4911.

An example of the differences is the provision in IRC 4911(d)(2)(C) that "self defense" lobbying, which is direct lobbying with respect to a possible decision of a legislative body that might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization, is not influencing legislation for purposes of IRC 4911. IRC 162(e) contains no counterpart, and the legislative history strongly suggests that no exception is to be inferred. Statements in the Conference Report of the Committee on the Budget, House of Representatives, in footnote 49 on page 597, and H. Report No. 1447, 87th Congress, 2d Session, pp. 17-19, strongly suggest that the holding of Cammarano v. United States, supra, which upheld the validity of regulations denying a deduction for lobbying, even if the expenses related to proposed legislation that affected the survival of the taxpayer's business, remains good law unless specifically contradicted by statute.

On May 13, 1993, the Service and Treasury issued a Notice of Proposed Rulemaking, IA-23-94, containing proposed regulations further defining the phrase "influencing legislation" under IRC 162(e). Because of the similarity between the definitions in IRC 162(e) and IRC 4911, the proposed regulations incorporate a number of ideas from the regulations under IRC 4911. Because of the differences, however, the proposed regulations are broader than the regulations under IRC 4911.

B. Legislative Bodies

IRC 162(e) disallows the deduction only for amounts spent or incurred to influence legislation considered by a "legislative body." Proposed Reg. 1.162-29(b)(2)(vii) makes it clear that the term "legislative body" does not include executive, judicial, or administrative bodies. Examples of administrative bodies include various kinds of special purpose bodies, whether elective or appointive.

C. Local Councils

IRC 162(e)(2) provides an exception to the general disallowance rule for certain lobbying expenditures related to local councils and similar governing bodies. Two kinds of expenses are excepted under IRC 162(e)(2). One is the

ordinary and necessary expenses (including travel and preparation of testimony) in connection with appearances before, of statements to, or sending communications to the committees or individual members of a local council. The other is the expenses of communication with an organization of which the taxpayer is a member about local legislation or proposed legislation of interest to the taxpayer or the organization. The portion of the dues that are paid to an organization that are attributable to either of these activities is not subject to the disallowance rule.

The Conference Report at p. 605 indicates that the term "local councils or similar governing bodies" includes any legislative body of a political subdivision of a state, such as a county or city council. Thus, the disallowance does not apply to the expenses of lobbying a city or a county council. For purposes of the IRC 162 lobbying rules, Indian tribal governments are treated as "local councils or similar governing bodies."

D. Attempting to Influence Certain Federal Officials

IRC 162(e)(1)(D) disallows a deduction for any "direct communication with a covered executive branch official in an attempt to influence the official actions or positions of [the] official." A "covered executive branch employee" includes the President; the Vice President; a person serving in level I of the Executive Schedule (e.g. a Cabinet Officer); or any other person designated by the President as having Cabinet-level status; any immediate deputy of an individual serving in a level I position; the two most senior-level officers of each agency within the Executive Office of the President; and, any other official or employee of the White House Office of the Executive Office of the President.

The Conference Report indicates that all written or oral communication with covered executive branch officials are included. A communication with the covered executive branch official will be considered with that official if the official is intended as the primary recipient.

4. Lobbying Communications

A. Scope

IRC 162(e)(4)(A) defines "influencing legislation" to mean any attempt to influence any legislation through a lobbying communication with any member or employee of a legislative body or with any government official or employee who may participate in the formulation of legislation. Proposed Reg. 1.162-29(b)(2)(ii)

defines a "lobbying communication" as a communication that either (A) refers to specific legislation and reflects a view on that legislation, or (B) clarifies, amplifies, modifies, or provides support for views reflected in a prior lobbying communication.

According to IRC 162(e)(5)(C), an attempt to influence legislation means the lobbying communication and all activities, such as research, preparation, and other background activities, engaged in for the purpose of making or supporting the lobbying communication.

An initial issue is the definition of "legislation". IRC 162(e)(4)(B) incorporates IRC 4911(e)(2)'s definition of "legislation." That definition which is incorporated in proposed reg. 1.162-29(b)(2)(iv), includes action on Acts, bills, resolutions and similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. As indicated above, the disallowance rules do not apply to certain expenses involved in lobbying on local legislation, so the impact of IRC 162(e)(2) should be taken into account. Action on acts, bills, etc. means the introduction amendment, enactment, defeat, or repeal of acts, etc. Legislation includes a proposed treaty required to be submitted by the President to the Senate for and consent from the time the President's representative begins to negotiate a position with the prospective parties to the treaty.

B. Specificity

The term "specific legislation" is not limited to acts, bills, etc. that have been formally introduced before a legislative body. Proposed Reg. 1.162-29(b)(2)(v) provides that "specific legislation" (the subject of a lobbying communication) means legislation that has already been introduced in a legislative body and a specific legislative proposal that the taxpayer either supports or opposes.

C. Lobbying Support

A lobbying communication also includes support activities such as research. However, support activities may be conducted for purposes other than to make a lobbying communication. Proposed Reg. 1.162-29(c)(1) provides that the purpose or purposes for which a taxpayer engages in an activity are determined based on all the facts and circumstances. Moreover, if a taxpayer engages in an activity both for a lobbying purpose and for some nonlobbying purpose, the taxpayer must treat

the activity as engaged in partially for the lobbying purpose and partially for the nonlobbying purpose. This division of the activity must result in a reasonable allocation of costs between nondeductible lobbying costs and other costs. The reg. cites several ways that a taxpayer might make an unreasonable allocation. Proposed Reg. 1.162-29(c)(2) provides that an allocation to the lobbying activity of only the incremental amount of time and costs that would not have been incurred but for the lobbying activity will not be reasonable.

D. Lookback

There are limits on a taxpayer's ability to anticipate when a support activity will culminate in a lobbying communication. Moreover, there are certain routine expenses that business taxpayers might incur whether or not they are ultimately involved in lobbying communications. The legislative history, in discussing a routine expense as opposed to a legislative tracking expense, calls for regulations that distinguish between attempts to influence legislation and "mere monitoring" of legislative activity. The Committee Report speaks of a need for a "lookback" rule, that would treat the costs of "mere monitoring" as the costs of lobbying where there is subsequent lobbying activity involving the same or similar legislation.

Prior to the publication of the proposed regs., numerous comments suggested that the administrative burdens for business taxpayers associated with a lookback rule might be onerous. Counsel, sympathetic to this argument, took the view that only those activities engaged in for the purpose of supporting a lobbying communication would be treated as supporting activity. This approach was seen as striking an appropriate balance between the taxpayers' need for contemporaneous certainty and Congress' objective of not allowing a deduction for lobbying activity.

E. Presumptions of Purpose

Counsel reasoned, when it considered the question of lookback, that Congress was expressing the concern that a test defined by purpose could be abused. To strengthen the Commissioner's hand, therefore, in proving purpose, it created the following two presumptions. Prop. Reg. 1.162-29(c)(3) provides that if an activity relating to a lobbying communication is engaged in for a non-lobbying purpose prior to the first taxable year preceding the taxable year in which the communication was made, the non-lobbying is presumed to be engaged in solely for that non-lobbying purpose. The Commissioner can rebut this presumption in

part by establishing that the activity was also engaged in for a purpose other than the non-lobbying purpose.

Conversely, Prop. Reg. 1.162-(c)(4) provides that if an activity relating to a lobbying communication is engaged in during the same taxable year as the communication is made or the immediately preceding taxable year, and is not within the preceding presumption, the activity is presumed to be engaged in for the sole purpose of making or supporting a lobbying communication. A taxpayer can rebut the presumption by establishing that the activity was engaged in for a non-lobbying purpose. If, during the same year, the taxpayer commences an activity that relates directly to the subject matter of specific legislation (then in existence) and makes a lobbying communication with respect to that legislation, it is expected that the taxpayer generally will be unable to rebut the presumption.

F. Routine Activities

Prop. Reg. 1.162-29(c)(5) treats certain activities as not engaged in for the purpose of making or supporting a lobbying communication. These activities consist of an activity undertaken to comply with the requirements of any law, reading any general circulation publications or viewing, or listening to other mass media communications available to the general public. In addition, if, prior to evidencing a purpose to influence specific legislation (or similar legislation), a taxpayer determines the existence or procedural status of that legislation, determines the time, place, and subject of any hearing to be held by a legislative body with respect to that legislation, or prepares or reviews routine, brief summaries of the provisions of that legislation, the taxpayer is treated as engaging in that activity with no purpose of making or supporting a lobbying communication.

5. Special Imputation Rule

Prop. Reg. 1.162-29(d) provides that if one taxpayer, for the purpose of making or supporting a lobbying communication, uses the services or facilities of a second taxpayer and does not compensate the second taxpayer for the full cost of the services and facilities, the purpose and actions of the first taxpayer are imputed to the second taxpayer. Thus, 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.

6. Cost Allocations

On December 27, 1993, the Service issued a notice of proposed rulemaking, IA 57-93, which generally describes the costs that are properly allocable to lobbying activities. IA 57-93 applies to the dues disallowance, notice, and proxy tax provisions. It is not intended for use in other lobbying situations. For example, IA 57-93's rules, which are designed to minimize business's routine recordkeeping burden are inappropriate for use in determining the amount of a private foundation's taxable expenditure under IRC 4945. (The Code does not treat a taxable expenditure as a routine event!) Similarly, IRC 4911 has many of its own allocation rules.

The proposed regs. permit taxpayers to use any reasonable method to allocate costs between lobbying and nonlobbying activities. A method is reasonable if it is applied consistently, allocates a proper amount of costs to lobbying activities (including labor and administrative costs), and is consistent with rules outlined by the Service. The regulations provide that a taxpayer may choose from three different allocation methods, a ratio method, a gross-up method, or an allocation method that applies IRC 263A principles.

A. The Ratio Method

The ratio method operates as follows. A taxpayer multiples its total costs of operations (excluding third-party costs) by a fraction. The numerator of the fraction is the taxpayer's lobbying labor hours; the denominator is the taxpayer's total labor hours. (Lobbying labor hours/ Total labor hours x Total costs of operations) The product of this calculation is added to the taxpayer's third-party lobbying costs. Using this method, a taxpayer may treat as zero the hours spent by personnel engaged in secretarial, maintenance, and other similar activities. However, if the hours are treated as zero for lobbying costs, they must be treated as zero for purposes of calculating total labor hours.

B. The Gross-Up Method

Under the gross-up method a taxpayer multiplies its basic labor costs for lobbying labor hours by 175 percent. Basic labor costs are limited to wages or other similar costs, such as guaranteed payments for services. Pension costs and other employee benefits, for example, are not included in basic labor costs. Third-party costs are then added to the result of the calculation to arrive at total

lobbying costs. The proposed regulations warn that taxpayer's 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. Such taxpayers would include 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.

C. IRC 263A Method

Many taxpayers engaged in lobbying activities are subject to IRC 263A, therefore, the regulations permit taxpayers to use the principles of that section and the regulations thereunder to determine costs properly allocable to lobbying activities. Specifically, under IRC 263A, lobbying is considered a service department or function. Therefore, a taxpayer may use its IRC 263A methodology to determine the amount of costs allocable to its lobbying department or function for purposes of complying with the regulations. Taxpayers not subject to IRC 263A may also use the principles of that section and the regulations thereunder to determine the amount of costs allocable to lobbying activities.

D. De Minimis Rule

The proposed regulations provide a special de minimis rule for labor hours spent by personnel on lobbying activities. If less than 5% of an employee's time is spent on lobbying activities, the taxpayer may treat the time spent as zero. The de minimis rule does not apply to direct contact lobbying with legislators and covered executive branch officials (as defined in IRC 162(e)(6).

An activity is direct contact lobbying if it is a meeting, a telephone conversation, a letter or other similar means of communication with a legislator or a covered executive branch official. If no substantial purpose of a meeting is a lobbying activity, a taxpayer may treat the meeting as involving no lobbying activity. It is presumed that a substantial purpose of a meeting with a federal or state legislator, a member of the staff of a federal or state legislator, a member of the staff of a federal or state joint legislative committee or similar body, or a covered legislative branch executive is a lobbying activity. However, a taxpayer may rebut this presumption by showing that the facts and circumstances clearly indicate otherwise.

7. De Minimis In-House Lobbying

IRC 162(e)(5)(B)(ii) provides for an exception to the disallowance rule for

taxpayers who are involved in a minimal amount of in-house lobbying. Where a taxpayers' total amount of these expenses do not exceed $2,000 (computed without taking into account general overhead costs otherwise allocable to lobbying), this exception applies. For purposes of this rule, in-house expenses include labor and material costs.

Payments made to a third-party lobbyist and dues payments allocable to lobbying are subject to the disallowance rules, regardless of whether or not the taxpayer's in-house expenses are exempted. In addition, the de minimis in-house rule does not apply to expenses incurred for political activity, grass-roots lobbying or foreign lobbying which continue to be disallowed under current law rules.

8. Dues Disallowance

The regs. under IRC 162 have, all along, provided for the disallowance of dues to the extent an organization is engaged in an activity prohibited under IRC 162(e). See, Reg. 1.162-20(c)(3). One of the significant drawbacks of this approach, however, has been the lack of a mechanism at the association level to ensure notification to members of the disallowance. In designing a system, based on dues disallowance, Congress had to build in an incentive (or penalty) to ensure that associations would notify their members.

Congress enacted a system based on the disallowance of dues. IRC 162(e)(3) denies a deduction for dues (or other similar amounts) paid to certain tax-exempt organizations to the extent that the organization, at the time the dues are assessed or paid, notifies the dues payer that the dues are allocable to nondeductible lobbying and political expenditures of the type described in IRC 162(e)(1). The amendments under section 13222 of OBRA 1993 apply to amounts paid or incurred after December 31, 1993. Payments that are similar to dues include voluntary payments or special assessments used to conduct lobbying.

9. Notice

IRC 6033(e) imposes reporting and notice requirements on tax-exempt organizations (other than IRC 501(c)(3) organizations) incurring expenditures to which IRC 162(e) applies. IRC 6033(e)(1) requires a tax-exempt organization that pays or incurs nondeductible lobbying and political expenditures to notify its members of a reasonable estimate of the portion of the dues allocable to those expenditures. The notification must be provided at the time dues or other similar amounts are assessed or paid. A deduction is then disallowed for the portion of

each member's dues that corresponds to the organization's dues income that is spent on lobbying.

The organization must disclose on its Form 990 the total amount of its lobbying and political expenses. The reporting requirement asks for the expenses as defined under IRC 162. For this purpose, an organization's lobbying and political expenses for the taxable year are allocated to the dues received during the year. Any excess amount of lobbying or political expenses is carried forward and allocated to the dues received in the following year.

The notification that an organization is required to provide to members must contain a reasonable estimate of the portion of the organizations' dues on prohibited lobbying and political activity. Presumably, the figure to be used is an estimate of a fraction combining the figures used for reporting purposes. For example, an organization might estimate its lobbying and political expenses for the year at $60x. Its estimated dues income may be $100x. The fraction that it would use in its estimate would be 60/100 or .60. If it spent $120x instead of $60x on lobbying and political activity and the dues received were $100, it would carry forward the extra $20. The estimate must be reasonably calculated to provide the organization's members with adequate notice of the nondeductible amount. The Conference Report refers to IRC 6113 and indirectly Not. 88-120, 1988-2, 454, when it discusses adequate notice.

10. Proxy Tax

IRC 6033(e)(2)(A) provides that if a tax-exempt organization fails to provide the notices, or if the notices underestimate the actual amount of dues allocable to nondeductible lobbying and political expenditures, the organization is subject to a tax on the aggregate amount of dues allocable to nondeductible lobbying and political expenditures paid during the applicable year. This mechanism allows a membership organization to elect not to provide its members with a disallowance notice in which case the organization will be required to pay the tax. The tax (referred to as the proxy tax) is paid at the highest corporate rate, currently set at 35%.

Suppose, as in the previous example, the estimated lobbying and political expenses for the year were $60x and the estimated dues were $100x. In this case, if actual lobbying and political expenses were $80x, the proxy tax is calculated for $20x, the amount the actual expenses exceed the estimated expenses - all other factors being neutral. By the same token, if dues income is overestimated the

notice of disallowance estimates dues income at $100x and the actual dues income is $80x. All other factors being neutral, the proxy tax is paid on (60/80 - 60/100)$80x.

It is also possible that an organization could overstate the portion of the dues that are not deductible in the notice of disallowance. It could do so by overestimating the amount of the disallowed expenses or underestimating dues income. The Conference Report indicates that the Secretary of Treasury will issue regulations to cover this eventuality.

11. Waiver

A membership organization's nondeductible lobbying expenses are allocated only to dues, and not to other sources of income. IRC 6033(e)(2)(B) provides that if a tax would be imposed on the organization because its estimate of the nondeductible portion of the dues was less than the actual amount allocable to nondeductible lobbying and political expenditures, the Secretary may waive the tax if the organization agrees to increase the amount reasonably estimated to be nondeductible for the following taxable year by the amount of the underestimate.

The first use of the waiver was announced in Not. 93-55, 1993-35 I.R.B. 21, which provided transitional rules for tax-exempt organizations with dues assessed or received before 1994 that are allocable to nondeductible lobbying and political expenditures paid or incurred after 1993.

A tax-exempt organization could: (1) provide its members with the notices required by IRC 6033(e)(1)(A) at the time and in the manner specified in that section; (2) pay the tax imposed by IRC 6033(e)(2)(A) on the amount of dues actually allocable to nondeductible lobbying and political expenditures; or (3) increase its reasonable estimate of dues allocable to nondeductible lobbying and political expenditures for the following taxable year pursuant to IRC 6033(e)(2)(B) by the aggregate amount of dues actually allocable to nondeductible lobbying and political expenditures paid or incurred during the taxable year.

This use of the waiver envisioned that organizations could "phase-in" to the notice of dues disallowance - proxy tax cycle as best suited them. In essence, organizations were given tax year 1994, as long as they "rolled" excess expenses into tax year 1995.

12. IRC 501(c)(3) Organizations

The Form 990 reporting requirement and the notice of dues disallowance (and proxy tax) requirements do not apply to organizations described in IRC 501(c)(3). However, under certain circumstances, OBRA 1993 also disallows charitable deductions for contributions made to IRC 501(c)(3) organizations. IRC 170(f)(9) states that the deduction is denied when a charity conducts lobbying activities on a matter of direct financial interest to the donor's trade or business where a principal purpose for making the contribution is to avoid the lobbying expense disallowance rule.

This rule is intended to ensure that business lobbying does not use a backdoor to obtain deductions. The phrase "matter of direct financial interest to a donor's trade or business should not be read so narrowly so as to assume that "business" as opposed to "labor" is primarily affected. Labor union members might have a "business" interest in a particular piece of legislation and contributions to an IRC 501(c)(3) organization by individual union members may not be deductible under IRC 170(f)(9).

There is an interesting interface between the rules of IRC 162 and the rules of IRC 4911 in the case of affiliated organizations. Many labor unions, trade associations, and social welfare organizations are affiliated with IRC 501(c)(3) organizations; often, a portion of members' dues is designated for the IRC 501(c)(3) affiliate. The affiliated IRC 501(c)(3) organization may engage in activities that would represent non-deductible lobbying if carried on by a labor union or trade association. For example, an electing IRC 501(c)(3) affiliated organization might carry out research concerning health care reform, the results of which are presented to Congress by an affiliated business league in a lobbying communication.

In this case, the IRC 501(c)(3) organization would have its tax treatment determined under IRC 4911, an IRC 162 notice of disallowance would have to indicate that the portion of the dues designated for the IRC 501(c)(3) organization was used for lobbying and political expense. The portion of the dues payment that was designated for the IRC 501(c)(3) organization is not deductible by virtue of IRC 170(f)(9).

13. <u>De Minimis Exception</u>

IRC 6033(e)(1)(B)(ii) excepts organizations that are engaged in a minimal amount of in-house lobbying from the notice of dues disallowance-proxy tax

structure. This is a clear counterpoint of the exception to the disallowance rules and it uses the same rules. Where an organizations' total amount of these expenses do not exceed $2,000 (computed without taking into account general overhead costs otherwise allocable to lobbying), this exception applies.

14. Other Excepted Organizations

IRC 6033(e)(3) provides that IRC 6033(e)(1)(A) shall not apply to tax-exempt organizations that establish to the satisfaction of the Secretary that substantially all the dues they receive are not deductible without regard to IRC 162(e).

Announcement 94-8, 1994-3 I.R.B. 1, published on January 18, 1994, stated that the Service is considering issuing a Revenue Procedure that will set forth circumstances indicating that an organization is excepted from the lobbying expenditure reporting requirements of IRC 6033(e).

The Prop. Rev. Proc. (i) sets forth specific circumstances in which certain tax-exempt organizations would be treated as being excepted from the requirements of IRC 6033(e)(3) and (ii) permits any other exempt organization to request a private letter ruling that substantially all of the dues or other similar amounts paid by members to the organization are not deductible, either directly or indirectly, without regard to IRC 162(e).

The Prop. Rev. Proc. takes into account the fact that only a few kinds of the organizations that are exempt from income tax under IRC 501(c) are the kind that should be subject to the notice of dues disallowance-proxy tax structure. Those include IRC 501(c)(4) social welfare organizations, IRC 501(c)(5) agricultural and horticultural organizations, and IRC 501(c)(6) organizations, which include business leagues. However, social welfare organizations and agricultural and horticultural organizations are not subject to the requirements if the largest amount of annual dues paid by members is $50 or less, or that more than 90% of their members are section IRC 501(c)(3) organizations. IRC 501(c)(6) organizations will be exempted from the requirements if over 90% of their members are IRC 501(c)(3) organizations.

Organizations can request a private letter ruling that they are excepted from the requirement where they can show that 90% or more of the dues or other similar amounts paid to the organization are not deductible, either directly or indirectly, without regard to IRC 162(e).

15. Role of Reporting - Sample Forms 990, 990-T

The Forms 990 and 990-T will play a significant role in administering these provisions. Beginning in 1994, the Form 990 will be used to satisfy the increased reporting requirements for organizations engaged in lobbying and political campaign activities. A series of check-boxes will also be used to tell us whether an organization is subject to the notice of disallowance-proxy tax structure, and, if so, whether the proxy tax is owed. Form 990-T will be used to pay the proxy tax.

Organizations shall include on any return required to be filed information setting forth the total expenditures of the organization to which IRC 162(e)(1) applies and the total amount of the dues or other similar amounts paid to the organization to which such expenditures are allocable. Associations that lobby will now have to pay particular attention to page 4, part VI, question 85 of Form 990. There are eight parts to this question that associations will have to look at concerning the nondeductibility of lobbying expenses. Form 990-T on page 2, line 36, has added the words "and any other tax." This is relevant for those associations that will pay the proxy tax. Page 7 of the instructions explains what to do. **See Exhibit A and B.**

16. The Anti-Cascading Rule

Taxpayers who are engaged in the trade or business of conducting lobbying activities on behalf of another person, are not subject to the general disallowance rules under IRC 162(e)(5). However, the rules do apply to payments by such other person to the taxpayer for conducting the lobbying activities.

17. American Society of Association Executives Lawsuit

The American Society of Association Executives (ASAE) has filed suit in the United States District Court for the District of Columbia, challenging the constitutionality of the new law and requesting injunctive relief. The ASAE claims that by placing "special tax burdens" on association members, the law discourages them from exercising their rights of free association. Also, because the new law deters associations and their members from informing government officials of their views on "issues of vital importance," the law burdens First Amendment free speech guarantees, thus placing a greater burden on associations than individual businesses or private persons, the provisions violate the Fifth Amendment's guarantee of equal protection."

In a similar case, Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983), the Supreme Court held that the exercise of First Amendment rights is not infringed by the government's failure to subsidize the right. Taxation With Representation of Washington (TWR) was a nonprofit corporation formed to promote the public interest in the area of federal taxation. The Service denied TWR's application for IRC 501(c)(3) status because the organization's activities included lobbying. In an opinion written by Justice William Rehnquist, the Court emphasized that Congress's decision not to subsidize a fundamental right does not infringe the right.

Included in its suit, the ASAE has filed a motion to enjoin Treasury from enforcing the nondeductibility provisions against the ASAE and its members. The association will have to overcome the long-accepted notion that tax deductions are a matter of "legislative grace." Treasury's position will likely be that the law does not prohibit lobbying but instead merely removes an incentive to lobby; removal of tax incentives is certainly within congressional discretion.

18. Conclusion

Although some questions about the new law have been resolved, the Service and Treasury face many difficult questions and comments at the public hearing about the proposed regulations concerning the definition of "influencing legislation," particularly questions involving "grass-roots activity. Ironically, the administrative difficulty of defining the term "lobbying" was one of the reasons Congress originally permitted deductions for "direct lobbying" when it enacted IRC 162(e) in 1962. This is a rapidly evolving area. Readers of this article are urged to keep abreast of current developments.